

GUST CSD Policy Brief

The Impact of Outward Foreign Investment Performance on Digital Transformation: The Mediating Effect of ESG Performance

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Keywords:

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SDGs:

8, 9, 12

Highlights:

- With the fast growth of digital technology and globalization in recent years, the notion of digital transformation (DT) has emerged, referring to the integration of digital technology into every segment of a business, which leads to substantial changes to how firms function.
- Additionally, outward foreign investment performance (OFIP/OFDI) has become essential to globalization. It is the process by which companies from one country establish or acquire operations in another country, aiming to expand their market reach and access new resources, technologies, and knowledge.
- Environmental, social and governance (ESG) performances may have a mediating role between OFDI and DT efforts. Firms engaging in OFIP activities may face increased pressure to improve their ESG performance, as international stakeholders often have higher expectations regarding sustainability and corporate responsibility, therefore influencing firms' DT efforts.
- To maximize the potential of DT, policymakers and business leaders should ensure that ESG performance is incorporated into their strategic decision-making processes and reflected in their international investment plans.

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Enterprise digital transformation (DT) is a process in which businesses plan and carry out business model, management, and operational transformations using digital technologies like the Internet of Things (IoT), big data, cloud computing, 5G networks, mobility, blockchain, artificial intelligence (AI) and so on, resulting in a new core competitiveness (Plekhanov et al., 2022; Verhoef et al., 2021; Wu, Lou and Hitt, 2019). Many conventional businesses are struggling because of being surpassed at the corporate level by innovative, rapidly growing digital competitors. For instance, the fast growth of internet merchants like Amazon and Alibaba has had a huge impact on traditional businesses, as seen by the bankruptcies of several big retail behemoths including Claire's, RadioShack and Toys 'R'Us. Banks like ING see Amazon as a big prospective rival, while big international shipping firms like Maersk see Alibaba as a potential threat. In the same stream, Netflix is affecting the TV broadcasting and film industries (Verhoef et al., 2021). Thus, digital technologies assist enterprises in understanding new markets and developing worldwide networks, hence expediting local product adaption and consumer interactions.

The fast growth of digital technology and globalization in recent years has substantially changed how organizations function and compete (Kong and Liu, 2023; Lu et al., 2023). As an inevitable response to these developments, the notion of digital transformation has emerged, referring to the integration of digital technology into every segment of a business, which leads to substantial changes to how firms function and give value to their consumers.

On the other hand, outward foreign investment performance (OFIP/OFDI) has become essential to globalization and international business (Cai et al., 2023; Li, Chen, and Wohlfarth, 2022). It is the process by which companies from one country establish or acquire operations in another country, aiming to expand their market reach and access new resources, technologies, and knowledge (Kong et al., 2021; Zhang et al., 2023). As such, Chinese OFDI has emerged as a significant force in the world economy (Liu et al., 2024; Tong et al., 2022) after China introduced the Going Global Plan in 2000 and the Belt and Road Initiative (BRI) in 2013 to advance global trade in general and expansion of OFDI in specific. OFDI in China is primarily concerned with how OFDI impacts a country's industrial structure, green growth, export trade, innovation efficiency, technological progress, and several other factors (Kong et al., 2021; Ren, Hao and Wu, 2022; Shi et al., 2023) but no systematic and in-depth studies have been conducted on how OFIP affects the digital transformation or the digital transmission of technology effect of OFIP as well as its impact mechanism.

More recently, Khurram et al. (2024) tried to investigate how OFDI may contribute to firms' DT efforts. More specifically, they investigate how Environmental, social and governance (ESG) performances may act as a critical factor in this relationship. Furthermore, the study seeks valuable insights for policymakers and practitioners interested in promoting digital transformation and sustainable development (Plekhanov et al., 2022).

Indeed, ESG performance has gained increasing attention from academics,

The Impact of Outward Foreign Investment Performance on Digital Transformation: The Mediating Effect of ESG Performance

practitioners, and policymakers as a critical factor influencing firms' long-term sustainability and success (Bissoondoyal-Bheenick et al., 2023; Fang et al., 2023). Therefore, firms engaging in OFIP activities may also face increased pressure to improve their ESG performance, as international stakeholders, such as investors and customers, often have higher expectations regarding sustainability and corporate responsibility (Khan et al., 2022; Xue et al., 2023). Consequently, improving ESG performance may become a strategic priority for firms engaging in OFIP, influencing their DT efforts (Liu et al., 2024; Zhang, Chen, and Tan, 2023; Zhang et al., 2023). In this context, the mediating role of ESG performance in the relationship between OFIP and DT becomes highly relevant (Fatemi et al., 2018; Wu, Shi, and Wang, 2023).

To support their intuition of a relationship between OFIP, DT, and ESG performance, Khurram et al. (2024) conduct an empirical study using a panel dataset of the A-share listed firms in the Shenzhen stock exchange and Shanghai stock exchange over the period 2010-2020. The total sample consists of 3654 companies (the sample started from 2010 due to the anomalous variance induced by the global financial crisis in 2009).

The study's findings suggest that OFIP has a significant positive impact on the DT of firms, indicating that companies engaged in OFIP can strategically leverage their international investments to drive digital innovation and competitiveness. Additionally, it indicates that the positive correlation between OFIP and DT is further strengthened through robust ESG performance. Companies excelling in ESG standards are better equipped to handle the complex challenges associated with DT, as they are more likely to have robust risk management frameworks, effective resource allocation strategies, and cultures that foster innovation and

adaptability. Furthermore, Khurram et al. (2024) study's suggests that companies focusing on ESG performance are more likely to attract and retain top talent, which lays the foundation for a strong and dynamic workforce capable of driving successful DT initiatives. Additionally, by adopting responsible and sustainable practices, these organizations improve their reputations, thereby strengthening their market position and stakeholder relationships. Given these findings, it is recommended that policymakers and business leaders incorporate ESG performance into their strategic decision-making processes, particularly when devising OFIP strategies and DT plans. By fostering a strong ESG culture, organizations can not only improve their DT outcomes but also contribute to sustainable economic development in the global marketplace, thereby creating shared value for all stakeholders. Indeed, when multinational corporations (MNCs) maintain high ESG standards, they convey not only general knowledge and technologies but also eco-friendly technologies and sustainable practices that would benefit the community. This transfer can facilitate progress in their DT efforts. In the same vein, companies that support ESG development may also become more attractive to investors, address agency problems, boost employee satisfaction, and improve information transparency, leading to enhanced technological innovation abilities, improved financial performance, and reduced financing constraints.

Based on these findings, to maximize the potential of DT, policymakers and business leaders should ensure that ESG performance is incorporated into their strategic decision-making processes and reflected in their international investment plans. Additionally, policymakers can consider adjusting or designing new incentive policies to encourage companies to adopt more sustainable practices in their DT and international investment endeavours. Future research

The Impact of Outward Foreign Investment Performance on Digital Transformation: The Mediating Effect of ESG Performance

can further explore how the ESG performance affects OFIP and DT in different industries and regions, and whether there are other moderating factors, such as government policies, corporate governance structures, and innovation cultures, that may impact this

relationship. Researchers can provide more comprehensive guidance to businesses and policymakers in achieving sustainable DT and international investment through a more in-depth analysis of these factors.

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The Impact of Outward Foreign Investment Performance on Digital Transformation: The Mediating Effect of ESG Performance

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The Impact of Outward Foreign Investment Performance on Digital Transformation: The Mediating Effect of ESG Performance