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Influencing Factors of Investment for Companies

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ABSTRACT

Companies always try to make the best investment decision to maximize profits. This article summarized the latest research progress in corporate investment. External and internal factors that influence enterprise investment decisions were analyzed. External factors include government policy and environmental factors. Government policies such as macroeconomic policies and globalization policies will affect enterprises' stock return rate and thus influence their investment decision. Furthermore, environment factors such as the development of science and technology, culture, society and COVID-19 will also have impacts on investment decisions. Internal factors include behavioral factors, company's performance and the risk in investment decisions. Influenced by behavioral factors such as disposition effect, mental accounting and diversification heuristic bias, enterprises have a tendency to reduce investment in projects. However, overconfidence will encourage the investment department of the company to invest. The relationship between corporation's current performance, historical performance and social performance will change the allocation of resources within the company and thus affect the enterprise investment. Also, attitudes to risk and uncertainty of the company are main issues that company should consider when they make investment decisions. In order to make a better investment decision, companies need to recognize different variables from the costs to the profits of an investment project.

***Keywords*：** *Investment, Government, Environment, Behavior, Performance, Risk*

1. INTRODUCTION

Investment is one of the most vital part for a company to keep their present value and increase their future value. All companies try to use different combinations of investments to enlarge their potential value of investment. Based on Xia's research about Investment Scale of Power Grid Enterprises, the empirical results proofed that company's internal structure has a greater influence than external factors [1]. Meanwhile, factors in external environment, including market size, technology, and the freedom of investment in host country, all play a vital role for a company to invest [2].

When doing investment, companies need to take a bunch of influencing factors into account. Furthermore, the influencing factors can be influenced by the different economic structures and conditions within the companies. In this case, investors have to analyze the most important factors to minimize their risks on investment. This article aims to analyze the influencing factors of companies' investment, providing a further understanding for companies. The influencing factors for companies' investment can be divided into two parts: internal and external. For external factors, this article gives a further understanding about government policies and environmental factors. For internal section, this article illustrates the factors about companies' behavior, performance, and how can they make decision about risks.

The reminder of this paper is organized as follows: Section 2 reviews the external and internal influencing factors for companies' investment; Section 3 concludes.

2. INFLUNENCING FACTORS

When making decision on investment, many aspects should be taken into account including the company's expectation to their profit, the cost of the investment program and the company's ability to finance the investment program [6]. However, the investment influencing factors for companies can be divided into two categories: external and internal factors. In terms of external factors, government policies and environmental factors play an important role in investment. For internal factors, the influencing factors always concern about the inner status of a company, including its behavior, performance and the risk in decision making process.

2.1. External Factors

2.1.1 Government Policy

The changes of different economic policies, such as macroeconomic policies and globalization policies, have different impacts on enterprise investment. Macroeconomic policy plays an important role in the operation of the enterprise market, and its change will affect the stock return rate of the enterprise, that is, the stock return rate of different enterprises has different sensitivity to the change of the macroeconomic situation. Li et al showed in their research on enterprise motivation of China's economic institutional change [4]. They reflect the changes of China's economic policies through five indicators: changes in tax policies, changes in securities regulatory system, changes in accounting standards and financial systems, changes in foreign trade policies, and changes in investment project evaluation and review policies. Among them, the influence of enterprises of different economic types on the change of economic policies is concentrated in the following aspects: securities supervision system and accounting system do not affect the motivation of non-state-owned enterprises, and they believe that the transformation of state-owned enterprises is the top priority of the government's economic policies. The impact of institutional changes on different types of companies will not be obvious as long as they complete three types of investment projects, including making full use of idle funds and improving the performance of managers, which are recommended by the government. Wang's research shows that Under the influence of the global economy, Chinese enterprises go to the international market [5]. However, many Chinese enterprises do not invest directly in the international markets, but invest in the international market through trade institutions. One of the most fundamental reasons for economic globalization is the power of capital, which enables developed countries with a large amount of surplus capital to seek greater profits in the saturated market. Developing countries have huge market potential and cheap labor to provide a better environment to meet such capital needs. Li said economic globalization bring more opportunities for foreign investment [6]. Enterprises can establish an enterprise with foreign investment, foreign trade, fair competition system, and according to the domestic and international market demand, constantly adjusting and optimizing the enterprise structure, the fusion of the open economy. A new system makes the economic policies of promoting the development of the enterprise investment in China.

2.1.2 Environmental Factors

In today's volatile market economy system, enterprises must adjust their own decisions and combine them with environmental factors if they want to maintain permanent competitiveness. Li et al. show that the development of science and technology, especially information technology, is the most important environmental factor to promote Chinese enterprises to make investment decisions [4]. By studying the impact of economic environment changes on enterprises' investment decisions, they found that science and technology have penetrated into every field of economic life, so the continuous improvement of science and technology promotes the investment decisions of enterprises. In " The Development Impact of external Environment on Enterprise investment Decision ", it is stated that social and cultural environment is one of the factors affecting enterprise investment decision [8]. Social and cultural environment includes a country's population status, lifestyle, national quality and other aspects, which makes people subconsciously accept social and cultural standards for corporate investment, thus greatly affects the investment decisions of enterprises. During the COVID-19, it has not only affected people's lifestyles, but also severely affected companies' investment decisions. According to Bernard 's research, enterprises holding large amounts of cash during COVID-19 may not reduce their cash reserves, but may increase their investment decision-making opportunities, which can bring advantages to enterprises' long-term competition [7]. Overall, the pandemic has had a negative impact on corporate investment activities, but has reduced their influence on investment decisions for cash-holding firms. Many enterprises do not timely adjust their investment decisions due to the changeable environmental factors, resulting in the corresponding development of enterprises and accompanied by some unfavorable factors. Therefore, environmental factors are very important for enterprises to make investment decisions.

2.2. Internal Factors

2.2.1. Behavior Factors

Behavioral finance studied how different kinds of psychological characteristics such as emotions and cognitive bias affect individual or groups' investment decisions [10]. Also, behavioral finance will not consider rational thinking because perception and frame of preference lead to irrational action taken by investors [9]. Behavior factors may also influence a company's investment. Khan and Afeef used Partial Least Square Structural Equation Model to analyze data which was collected from 244 institutional investors and found that disposition effect, overconfidence behavior, mental accounting and diversification heuristic bias have a significant influence on investment decisions of investors [10]. One of the most common factor in these four is disposition effect. Disposition effect is defined by Shefrin and Statmen as investors have a tendency to hesitate realizing loss and prefer to realize gains [10]. As a result, investors prefer to redeem funds more in bear market rather than redeem funds in bull market [10]. Furthermore, a number of shareholders are risk-averse. These shareholders who are relatively conservative refuse to invest in riskier projects. Also, overconfidence, which is one of psychological characteristics, is another common influencing factor. Psychologists and behaviorists believed that those who are overconfident will overestimate their knowledge and underestimate the association risk [10]. Therefore, overconfidence affects investors' rational judgment when they make a decision [10]. If the investment department of a company is overconfident, they would continue to do the same plan since the plan is profitable in the former investment, therefore they underestimate the risk. Investors in financial markets often categorize their portfolio into different assets groups [10]. Mental accounting and diversification affect their portfolio performance [10]. Because a company is made up of individuals, individual behavior factors will influence the company's decision. In summary, shareholders' psychological characteristic and groups' behavior factors may affect a company's investment, which is a fact that cannot be ignored.

2.2.2. Company's Performance

The behavioral theory of the firm suggests that when a company is below its performance aspiration, managers have a tendency to engage in problematic search which will influence the company's resource allocation such as marketing expenditure [12]. Wang and Lou found that both historical performance and social performance affect a firm's marketing investment, but in different ways in a study of panel data on 421 S&P 500 companies [11]. If the company achieves its goals or exceeds its expectations then the allocation is reasonable and the company will not change the investment decision [11]. In this circumstance, it is believed that the company has made a better investment decision. However, if the result is below historical performance, the firm will change its investment decision. The firm may spend more money on acquiring products [11]. Also, company will analyze problem and increase innovation which can help it improve its performance [11]. Therefore, a plenty of money will be invested in innovation [11]. However, another possible circumstance is that social performance interacts with historical performance to generate inconsistent performance feedback [11]. Under this circumstance, managers may be encouraged to become more willing to invest in marketing. When the firm's current performance exceeds historical performance but is inferior to social performance, it is better to reallocate resources and make a new investment decision [11]. On the contrary, the company's current performance may exceed social performance but below historical performance, which is due to the fact that the whole industry is in decline [11]. In this case, as long as the company performs better than its competitors, it still has an advantage. Therefore, the company might increase its investment in marketing activities such as advertising and promotion in order to solve this problem [11]. Also, Joseph and Gaba used Poisson specification to analyze the data and figured out that managers may be encouraged to persist with current products and reduce important investment activities in respond to ambiguous performance feedback [13]. In conclusion, factors including the company's current performance, historical performance and social performance will all affect company's investment decision.

2.2.3. Risk in The Investment Decision

Risk is a kind of possibility that may be exposed to losses. Identifying and managing risks need long-term experience and information [14]. Harcourt et al mentioned that the investment risk depends on both empirical analysis and financial theory [3]. They can help company to find out the limitations of the theories they used on investment, and therefore to minimize their risks. Chavas summarized that risk and uncertainty are two main issues to be considered for the investment of a company, since these two elements play a significant role in investment [15]. In general, there are always different types of risks in an investment project. Belli mentioned that when a company evaluates an investment project, they need to recognize different variables from the costs to the profits of an investment project. These analyses help the company filter and identify which is the biggest risk of the investment project. Based on the filtered information, companies can have a better understanding about these investment projects and choose whether to invest them or not according to their own risk orientation. Also, for the companies which have already invested these investment projects, they can also change their strategies to manage these risks [16]. Furthermore, Forbes mentioned the reason why there are risks in the investment is that investors cannot get fully comprehensive information about any investment project. In this case, uncertainty comes into the investment decision making process [16]. However, sometimes uncertainty can be forecast. In order to have a better forecast and narrow down the uncertainty in the investment project, Savvides concluded that companies should have a further understanding about the uncertainty of the variable in question, which depends on the quality and quantity of the variable's information in a certain time [16]. Also, Chavas believed that time plays an important role in risks since risks can act differently at different time period, which means risks have a temporal dimension [15]. Therefore, time should also be taken into account as a factor when companies analyzing the risks.

3. CONCLUSION

In this paper, based on 17 references, influencing factors of the investment decisions of enterprises were analyzed from the external and internal aspects. It is found that the government policies and environmental factors, as external factors of enterprise investment decisions, affect enterprises' willingness to make investment decisions. As long as the investment decisions of enterprises in the external environment are well controlled, enterprises can effectively maintain stable operation. At the same time, the influence of shareholders' psychological characteristics and behavior factors on corporate investment cannot be ignored. The C-company's current performance, historical performance and social performance are all internal factors affecting investment decisions. Risk and uncertainty are important contents to consider when deciding whether to invest or not. Enterprises understand investment projects and make choices by screening and identifying the biggest risks in investment projects. These findings are closely related to the influence of companies on investment decisions. Based on the comprehensive analysis of the influencing factors, this article could provide an effective reference for the enterprises and investors to make correct investment decisions.

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