



Summary

EMERGING MULTINATIONALS: WHO ARE THEY? WHAT DO THEY DO? WHAT IS AT STAKE?

Monday, 27 March 2006
OECD Headquarters – Room D
2 rue André-Pascal, Paris 75016

With support from

Boletín InformativoTechint



On 27 March 2006, the Development Centre organized a one-day experts' meeting on "Emerging Multinationals: Who Are They? What Do They Do? What Is At Stake?". The meeting, which was opened by Richard Hecklinger, Deputy Secretary-General, attracted more than 60 participants – including speakers from Banca Intesa, BIAC, CEPIL, Deutsche Bank, Goldman Sachs, Harvard Business School, Ifri, INSEAD, Macquarie Graduate School of Management, McGill University, Ministère de la Défense, UN Economic Commission for Latin America and the Caribbean, UNCTAD, Université Pierre-Mendès-France Grenoble 2, World Bank Group, and Xi'an Jiaotong University. The Chief Executive Officer of Business Leadership South Africa gave a keynote address on "South African Multinationals and Economic Development in Africa" which was introduced by H. E. Bruno Cabras, Italy's Permanent Representative to the OECD. Speakers from the OECD Secretariat represented the Development Centre, the Directorate for Financial and Enterprise Affairs, and the International Energy Agency.

Developing countries are increasingly becoming important source of foreign direct investment (FDI) to both OECD and other developing countries. The outward FDI stock from emerging, transition and developing economies multiplied by 11 since 1985 (although the year-on-year variance remains strong) and represents a growing share of global FDI stock (11% in 2004 vs. 7% in 1990). Indirect estimates indicate that South-South FDI flows rose from an estimated \$14 billion in 1995 to \$47 billion in 2003. Developing Asia dominates the scene, although new source areas, such as Russia and Gulf countries, are emerging. At the country level, South Africa is also important (more than India, close to mainland China). Most developing countries are regional in their OFDI patterns and South-South investment accounts for an increasing share of inward FDI (IFDI) in the South – with peaks in individual areas and sectors such as telecoms in Africa where emerging multinationals (MNCs) account for roughly half of total IFDI.

MNCs may significantly contribute to economic growth and development in host countries by increasing overall investment and creating technology and knowledge spillovers. In fact, increasing South-South FDI is particularly important for the international development agenda as the surge of recent years has to an important extent compensated developing countries for the decline in FDI flows from high-income countries (from \$130 billion in 1999 to \$82 billion in 2003). In addition, the share of South-South FDI is significant in several low-income countries under stress, including post-conflict ones such as Sierra Leone.

Despite acknowledging its positive trend, our knowledge about FDI outflows from the South is still limited. In part this reflects the relative novelty of developing countries as a significant source of capital, in part the absence of data. Differences in the way data are collected, defined and reported help to explain some of the oddities in global data compilations – in particular, while inward and outward FDI should in principle balance, they rarely do. In 2004, global FDI outflows stood at \$730 billion, whereas the inflows were \$648 billion. At the bilateral level, outflows reported by the investing economies seldom resemble the data provided by the recipient country. Existing criteria to define nationality differ – the principle of control, that of incorporation (used in the UK and the US), and that of corporate headquarter (used in Continental Europe).

All such limitations are further magnified in the case of South-South capital flows. Emerging MNCs may include companies controlled by non-resident entrepreneurs (such as Lakshmi Mittal), companies that move their primary listing to an advanced country's financial market and yet maintain a strong association with their countries of origin, companies incorporated in developing countries that are in turn subsidiaries of OECD MNCs, companies from developing countries that are owned by financial investors based in OECD countries, and finally companies established in offshore financial centres. Very few developing countries collect activities data and the relative scarcity of corporate data further limits the possibility of making meaningful comparisons. Moreover, a number of different institutions may be responsible for collecting similar statistics

and a major effort is needed to make sense of different sources – this is the case for instance in China where the statistics maintained by the central government (e.g., those provided by MOFCOM on its website) are rather incomplete.

The expansion in South–South FDI flows reflects developing countries’ increasing openness to capital and trade, their increasing participation in international production networks, and the increasing size and sophistication of developing country firms. Because of increased globalization of economic activities, developing-country companies are faced with growing competition in sales and in access to resources and strategic assets. As one paper shows, some such companies have managed to defy the traditional obstacles posed by their emerging market location and become emerging giants (defined as companies which are able to create value, generate adequate returns to investors, and attain a critical size in terms of employees or assets). They have been able to exploit three kinds of generic opportunities – exploiting as business opportunities their unique knowledge of domestic product and factor markets as well as local institutional voids.

As many developing-country governments have eased their policies toward capital outflows, their companies, like OECD-based MNCs, have expanded their operations abroad and hence become “emerging MNCs”. When studying the motivations that underline the decision to invest overseas – despite the well-known “liability of foreignness” – the traditional eclectic OLI framework is useful, but needs to be amended. Besides seeking markets, resources, and efficiency, emerging MNCs are also motivated by the “asset augmenting” objective. Moreover, push factors may be as important as pull factors. In particular, there are various forms of “defensive OFDI”, such as the need to jump over tariff and non-tariff barriers, to prevent accusation of job destruction (Indian providers of business process outsourcing), to counter eroding domestic margins (China electronics), and to reduce exposure to political risk at home (Russia). Furthermore, political and geostrategic considerations appear to play a very important role, in particular in natural resource sectors and/or in countries like China where the boundaries between the private and the public sectors are notoriously porous. This may partly explain the resurgence of protectionism – both in OECD and non-OECD countries – which is associated to the current phase of FDI from China and other developing countries.

The recent literature on emerging MNCs is mostly based on few anecdotal evidence, and deduction and inference from the history of North–South capital flows, rather than on a large body of systematic research. Three contributions presented at the meeting aimed at building a sounder empirical basis for further analysis. A survey reveals that the three most important motives for Chinese firms to engage in FDI were market seeking, strategic asset seeking, and global competitive strategy. Firms from more open and developed regions, such as Shanghai, cared more about the later two factors than the first one, while firms from less developed and inland regions, such as Xi’an, cared more about the first. A large portion of SOE firms was driven to invest abroad by the support from domestic government. Both in domestic and international markets, the biggest disadvantage for Chinese firms, especially private ones, was the difficulty of accessing finance. The sample firms expressed strong demand for better investment environment in the host countries. Their concerns were concentrated on exchange rate volatility, unexpected operational losses, and the decline of local demand. In general, Chinese firms are still on the learning curve to deal with market risks in hosting countries/regions.

A somewhat similar exercise was conducted in Latin America. Although there are examples of smaller companies having undertaken productive investments abroad, the focus was on the large firms which are responsible, as a group, for most of the outward investment undertaken from the region. These companies can be classified into two main categories – global investors and regional players – according to the geographical extent of their international productive investments. In some cases, companies are truly global players (CEMEX), catering to markets

worldwide, whereas in others, the global nature of investments has to do with the availability of natural resources. In services, the global trans-Latins are especially visible in the engineering industry. The development of most global trans-Latins was strongly influenced by State policies – albeit under very different forms. Some such companies remain fully or partially State-owned (Petrobras, ENAP, PDVSA); others began either as State-owned companies and were subsequently privatized – CVRD, Embraer, CSN, Usiminas – or derived most of their demand from governments (especially in public service infrastructure and heavy industry); and finally others are private companies that developed their own managerial, financial and productive capacity in relatively protected environments, which enabled them to reach significant scale and capacity before facing the challenges of globalization head-on. In the case of Embraer, an exception for the high-tech nature of its activities, public investment in productive and research and development (R&D) capacity and in forging institutional links between the company and R&D institutions over several decades was crucial, as is the existing export financing system. On the other hand, regional players have leveraged their know-how on operating in developing country settings and on developing country's consumer patterns to expand internationally.

Participation to global value chains also presents opportunities. Another paper analyzed in some depth the experience of three companies from China, Mexico and Turkey in one particular industry – the production of so-called white good appliances. The authors argued that the paths towards competitive insertion in the global economy can be diverse in terms of corporate strategies and governance structures. While these firms still remain regional in their geographical reach, their mindset is increasingly global – for instance in introducing organizational arrangements close to the global frontier and in developing their own brands in close cooperation with global consultants. At the same time, they maintain a very high domestic market share, confirming that accessing international specialized intermediaries is complementary with, and not a substitute to, the success in circumventing local institutional voids.

If the meeting served to highlight some incipient trends, it was particularly useful in drawing attention to the many unanswered questions. With no pretension to provide an exhaustive listing, topics that deserve continuing attention from the development community, including the Development Centre, include the following:

- **Which policies can be implemented to minimize the negative externalities of OFDI (namely investment displacement and its effects) and maximize positive ones?** According to the Latin American study, there still very little in the way of active promotion of OFDI [except for the generalization (to different degrees) of restrictions] and existing regional trade agreements such as Mercosur and the Andean Community play a relatively minor role in determining investment from countries in the region. On the other hand, this support has been determinant for successful Asian OFDI.
- **Should specific policies be enacted to encourage South-South investment flows?** Business in general looks for stable and transparent rules, macroeconomic and political stability, and high-quality infrastructure, both in the home and in the destination country. The China survey showed that more than half of MNCs thought that preferential treatments and investment promotion services provided by the host country was important or very important in their choice to invest in a specific country. Chinese firms investing abroad are still in their early stage of overseas operation, so attractive government policies in the host countries/regions are important for their choice of location.
- **What space is there to increase capacity of the home country to take advantage of positive externalities in terms of technology and skills feedback?** In high-performance OECD countries, appropriate policies have served to develop human resources, physical infrastructure, technology, and create backward linkages of the internationalized firms with other domestic companies and with local research institutions.

- **What are the main linkages between microeconomic and macroeconomic determinants of FDI flows?** Emerging MNCs may often invest abroad (rather than export) to fly away from domestic inefficiencies – such as exchange rate volatility or high capital costs due to poor country-risk ratings – and avoid the risk of protectionism in export markets. Any move to reduce global imbalances by adjusting the exchange rate of major developing countries' currencies (notably the Chinese *yuan*) is liable to put pressure on emerging MNCs to invest in industrial countries – but if this happens, *a fortiori* on the basis of increased purchasing power for hard currency-denominated assets, protectionist instincts are bound to gain further momentum.
- **Do firms from developing countries that invest abroad perform better than those that do not?** This is a complicated issue to tackle even in OECD countries and is made even more taxing elsewhere as private firms are not willing to reveal information on their performance. In the Chinese case, but probably in other countries as well, this is due to the fact that, as long as restrictions are imposed on foreign exchange, firms worry that a reported good performance in the foreign market might come to the attention of the tax bureau or the local government.
- **Can emerging MNCs deploy some comparative advantages compared to their Northern counterparts when they invest in other developing countries?** Such firms often have lower overhead costs and their managers are indigenous to the region. In addition, geographical proximity and cultural similarities can make coordination of foreign operations more effective. These companies may also have greater experience than companies from developed countries with the economic and political conditions of the host country, and are capable of better managing risk in post-conflict and other politically difficult situations.
- **Do emerging MNCs use resources, technologies, products, and services more suitable to the markets and the level of economic development of developing countries?** Narrower technological gaps between Southern MNCs and host economies, compared to their Northern counterparts, may foster positive spillovers to host developing countries. Early work seemed to corroborate the expectation that Southern MNCs have a more benign impact on host economies than Northern peers because they have a better appreciation of local conditions, are culturally closer, and use “intermediate”, small-scale technologies” that directly substitute labour for capital. Unfortunately, empirical research has not caught up with the policy debate. The only study on the differential impact of ownership on technology transfer and technology compares South African and OECD companies in Tanzania. The results show that South-South FDI do indeed have a higher potential.
- **May emerging MNCs – not least because they have different ownership structure and corporate governance – be more “patient” capital and show a higher degree of “loyalty” to the host economy?** The dynamism of Brazilian investors in Argentina after the 2001 default and in Bolivia over the past few years provides such an example. The enlargement and diversification of the pool of countries' sources of FDI may increase their flows and temper fluctuation, positively contributing to the economic development of host countries.
- **Which actions are Southern companies implementing to improve their environmental and labour standards?** It is generally believed that companies from the South follow lower environmental and labour standards, although the evidence on this is still scattered and inconclusive.