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Professor Klaus Schwab
Executive Chairman, World Economic Forum

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Augusto López-Claros
Director, Global Competitiveness Network, World Economic Forum

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Latin American Multinationals

LAURA ALFARO and **ELIZA HAMMEL,** Harvard Business School

An exciting phenomenon is taking place in Latin America. Chilean companies are operating plants in Peru and Argentina. Brazilian firms are investing not only in neighboring countries, but also in the United States and Europe. US workers who once fretted about losing jobs to Mexico are now working in Mexican-owned plants in the United States. The firms making this happen are part of an emerging group of Latin American firms many are referring to as "multilatinas"—Latin American Multinational Corporations (MNCs). The expansion of the multilatinas is generally viewed as a positive trend, part of overall growth in foreign direct investment (FDI) flows in the region over the past decade and a sign of the increasing sophistication of Latin American firms. But how important is this trend and how can it be explained? What are the implications for the region?

The benign view of FDI was not always predominant. Following World War II, strategies of import substitution for economic development spread throughout Latin America. Countries combined high tariffs with restrictions on MNC activity. FDI, regardless of its source, was regarded with suspicion. Critics argued that foreign firms exploited local markets, monopolizing rather than diffusing their know-how and repatriating exorbitant profits. Even in this environment, a first wave of multilatinas emerged in the late 1960s and 1970s, as firms established operations in mostly neighboring countries to serve local markets. Typically driven by the need to bypass tariffs, these earlier MNCs were quite different from today's multilatinas.

Beginning in the 1980s, Latin American countries began to liberalize their economies. The 1980s debt crisis severed developing countries' access to credit and portfolio investment and instilled the view that state intervention had failed. After decades of skepticism, a broad consensus began to emerge regarding the potential benefits of FDI to host economies through the provision of capital, technology, and know-how. Almost every country in Latin America reduced trade barriers, opened to foreign investment, and relaxed exchange controls. FDI soared worldwide in the 1990s, growing more than 25 percent per year in Latin America. While some predicted that the fall in tariffs would discourage intra-regional FDI, relaxation of capital controls and FDI restrictions enabled Latin American companies to transfer capital abroad more easily and invest in neighboring countries. At the same time, new regional pacts, such as Mercosur facilitated expansion abroad, and privatizations in neighboring countries afforded opportunities for acquisitions.

The expansion of Latin American multinationals

While many are heralding the emergence of multilatinas, the scarcity of data on intra-Latin American FDI makes it challenging to determine how significant this trend really is. Nevertheless, the available numbers are suggestive. Annual FDI outflows from Latin America surged in the

1990s, rising from US$1 billion in 1990 to US$11 billion in 2004.[1] The growth in the number of merger and acquisition deals reported by Securities Data Corporation (SDC) also illustrates the rise of the multilatinas. Before 1993, the average number of foreign deals reported for the largest Latin American countries was about four per year. This rose to about 25 in the mid-1990s and to about 40 per year in the late 1990s and the early 2000s.

The multilatinas are a varied group. Although the leading firms tend to be headquartered in the largest countries, Brazil, Mexico, Argentina, and Chile, most other countries can boast some MNCs. Five of the top 25 multilatinas are steel companies from Brazil, Argentina, and Mexico. Many companies are leaders in their respective industries, such as the Brazilian Gerdau Group, which owns steel mills in Argentina, Canada, Colombia, the United States, and Uruguay. Several emerged from privatized companies, such as the Brazilian mining and oil companies, Companhia Vale do Rio Doce and Petrobras.

Most multilatinas tend to expand regionally before venturing farther abroad. For consumer products, this can often be due to the fact that the cultural similarity of most Latin American countries makes regional firms better able to cater to regional tastes. The El Salvadoran restaurant chain Pollo Campero and Mexican tortilla manufacturer Gruma, for instance, have facilities throughout the region, including the United States. At the same time, a firm that lacks international experience might want to acquire the skills needed to manage across borders by first learning in a country that is similar and nearby. This could explain the path of the Argentine candy manufacturer Arco, which established distribution facilities throughout the region before building a plant in the United Kingdom.

Cemex, the third-largest producer of cement in the world, captures many of these trends. Formerly Cementos Mexicanos, the company began to establish operations abroad in the late 1980s and early 1990s, by acquiring distribution facilities in Spain and the United States. The company subsequently continued its international expansion, in the Caribbean, South America, and then farther afield to Egypt. In 2000, its acquisition of Southdown in the United States transformed Cemex into the largest producer of cement in North America. In 2004, the company closed a deal worth nearly US$6 billion in the United Kingdom. A world leader not just in terms of size, Cemex began exploiting state-of-the-art information technology even before its European rivals, enabling it to dramatically improve the operating efficiency of its acquisitions.

Why are Latin American firms investing abroad?

Although international expansion of Latin American firms might be attributed simply to the pursuit of profits in other countries, the phenomenon is not so straightforward. Doing business in another country incurs added costs associated with communications, stationing personnel abroad, barriers related to local customs, and exclusion from local business and government networks. Foreign firms seeking to reduce risk by diversifying geographically or to take advantage of access to cheaper capital than is available to local firms could achieve these objectives through portfolio holdings, thus avoiding the complexities of operating in a different political, legal, and cultural environment.

A generally accepted view holds that multinational activity arises from the possession of firm-specific intangible asset such as patents, technologies, brands, and organizational know-how that enable a foreign firm to outperform their local competitors.[2] Because high transaction costs can make selling or leasing these assets to other firms unfeasible, firms prefer to engage in foreign activity directly.

At first glance, emerging market multinationals would not seem to fit the logic of this conventional wisdom: firms in developing countries are generally not known for having the most innovative technology or access to superior human capital. Moreover, standard economic models predict that countries with relatively low supplies of skilled labor or capital—that is, emerging markets—will host foreign MNCs rather than establishing their own affiliates abroad.

How, then, can the existence of these world-class multinational firms from emerging markets, and in particular from Latin America, be explained? Taking a broader view of what constitutes intangible assets helps to explain the existence of these MNCs. In relation to their northern competitors, third-world multinationals are often closer to their host countries geographically, culturally, economically, and politically. As such, their know-how and technologies may be particularly well suited for the other emerging markets where they invest, and they may possess competitive advantages that enable them to circumvent or exploit local institutional voids.[3] Early work on the subject found the third-world MNCs of the 1960s to possess superior knowledge of small-scale labor-intensive technology.[4] The Mexican baker, Grupo Bimbo, is an example of a company that has successfully exploited institutional voids. Through backward integration into distribution, the firm developed a remarkable network capable of delivering fresh bread to millions of different points of sale, often quite small and in hard-to-reach locations. By exploiting this capability as they expanded across the region, they successfully competed with rivals relying on inefficient outside providers.

Strategic reasons can also drive a firm's decision to expand abroad. In the absence of fully developed financial markets, international expansion may help lower financing costs. Cemex has been particularly successful in this regard, channeling its financing activities through its Spanish subsidiary and securing developed-country interest rates on its debt. A buy-or-be-bought environment in some of the consolidating industries might also be driving the growth of the multilatinas. With the growth of global players and opening of markets, local firms may need to expand internationally in order to compete. While in these

cases the ownership of intangible assets does not play a direct role in explaining MNC activity, they may nevertheless be a prerequisite for successful expansion abroad.

Is all of this good news for Latin America?

MNC activity has historically stirred strong emotions in both home and host countries, and many of the traditional arguments for and against FDI apply to regional MNC activity as well. Outward FDI may lead to lower wages and fewer jobs in the source country, while MNCs could potentially limit the growth of host country firms. Monopolization of markets by emerging giants is also a concern, especially with antitrust legislation and litigation being either non-existent or in their infancy in the region. On the positive side, the multilatinas are a potential additional source of valuable productivity externalities for Latin host countries. Perhaps the biggest gain is in the "new culture" reflected by these firms. Latin American firms are responding to global trends by restructuring, developing a variety of tangible and intangible assets—including advanced management capabilities—and switching their overall focus to global markets. Admittedly, these firms face significant constraints, not least that the costs of obtaining financial, technological, and human resources are greater than those faced by competitors in industrialized countries. Yet, after decades of protection and transition, Latin American firms are thinking and competing globally—and succeeding.

Notes

1 Data taken from UNCTAD *FDI Database*. http://www.unctad.org/Templates/StartPage.asp?intItemID=2921&lang=1 Accessed 18 January 2006.

2 See Dunning, 1981.

3 Khanna and Palepu, 2004.

4 Wells, 1983; Lall, 1983.

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