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1. The rise of TNCs from emerging markets: the issues

Karl P. Sauvant

INTRODUCTION

The subject of this volume – the rise of transnational corporations (TNCs) from emerging markets: threat or opportunity? – is topical and important, and it poses a number of challenges that will require considerable policy attention in the future.

1.1 TOPICALITY

The topicality of the subject is exemplified by a spate of recent high-profile takeovers by emerging-market TNCs of firms in developed and developing countries. Examples are:

- Lenovo's (China) acquisition of the personal computers division of IBM (United States). When the deal was completed in 2005, Lenovo paid $1.25 billion with a total cost of $1.75 billion, including assumed debt.
- CVRD's (Brazil) takeover of INCO (Canada) in 2007, for $16.7 billion.
- Tata's (India) successful bid (against the competition of Companhia Siderúrgica Nacional of Brazil) for Corus (United Kingdom/Netherlands). The deal was reached in 2007, for a total price of $13.5 billion.
- Hindalco (India) bought Novelis (US) in 2007 for $6 billion.
- Dubai Ports World's acquisition of P & O Steam Navigation Company (United Kingdom), an event that led to an excited policy debate in the US as Dubai Ports World would then have controlled a number of ports in that country (Dubai Ports World eventually had to divest itself of its US assets). The sale for $6.8 billion dollars was approved in 2006.

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- Cemex (Mexico) bought Rinker (Australia) for $15.5 billion in 2007, the largest takeover in Australia's history.
- Lukoil Overseas Holding Ltd (Russia) purchased Nelson Resources Ltd (United Kingdom) in 2005 for $2 billion.
- Oger Telecom (Saudi Arabia) purchased Turk Telekomunikasyon AS (Turkey) for $6.55 billion in 2005.
- America Movil SA de CV (Mexico) acquired Telecom Americas Ltd (Brazil) for $2.27 billion in 2002.

These are just a few examples of how a new breed of firms from emerging markets, the new kids on the block, are becoming important players in the world foreign direct investment (FDI) market. Fittingly, an editorial in the *Financial Times* – enigmatically entitled 'Empire strikes back as Tata bids for Corus' – concluded as follows:

> The new trend for foreign purchases [by TNCs from emerging markets] has only just begun: the Tata-Corus deal is a dramatic demonstration of the new, self-confident mood of Indian business. Over the next 30 years, China and India will grow to dominate the world economy. They will give birth to great industrial companies that own plants all around the world. National pride may suffer a little but economic nationalism and imperialism have had their day and that can only be a good thing.[1]

This quote captures the underlying dynamic that is driving the rise of emerging-market TNCs, namely the re-emergence of China and India as important players in the world economy. As Jeffrey D. Sachs reminds us (in Chapter 2), the Asian economy accounted for some 60 per cent of world GDP at the beginning of the 19th century, and the region is in the process of regaining this share. (China alone accounted for over 30 per cent of world GDP (at purchasing power parity) at the beginning of the 19th century, a share that declined to about 5 per cent in the 1950s and recovered to 15 per cent in 2006.) But as we can observe, this process is broader (reflected, for instance, in the growing share of emerging markets in world exports), and encompasses a growing number of developing countries and economies in transition. It is therefore not surprising that this underlying structural shift finds its expression also in the rise of TNCs from emerging markets and hence outward foreign direct investment (OFDI) from them. The subject of this volume is therefore not only topical, but it is also important, and it will remain with us for the foreseeable future.

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1.2 IMPORTANCE

OFDI from emerging markets is not a new phenomenon: firms based in these countries have invested abroad for decades; this is reflected in their almost 13 per cent share in the world FDI stock in 1980 (Table 1.1).[2] What is new is the absolute magnitude that this phenomenon has achieved, growing rapidly, but largely unobserved, over the past 20 years or so in the shadow of the global expansion of FDI in general, driven primarily by TNCs from developed countries. More specifically, world FDI flows were about $50 billion during the early 1980s, of which flows originating in

Table 1.1 Distribution of OFDI by region and selected countries, 1980–2005 (%)

Region	**Stock**			
	1980	***1990***	***2000***	***2005***
Developed economies	87.3	91.7	86.2	86.9
European Union	37.2	45.2	47.1	51.3
Japan	3.4	11.2	4.3	3.6
United States	37.7	24.0	20.3	19.2
Emerging markets	12.7	8.3	13.5	11.9
Africa	1.3	1.1	0.7	0.5
Latin America and the Caribbean	8.5	3.4	3.3	3.2
Asia and Oceania	2.9	3.8	9.5	8.2
Southeast Europe and CIS	..	0.01	0.3	1.2
World	100.0	100.0	100.0	100.0

Region	**Flow**			
	1978–1980	***1988–1990***	***1998–2000***	***2003–2005***
Developed economies	97.0	93.1	90.4	85.8
European Union	44.8	50.6	64.4	54.6
Japan	4.9	19.7	2.6	4.9
United States	39.7	13.6	15.9	15.7
Emerging markets	3.0	6.9	9.4	12.3
Africa	1.0	0.4	0.2	0.2
Latin America and the Caribbean	1.1	1.0	4.1	3.5
Asia and Oceania	0.9	5.6	5.1	8.6
Southeast Europe and CIS	..	0.01	0.2	1.8
World	100.0	100.0	100.0	100.0

Source: UNCTAD 2006.

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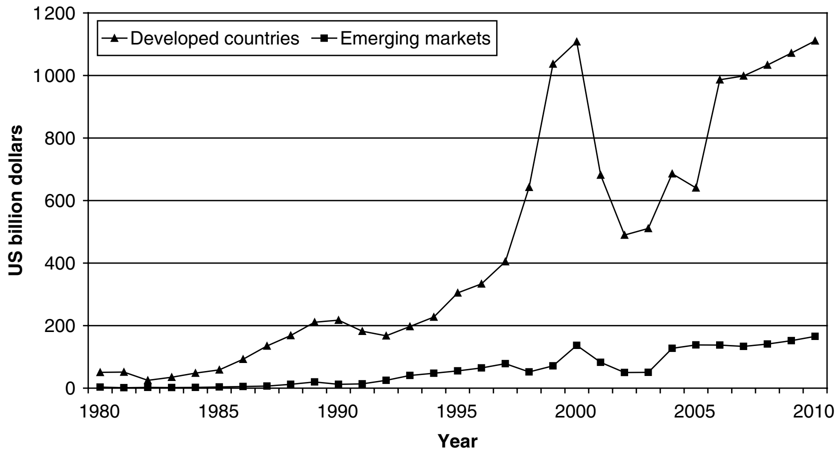

Note: Data for 2006–2010 are forecasts for 82 countries responsible for the bulk of all OFDI flows from both developed and emerging markets; Data for 2006–2010, Kekic and Sauvant (2006).

Source: Data for 1980–2005, UNCTAD 2006.

Figure 1.1 OFDI flows from developed countries and emerging markets, 1980–2010

emerging markets were negligible. By 2005, world OFDI flows had risen to \$779 billion, of which \$133 billion originated in emerging markets – almost three times world FDI flows two decades earlier.[3] Estimates are that the level of OFDI from emerging markets will remain at this level at least until 2010, although they may well be higher (Figure 1.1).[4] These flows had accumulated to a stock of \$1.4 trillion by the end of 2005. Overall, emerging markets now account for roughly 15 per cent world's FDI flows, FDI stock, cross-border mergers and acquisitions and greenfield investments.

The regional distribution of OFDI from emerging markets has undergone a dramatic change over the past 25 years (Table 1.1). In particular, the role of Latin America and the Caribbean versus that of Asia as dominant home region has been reversed: the former accounted for two-thirds of OFDI stock of emerging markets in 1980, a share that declined to one quarter in 2005; over the same period, the share of Asia rose from nearly one quarter in 1980 to almost two-thirds in 2005. Moreover, a good part of this investment is in other emerging markets. In developing Asia, for example, perhaps some 40 per cent of FDI originates in other emerging markets.[5] More broadly, emerging market TNCs have become important investors in many of the poorest countries in Africa and Asia. This reflects

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the tendency of TNCs, including emerging-market TNCs, to invest typically in their own region, as Alan Rugman examines below (Chapter 6), and explores in particular for Chinese TNCs. Part of the reason for this pattern is that firms typically have better regional than global knowledge; however, it also shows how difficult it is to become a truly global player. Firms headquartered in China are also the subject of discussions by Peter J. Buckley *et al.*, who investigate factors explaining China's OFDI (Chapter 7).

Moreover, while a fairly limited number of economies accounts for the bulk of this OFDI,[6] with firms from Brazil, Russia, India and China (the BRIC countries)[7] being particularly visible, over 90 emerging markets reported at least some OFDI flows in 2005. In fact, the number of emerging markets with an OFDI stock of over $5 billion has risen from 6 in 1990 to 24 in 2005 (Table 1.2). This reflects the fact that there are at least 20 000 emerging-market TNCs (defined as firms controlling assets abroad). Most of this OFDI is in services, including trade-supporting services.

It is not surprising that there is such a high number of emerging-market TNCs: like their competitors from developed countries, they too face the same opportunities and pressures of the globalizing world economy. More specifically (and apart from the structural changes mentioned earlier), the strategies of firms, whether large or small, from developed countries or emerging markets, are increasingly driven by a combination of three factors:

- the worldwide liberalization of FDI regimes, which opens new opportunities for firms to expand;
- advances in transport, communication and information technologies, which create opportunities to manage integrated international production networks consisting of parent firms and their foreign affiliates located in various countries; and
- competition among firms, which drives firms to take advantage of these new opportunities and possibilities.

These factors were also present 30 years ago or so, when the transnationalization process of firms from developed countries gathered speed. But the economic globalization process (itself partly driven by the growth of FDI), as John H. Dunning, Changsu Kim and Donghyun Park explore below (Chapter 8), created a new environment within which emerging-market firms (as well as those from developed countries) are under greater pressure than ever before to transnationalize. Increasingly a portfolio of locational assets in the form of a regional or global network of foreign affiliates becomes one source of the international competitiveness of firms. No wonder, then, that firms from emerging markets are increasingly investing abroad.

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Table 1.2 Emerging markets with an OFDI stock of $5 billion or more, 1990, 2005 (US$m)

Economy	1990	Economy	2005
Brazil	41 044	Hong Kong (China)	470 458
Taiwan Province of China	30 356	British Virgin Islands	123 167
South Africa	15 004	Russian Federation	120 417
Hong Kong (China)	11 920	Singapore	110 932
Singapore	7 808	Taiwan Province of China	97 293
Argentina	6 057	Brazil	71 556
		China	46 311
		Malaysia	44 480
		South Africa	38 503
		Korea, Republic of	36 478
		Cayman Islands	33 747
		Mexico	28 040
		Argentina	22 633
		Chile	21 286
		Indonesia	13 735
		Panama	12 891
		Venezuela	10 665
		UAE	10 087
		India	9 569
		Colombia	8 876
		Bermuda	5 982
		Kuwait	5 403
		Bahrain	5 058
		Nigeria	5 026

Note: As already noted earlier, data on OFDI from emerging markets need to be interpreted with caution. The phenomenon of trans-shipment FDI has already been noted; it is reflected in the stock data as well. Another difficulty is that flow data (although recent) do not accumulate, even closely, to stock data; that appears to be the case for Russia. As for the 1980 data, Brazil accounted for nearly half of the stock reported here; it is quite possible that most of it was in tax havens.

Source: UNCTAD 2006.

1.3 CHALLENGES

But the growth of this investment poses a number of challenges. There is, first of all, the challenge for the firms themselves. To be competitive in the international FDI market, firms need ownership-specific advantages. When combined with the locational advantages of host countries and those of internalizing transactions within their own corporate networks (as opposed

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to, say, servicing a foreign market through exports), ownership-specific advantages allow firms not only to survive in foreign markets, but also to prosper in competition with domestic rivals.[8] The bottleneck in this respect is often not so much finance or even technology, but human resources with the experience of managing regional or global production networks and the various challenges and risks associated with that; this experience becomes all the more important if international expansion takes place through mergers and acquisitions (M&As) as these typically pose the additional challenge of integrating already-established operations, often with their own distinct corporate culture, into a new corporate environment. And success as regards M&As is, as John Cantwell and Helena Barnard discuss (Chapter 5), one indicator of the competitiveness of emerging market TNCs. This volume does not explore these issues, although Ravi Kant's account (Chapter 3) of the experience of Tata touches upon some of these matters in the broader context of the transnationalization of that firm, and Paulo Resende and Alvaro Cyrino's discussion (Chapter 4) of the internationalization of the supply chain provides a taste of one of the specific managerial tasks involved.

Host countries too, face challenges of a mixed nature. For one, emerging markets have now become an important source of FDI that can be tapped. To do that, host countries must get away from a mindset that FDI flows originate only in developed countries, and from, as a result, gearing their efforts to attract such investment only (or overwhelmingly) from those countries. This is already beginning to take place. Thus for example, a number of countries have established branches of their investment promotion agencies (IPAs) in China, precisely to tap into that country's reservoir of FDI. Furthermore, IPAs in Africa expect that, in the future, a good part of their FDI will come from Asia, and presumably, will direct their promotional efforts more toward that region (UNCTAD 2006, p. 220).

While the impact of emerging-market TNCs on host countries may not be systematically and substantially different from that of their developed-country competitors, it may well be that especially smaller firms among them may at times be less sensitive to some host country concerns, or engage in practices that may compare unfavorably with those of other foreign firms. At the same time, as Carrie Hall documents (Chapter 11), it may be that such negative aspects are, at least for some larger emerging-market TNCs, counterbalanced by more sharply developed corporate social responsibility practices, as firms from emerging markets are presumably more attuned to the conditions of poverty characterizing most of their home economies.

But there is also a broader and in some ways more difficult challenge, particularly for host countries in the developed world: they need to see the rise

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of TNCs from emerging markets not as a threat but as an opportunity, as an additional avenue to integrate emerging markets fully into the world economy. In other words, they need to accept that emerging-market TNCs are here to stay.[9] In fact, they will become more important and need to be integrated as smoothly as possible into the world FDI market dominated so far by developed-country TNCs. It is not easy to integrate rising powers (as we know from other contexts), especially if they challenge established players across a growing range of industries. The defensive reactions to some of the takeovers mentioned earlier in this chapter – (or attempts thereof, such as CNOOC's (China) bid to acquire UNOCAL (US), or the possibility of Haier (China) taking over Maytag (US) – bear this out, and are examined by Andrea Goldstein (Chapter 9). They are particularly acute if market entry takes place through cross-border M&As as, by definition, these do not lead to the immediate creation of new production capacity but rather represent only a change in ownership, from domestic to foreign hands. Moreover, M&As are often accompanied by restructuring, which can involve the closing down of business activities and lay-offs of personnel (even though such actions may be needed to ensure the survival of the entity involved). M&As can acquire an additional edge and become especially controversial when the acquiring firms are state-owned enterprises and acquisition targets are in sectors considered sensitive by host countries, be it for security or economic development reasons, or because they are national champions. Related issues concern the internal governance of emerging-market TNCs in the light of the perception that these firms may have limited experience in managing international production networks and may sometimes not be as well governed as would be desirable; the latter issue is examined by Rainer Geiger (Chapter 10).

All this means that there is a growing tension, especially in host countries in the developed world, between their desire to attract FDI and their uneasiness with respect to the 'new kids on the block' that disturb the established order.[10]

Tensions – although not yet visible – are also likely to emerge in the home countries of emerging-market TNCs. The basic reason is that the overwhelming number of emerging markets, be they developing countries or economies in transition, are capital-importing countries, that is, economies that need capital to advance their development. Allowing OFDI, let alone encouraging it, is counterintuitive and therefore not an obvious policy choice for home country governments, even if they understand that their firms, to remain internationally competitive, require a portfolio of locational assets. So far, this tension has not surfaced, as it is partially obscured by national pride in the success of one's own firms in acquiring major assets in developed countries. But it may only be a question of time until pride is

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replaced by concern, in particular, about productive capacity and jobs being created abroad and not at home, and about 'hollowing out'.

What this calls for is a policy debate in emerging markets that are home countries, involving all stakeholders – business, unions, non-governmental organizations, the government. Such a dialogue requires of course an understanding of the impact of OFDI on the international competitiveness of domestic firms and the economic performance of home countries. Reference has already been made to the analysis by John Cantwell and Helena Barnard (Chapter 5), dealing with the former issue. Steven Globerman and Daniel M. Shapiro examine (Chapter 12) the latter issue. Theodore H. Moran (Chapter 13) takes this analysis a step further by discussing policy implications. As Moran points out, these analyses partly build on work that was done some 30 years ago for developed countries, when OFDI from them became a hotly debated issue. Work at that time showed that, on balance, such investment is beneficial for home countries, with the benefits accruing through a number of channels. Little work on that subject has been done since then, and virtually no work in the context of emerging markets. The chapters in this volume are, therefore, pioneering. They can serve as building blocks for a more comprehensive understanding of this subject and the policy options that emerge from it.

For governments of developed countries, these policy options all pointed in one direction: to liberalize OFDI flows (and, by now, they have almost all completely done so) and to develop a set of instruments designed to protect and encourage such flows. At the national level, these instruments include the provision of information on investment opportunities, insurance against certain risks offered to firms investing abroad, and the provision of certain types of finance for overseas projects.

At the international level, developed countries pioneered bilateral investment treaties (BITs), with the first one concluded between Germany and Pakistan in 1959, to promote and protect FDI.[11] Originally concluded virtually entirely between developed and developing countries, the number of BITs between emerging markets accounted for 26 per cent of the total number of BITs at the end of June 2006, and 30 per cent of the BITs concluded between 1 January 2005 and 30 June 2006 (UNCTAD 2007a). This is, in and by itself, a sign that governments of emerging markets see the need to protect and promote the outward investment of their firms in a bilateral context; in fact, a number of them have also done so in a regional context, for example, in NAFTA, MERCOSUR and ASEAN.

But emerging markets, and particularly developing countries as a group, have resisted efforts led by developed countries to do the same at the multilateral level of the World Trade Organization (WTO).[12] It remains to be seen whether this attitude will change in the light of developing countries

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themselves becoming important outward investors (including those that were among the leaders of an investment agreement in the WTO, India and Malaysia). Edward M. Graham (Chapter 14) is skeptical in this respect, while Joseph E. Stiglitz (Chapter 15) points in particular to the importance of such an agreement taking into account the needs of developing countries. While the question of a multilateral framework on investment is currently not on the agenda of the world community, it may well be that the rise of TNCs from emerging markets changes the underlying interest situation of key emerging markets in such a manner that they too seek a multilateral framework for this international economic activity, complementing the institutional arrangements that already exist for international trade and finance. Other emerging markets, for their part, may find it in their interest, and to their benefit, to deal with investment matters in a multilateral rather than a bilateral (or regional) context, as the former typically is more favorable for smaller countries. The explosion of international investment disputes in recent years and the discussions of a review mechanism this has triggered[13] may well give additional impetus to a multilateral approach.

CONCLUSION

The rise of TNCs from emerging markets poses threats and offers opportunities. The threats consist mostly of challenges to integrate the newcomers smoothly into the international FDI market and the world economy, at levels eventually on par with the best-managed TNCs. The opportunities consist mostly of the potential for OFDI from emerging markets to strengthen the economic performance of their home countries, and the fact that emerging-market TNCs represent a new source of capital, technology, skills and access to markets for host countries to advance their own development.

The contributions in this volume – all of which are mentioned in the course of this chapter – examine a number of issues related to the rise of emerging-market TNCs. They were discussed during the International Conference on *The Rise of Transnational Corporations from Emerging Markets: Threat or Opportunity* held at Columbia University on 24–25 October 2006, and subsequently finalized in the light of these discussions; the event was organized by the Columbia Program on International Investment, Fundação Dom Cabral (Brazil) and the South–South Unit in the United Nations Development Programme (UNDP). The essence of these discussions is captured by Lorraine Eden (Chapter 16). As the subject of this Conference and this volume is complex and has not yet received the attention it deserves, this book can only be a step in the direction of

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fostering a much better understanding of, and developing appropriate policy options for the rise of TNCs from emerging markets.

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NOTES

1. 'Empire strikes back as Tata bids for Corus', *Financial Times*, 21 October 2006.
2. There was a burst of literature in the 1980s drawing attention to FDI by firms from developing countries. See Kumar and McLeod (1981); Lall (1983); Lecraw (1981); Oman (1986); Wells (1983). An example of later writing is Dunning, Van Hoesel and Narula (1998).
3. For extensive recent discussions of OFDI from emerging markets, see UNCTAD (2006) and Goldstein (2007); some of the chapters below also document various aspects of this development. Unless otherwise noted, the data below are from the *World Investment Report* and especially UNCTAD (2007). It should be noted that some 10 per cent of OFDI flows from emerging markets originate in offshore financial centers, often consisting of trans-shipment FDI from other emerging markets and from developed countries.
4. In the case of Brazil, for example, outflows of FDI in 2006 actually surpassed FDI inflows, and the same is predicted for India in 2007. See ECLAC (2007, p. 68) and Bhutani (2007). The same situation is more difficult to imagine for China, given its high levels of FDI inflows. However, it is conceivable that as inflows stabilize while outflows soar, driven not only by the government's 'Go Global' policy, but also by China's State investment company, to be established in the course of 2007 to invest part of China's official reserves more profitably abroad. Even before that company was formally established, it acquired in May 2007 non-voting shares worth $3 billion (9.9 per cent) of The Blackstone Group (the second largest US private equity firm), in this manner not triggering an examination by the Committee on Foreign Investment in the United States (*China Daily*, 22 May 2007).
5. Some of this FDI, though, is indirect FDI, the ultimate parent firms of which may be headquartered in a developed country. A good part of OFDI from Hong Kong (China) and Singapore, for example, is from foreign affiliates located there. (Reference has already been made (note 3) to trans-shipment FDI in offshore financial centers.)
6. In 2005, the five most important emerging-market home economies accounted for about two-thirds of the OFDI stock of all emerging markets, and the top ten for 83 per cent.
7. See Sauvant (2006).
8. For an explanation of what drives FDI, see Dunning and Lundan (forthcoming).
9. In 2005 there were 47 firms from emerging markets listed in *Fortune*'s Global 500, as compared to 19 in 1990 (UNCTAD 2006, p. 122).
10. This uneasiness can fuel a broader backlash against FDI, see Sauvant (2006).
11. Double taxation treaties are also important; they are meant to avoid, as their name suggests, the imposition of double taxation on the profits of TNCs. By the end of June 2006, 2799 such treaties existed; see UNCTAD (2007a).

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12. Beyond the General Agreement on Trade in Services (which covers FDI in services) and the Agreement on Trade-related Investment Measures (which covers certain performance requirements).
13. See Sauvant with Chiswick-Patterson (forthcoming).

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