Multinationals from emerging economies: Can they become a key force in the global landscape?

Business Operations in Emerging Economies Module

Master in International Business

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18/01/2011
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1. Introduction

Twenty years ago, nobody would have ever believed that a Mexican company could become the largest cement manufacturer of the United States (Smith, 2009), or that an Indian car manufacturer could acquire Land Rover and Jaguar (Milner, 2008). In fact, currently the strange thing is to wake up without reading news in the media about operations concerning multinationals from emerging economies.

These companies, also known as EMNCs (Department of Economic and Social Affairs of the United Nations, 2007; Gammeltoft, Pradhan, Goldstein, 2010) have proven to be able to compete on equal terms with main the leaders coming from the so-called “developed” countries. According to the Fortune Global Top 500 companies ranking, 3 Chinese companies (Sinopec, State Grid, and China National Petroleum) - all of them with revenues beyond $150 billion - are in the top 10. Exhibit 1 shows how emerging economies, especially China, are placing their companies among the largest companies in the world while the western companies lose steam.

According to this data, in 2005 USA had 176 companies in the top 500, while China had only 16, India 5, Taiwan 2 and Russia 3. In 2010, USA has 139 (-21%), whereas China has 46 (+187.5%), India has 8 (+60%), Taiwan has 8 (+300%) and Russia doubled to 6 (+100%).

In addition to this, as the UNCTAD states in its World Investment Report of 2010, emerging economies have been strengthen, or less damaged, by the global downturn of the economy. For many companies, this period has been especially opportune since it has allowed them to increase their investments in western companies, in many cases, directly acquiring them like the examples shown above.

As a consequence, there is rising reluctance among the firms from developed countries about whether the emergence of these economies is good or not.

On one hand, the success of countries like China or India boosts both global supply and demand. On the other hand, the extreme competition based on dramatic lower prices and the appearance of strong new contenders, is causing huge problems to the local industries of developed economies.

This work will analyse how likely the entrepreneurial world might change in the coming years as a consequence of the emergence of these new contenders. Furthermore, the paper will highlight some of the basic key elements that helped some EMNCs to emerge, and which are the chances of them replacing the current top firms.
1.1. A new trend in FDI?

1.1.1. Issues regarding FDI measures

Foreign Direct Investment is widely used as a tool for measuring the trends in global trade relationships. However, especially while recognising the FDI outflows from developing economies, there are several issues that analyst need to be aware of while observing these data. Aykut and Ratha (2003) summarise some of this problems as the following:

- underreporting outflows by high-income-OECD countries. For example, the total OFDI reported by Hungary in 2001 amounted for $0.3 billion, whereas US alone recognised $5.9 billion from Hungary;
- underreporting inflows by some developing countries. India’s different identification of what was FDI with the IMF that lowered their FDI inflows by $2-3 billion per year;
- overestimation of South-South FDI flows as a consequence of round-tripping of flows;
- transactions channelled through offshore financial centres;
- and FDI from the developed countries that as it gets channelled through a emerging country, it causes an overestimation of South-South FDI.

Also, in some cases like China, government policy of incentives favouring OFDI is leading to recognise domestic transactions as international in order to gain benefits from them.

1.1.2. Defining the “Emerging Markets”

“Emerging Economies” was firstly used by Antoine W. van Agtmael in 1981, and referred initially to countries that in GDP terms were between the top less developed and the less top developed. Currently, the term is not used just in GDP terms. It includes countries that are pursuing “political and economic reforms and a more complete integration into the world economy” (Foster, 2011).

Even though this term is commonly used, there are still different interpretations. Organisations such as UNCTAD, OCDE and other media as “The Economist” or CNN’s Fortune 500 set different criteria for defining which countries should be considered “developed” and which ones should be conceived as “emerging” or “developing”.

The Economist lists 28 countries: Mexico, Brazil, Argentina, Colombia, Peru, Chile, Venezuela, South Africa, Egypt, Morocco, Poland, Turkey, Czech Republic, Hungary, Russia, Slovakia, India, Indonesia, China, South Korea, Hong Kong, Malaysia, Pakistan, Philippines, Singapore, Thailand, Taiwan, Israel and Saudi Arabia (Foster, 2011). However, this list does not show the significant differences among these countries, putting together in the same group disparate countries such as Singapore ($57,238 GDP/capita) and Philippines ($3,725 GDP/capita) (IMF, 2010).
On the other hand, FTSE differentiates two types of emerging markets (FTSE, 2010): advanced emerging (6: Brazil, Hungary, Mexico, Poland, South Africa and Taiwan) and secondary emerging (16: Chile, China, Colombia, Czech Republic, Egypt, India, Indonesia, Malaysia, Morocco, Pakistan, Peru, Philippines, Russia, Thailand, Turkey and UAE). Note that many countries in FTSE are directly listed as “Developed” (Israel, Hong Kong, Singapore, and South Korea) and others are listed as “Frontier”, a lower level to “secondary emerging” (Argentina, Slovakia and Venezuela).

1.1.3. **Emerging economies FDI outflows trends**

Publications in the last part of the past decade show how increasingly the FDI from emerging countries has grown. Figure 1 illustrates the evolution of shares of developing and transition economies in global FDI, both inflows and outflows (UNCTAD, 2010). Moreover, UNCTAD’s World Investment Report 2010 highlights the fact that, despite the current crisis, the relative weight of emerging economies is likely to keep growing as both destination and source of FDI in the short and medium.

![Figure 1. Shares of developing and transition economies in global FDI inflows and outflows, 2000-2009 (Per cent) Source: UNCTAD, World Investment Report 2010.](image1)

Compared with historical data, emerging economies and developed ones had similar levels in term of outwards FDI in the 80s (see figure 2). The gap started to broaden during the 90s, when many emerging economies faced internal crisis (Mexico in 1994, Asia in 1997, Russia in 1998, Brazil in 1999, Argentina in 2001) (The Economist, 2006). However, the deep impact of the financial crisis in the develop countries, and the resistance of developing economies to these turbulences, is currently reducing this gap.

![Figure 2 Outward FDI trend, from 1980 to 2009. Measure: US Dollars at current prices and current exchange rates in millions. Data: UNCTAD.](image2)
The main investors can be found in Asia. In fact, the company from an emerging economy with the largest amount of foreign assets is the Hong Kong based Hutchinson Whampoa, a conglomerate that operates mainly in the telecommunications and logistics sectors. According to the UNCTAD, the company lists 25 in the top non-financial TNCs ranked by foreign assets in 2008, accounting for $70,762m foreign assets over total assets of $87,745m. Chinese Citic Group is also present, ranking 48th, with a total value of foreign assets of $43,750m.

1.2. The Three waves theory

Antoine W. van Agtmael (2007) identifies in his book “The emerging markets century: how a new breed of world-class companies is overtaking the world” three main waves that help to understand the development of the EMNCs, and the evolution of the relationships between the Developed and Emerging Countries.

First Wave Foreign Direct Investment in Overseas Plants

After World War II, multinationals mainly from North America, Western Europe and Japan saw the opportunity of opening manufacturing plants in emerging economies in order to take advantage of some benefits these offered (cheap labour, access to raw materials and presence in interesting future markets). These companies opted for directly importing everything needed for developing their activities (managers, machinery, capital technology). Some countries interpreted this as neo-colonialism and preferred to stay isolated, while others understood that it was an ideal chance for obtaining the capital and technology needed for the development of local industry.

From an historical perspective, countries that welcomed FDI not only receive capital and technology, but they also eased the familiarisation of domestic workforce with global technology, western management methods and the rigid standards for service and efficiency.

Second Wave: Outsourcing and Off-shoring

As a logic evolution of the first wave, emerging economies started to be able to provide by themselves added value to companies. They could easily access capital markets, get the latest technology and learn how to master it. Education, in many cases (Singapore, Finland, South Korea), was identified as a key area for the future development of the country by local governments. Local universities were able to produce skilled workers, usually specialized in their countries main industries.

As a consequence, multinationals realised that, in many cases, there was no need for setting up expensive overseas subsidiaries. Instead, firms from developed countries opted for outsourcing and off-shoring non core activities to companies from emerging economies. The
development of communication and transportation technologies enabled this process, making it easier to control all the processes from their local HQs (The Economist, 2006).

Firstly, the companies opted to outsource the processes that were not part of their main core competences and could be easily done by any other party. Over the time, the level of the technology of outsourced processes climbed, with emerging companies providing sophisticated products and even their design.

Even though multinational firms kept a dominant position in this relationship, thanks to their brand names and international distribution structures, they developed a reliance on their partners’ process technologies.

Third Wave: Peer-to-Peer Emerging World-Class Competitors

This wave responds to what is happening in the present. Several companies from different emerging economies are starting to put their names in the very top positions of their respective industries. In addition to this, they are taking an aggressive attitude, translated in mergers and acquisitions, with the clear intention of being the market dominants. Some examples are:

- Tata’s successful bid for Corus (UK/Netherlands) on 2007, for a total price of $11.3 billion. (Rai, 2007)
- Hindalco’s acquisition of Novelis for $6 billion (Pam, 2007)
- Lenovo’s acquisition of IBM’s personal computer division in 2005 for $1.25 billion (Bukovinsky, 2005).

However, as it happened with the takeover of Ulker over the premium chocolate brand Godiva (Kale, Singh and Raman, 2010), multinationals from emerging economies do not aim to change the identity of these companies, but to keep it and learn from them as well as using their understanding of how local markets work.

1.3. A fourth wave?

As van Agtmael shows, most of the companies from emerging economies are no longer mere outsourcing solutions for western companies but international contenders that are increasingly growing in a wide selection of industries. Following aggressive strategic decisions, these EMNCs are opting for taking advantage of the existing difficulties that some developed industries are facing in order to acquire them.

Nevertheless, is it possible for these new contenders to replace the traditional leaders of their industries and change the current Status Quo? Will we see companies like Hyundai or Tata competing directly in terms of quality with almighty German car manufacturers? Is this going to become a Fourth Wave?
2. Highly competitive Multinationals from emerging economies: characteristics.

Multinationals from emerging countries are becoming increasingly relevant thanks to different conditions that give them advantages in the global markets. This paper highlights three main categories of advantage for these companies: 1) privileged access to national resources (UN, 2007); 2) high-tech focused companies; 3) companies using the vast domestic market to exploit economies of scale.

Some of the major players coming from emerging economies are state-owned firms that thanks to their exclusive access to national resources have been able to expand internationally. Oil is an illustrative example, e.g., Russian Lokoil and Gazprom. By having the strong support of their local government, these companies have invested heavily abroad in order to become more competitive. These investments have two main objectives: diversify their portfolio by integrating upstream activities such as exploration and production, and secondly, integrate downstream activities, refining and distribution, in order to reach directly their customers. Others, as Petrobas and Petronas, have developed strong competences in specific areas such as deep-water exploration. In the case of other large emerging economies that lack the natural resources, such as China and India, they have built large companies that acquired foreign reserved of oil and gas assets in order to meet internal needs of those resources.

On the other hand, governments of smaller size countries with limited natural resources, focused on enabling conditions for productivity and foster private sector development so that a “created prosperity” (Porter cited in Esposito, 2011) would be achieved in the future. Some of the countries that took these measures are Taiwan and South Korea, which now are host some of the highest technology companies (Samsung, LG, HTC, Hon Hai Precision) in the world.

Finally, as a consequence of the immense domestic market dimensions of China and India, and a cheap labour market, companies from these countries have acquired expertise in mass production at low prices that can be exploited internationally. Textiles companies in China are a good example of this.

3. Becoming international main players: three cases

3.1. Samsung (S. Korea): in the 4th wave

Samsung history show how companies from emerging economies can finally become global leaders.
According to their latest financial information, the group achieved a total revenue of $175 billion, i.e., the total amount of Ireland’s GDP in 2010 (IMF, 2010).

Samsung, founded in 1938, was initially conceived as a trading company specialised in groceries. In the 50s the company moved into the manufacturing sector: sugar and fabrics. Finally, in 1969, Samsung Electronics is created, the area that has given popularity to this Korean company. The company grew with the intention of becoming a vertically integrated firm imitating Japanese firms.

Four factors characterised initially the entrance of Samsung in the electronics industry and how the company competed in the following years (Kim, 1997). Firstly, an emphasis on mass production, which was easy for them since they already had that know how as a consequence of their manufacturing activities in the sugar industry. Secondly, Samsung had no experience in electronics thus it had strong dependence of externally developed technology, normally coming from Japan. Thirdly, the main strategy was based on imitating Japanese companies. And, finally, there was a strong governmental support which helped the company to grow.

In order to address the lack of technology, the company created joint ventures with foreign firms like Sanyo and NEC. Another measure taken was the training of their staff. Korean employees were sent to Japan in order to acquire the Japanese expertise of assembling technologically simple products.

Giving the countries small market, the company’s strategy was exports-led. Most sales were made through Original Equipment Manufacturer (OEM) channels. The clients provided the designs, quality controls and engineering support while Samsungs concern was to increase productivity.

The company continue to grow international under its own brand, but international consumers saw Samsung’s products as lower quality compared to Japanese competitors, which were perceived as high quality products (Nebenzahl and Jaffe, 1991 cited by Kim 2006).

Seoul ‘88 Olympic Games helped to improve Korean country-of-origin perception, and even if this had positive effects on Samsung brand, the Korean company was still much behind Japanese leaders (Nebenzahl and Jaffe, 1991 cited by Kim 2006).

According to Rocks and Ihwan article in BusinessWeek (2004), the company decided to move towards an innovation-driven firm after its CEO, Lee Kun Hee, in 1993 visited some retailers in the US. According to these authors, “Samsung products were lost in the crowd, while those from Sony and others stood out. So he ordered his managers to concentrate less on cost saving and more on coming up with unique products. The bottom line: Great design could catapult Samsung to the top ranks of global brands”.

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Once this strategy was taken, the culture of the company changed. There were some visible changes, such as the creation of the Innovative Design Lab of Samsung, where creative people could learn from international experts, and moving its design centre from Suwon, a small city, to Seoul in order to attract young designers. Besides, other subtle changes occur, such as an encouragement of new thinking from young people, moving from the traditional Korean culture of youngsters deferring to their elders.

In the next four years, the allocation of staff on design activities doubled, the design budget risen by 20-30 percent per year, design centres were opened internationally (Japan, USA, UK, China) and the Chief Design Officer position was created to provide a shift of authority from engineers to designers.

The results of this strategy were excellent. In 2004, was the first Asian firm obtaining more Industrial Design Excellence Awards (5) than any European or American rival (http://www.idsa.org/content/panel/idea-2004-gallery).

Today, Samsung brand is listed by Best Global Brands 2010 ranking in the 19th position, followed by Japanese former leaders, Sony (34th), Canon (33rd) and Panasonic (73rd).

3.2. **Arçelik (Turkey): entering the 3rd wave**

Arçelik is a Turkish company founded in Sütlüce as an office furniture manufacturer in 1955. However, the company moved rapidly to the home appliances industry and produced the first washing machine in Turkey in 1959 and the first refrigerator in 1960.

Now, Arçelik is the diamond of the Koç Holdings conglomerate, Turkey’s largest multinational. According to their 2009 annual report, the company sells its products in over 100 countries, has production facilities, 11, in 4 countries, and has sales and marketing delegations in 18 countries.

The group started to have some regional presence thanks to the internationalization of supermarket brands Migros and Ramstore. Nonetheless, the company started to truly focus on exports thanks to an agreed tariff reductions between Turkey and the Europe in 1988. The company starting acting as a OEM supplier of refrigerators for Sears Roebuck in 1988 and another with European leader Whirpool for manufacturing dishwashers. Arcelik committed not to compete in the European market with their own brand, but logically, these agreements helped them to obtain useful know-how which could be incorporated in their core competences.

However, even though there were several positive outcomes in working as OEM for top white industry companies, the company also faced the problem of boosting their own brand name.
In order to address this issue, Arçelik took a new strategy focused on acquisitions of foreign brands. The first success was the acquisition of Beko, a British TV and white goods manufacturer. Later, the company also added other brands: Arctic (Romanian), Blomberg (German), Elektra Bregenz (Austrian), Flavel (British), Grundig (German) and Leisure (British) (Arçelik, 2011).

This aggressive approach has reported substantial results to the Turkish company. Exhibit 2 shows the spectacular increase in sales it experienced. Furthermore, currently Arçelik is undisputed leader in the white goods industry in Turkey and Romania, 2nd player in the UK, and among the first five players in the rest of Europe.

3.3. Hon Hai Precision (Taiwan): a 2nd wave giant

Hon Hai Precision: about 995,000 results in Google. On the other hand, the Sheffield United, an English Football team that is actually struggling in the second-highest division, produces three times more results.

Yet, this company recorded revenues of $61.9 billion in 2008 (Datamonitor, 2010) and is behind the production of several well-known consumer goods such as the iPhone4, the iPad and the Play Station 3 among others. In addition to this, its CEO, Terry Gou, is listed by Forbes as the richest Taiwanese, and ranks #136 worldwide with an estimated net worth of $5.5 billion.

The Taiwanese company, widely known as Foxconn (its main brand name) operates in Europe, America, Australia and Asia. It employees over 200,000 people and is headquartered in Taipei, Taiwan.

According to van Agtmael, “Hon Hai’s competitive edge lies in the fact that it can serve many masters, …, while promising utmost discretion and security when producing goods for competing firms”. (2007, p.104). Furthermore, there are other three important factors. Firstly, an efficient business model vertically integrated, from the design and assembly of electronic components to the manufacturing of the structural elements for electronic products. The plant located in Longhua became the largest manufacturing base in the world of “3C”s with the shortest supply chain. Secondly, high efforts in R&D which are translated into a strong patent portfolio (“nanotechnology, green manufacturing processes, flat-panel display technology, wireless connectivity, precision mould engineering, server technology, ptoelectronic/optical communication materials, application technology and network technology” (Datamonitor, 2010). This builds considerable entry barriers for potential competitors. Finally, Hon Hai is the largest contract electronic manufacturer in the world (ranking 112 in the Fortune Global 500 companies) (2010).
As van Agtmael highlights, Hon Hai is proactively hidden in the shadows while they let their customers have all the praise for their high-tech products (2007), although this should not be interpreted as a conformist stance.

Latest news show that the company is actively seeking to increase their capacities and capabilities by some strategic acquisitions directly from its western customers. Over the past years, Hon Hai bought plants from HP, Nokia, Motorola, Sony and Dell (Wang, 2009). By doing this, the company is also increasing the reliance of customers on them.

It seems anyway that the Taiwanese company sees that operating as a manufacturer for other brands is reporting enough success to them. Nevertheless, if their executives change strategy, Hon Hai seems more than prepared for becoming an important brand and a key player in the future. Thanks to huge investments in R&D, the company is ready for developing cutting-edge products, even though, probably it should develop their designing capabilities as Samsung did.

4. Conclusion

In PWC’s article “The world in 2050”(2011), the consultancy firm shows evidence of what has already mentioned in this paper, i.e., that emerging economies will soon equal in absolute terms the leading economies. It is expected that by 2020 the largest E7 emerging economies (China, India, Brazil, Russia, Indonesia, Mexico and Turkey) will be larger than the G7 countries in terms of GDP in purchasing power parity. By that date, China is likely to overcome US as larger economy in the world and by 2050 also India will surpass the US.

A direct challenge that will emerge from the development of these huge economies is the pressure on natural resources such as water, energy and metals pushing the prices of this up, which will affect globally to all players and will reward efficient firms.

In addition to this, western companies will not be able anymore to ignore emerging economies. Currently, UK exports to the BRICs accounts just for a 7% of the total (Hawksworth and Tiwari, 2011). This is likely to change in the future, and a strong presence in these countries will become a key element for business success. Yet, being successful in these countries is not going to be as easy as some western might think (Dawar and Frost, 1999). Local companies are closer to their domestic market needs and demands, and, furthermore, they “free to let the market define them” (Dawar and Frost, 1999, p.123).

Future international leadership of today’s EMNCs is still a question open for an answer. Samsung case indicates that companies taking the proper steps and mixing correctly the best practices of local companies and foreign ones can achieve their goal of becoming international leaders. However, these companies, as it happened to Samsung, will have to deal with the concerns over the country-of-origin in order to do so.
5. References


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Appendix I

Exhibit 1. Evolution of EMNCs over the last years.

<table>
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<tr>
<th>Year</th>
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Exhibit 2. Arcelik Sales

Exhibit 3. Hon Hai Precision sales evolution.