



Southern Multinationals A Growing Phenomenon

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South-South FDI now accounts for one third of all FDI going to developing countries, and is growing. This is good news because this FDI typically reaches very poor and remote developing countries.

This is because Southern multinational corporations (MNC) are more familiar with challenging investment climates and are also better equipped to deliver products tailored to low income consumers. South-South FDI flows are primarily regional, and concentrated in the infrastructure and extractive sectors, with an increasing sector diversification. Southern MNCs¹ are attracted to new profitable markets, resources and strategic assets. The motivation is less about seeking low factor costs, which means that developing countries should be less worried about these FDI outflows. While governments in many developing countries are encouraging outward FDI, Southern MNCs continue to face regulatory and operational challenges in their home economy. Many Southern MNCs new on the international market are having growing pains, similar to those of Northern MNCs a few decades ago, and are moving up the ladder of corporate social responsibility. To benefit from South-South FDI, developing countries, whether host or home to FDI, need to pursue investment climate reforms..

Growing South-South FDI Flows

Recent highly publicized acquisitions such as Lenovo's purchase of IBM's PC business and Cemex's acquisition of UK's RMC highlighted the phenomenon of the emergence of Southern multinationals, a trend

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Table 1: Selected large M&A deals by Southern Multinationals, 2004-2005

Year	Acquiring Company (Country)	Acquired Company (Country)	Sector of the Acquired Company	Value (\$ billion)
SOUTH-NORTH DEALS				
2005	Cemex (Mexico)	RMC (UK)	Cement Industry	\$4.1
2004	AmBev (Brazil)	John Labatt (Canada)	Malt Beverages	\$7.8
2004	Gold Fields (South Africa)	Noriment Ltd (UK)	Metal Services	\$1.3
2004	Tata Motors Ltd (India)	Daewoo Vehicle (South Korea)	Motor Vehicles	\$0.1
SOUTH-SOUTH DEALS				
2005	America Movil (Mexico)	TIM Peru (Peru)	Telecom	\$0.5
2004	Telefonos de Mexico (Mexico)	Columbia Telecomunicaciones	Telecom	\$0.4
2004	Anglogold Ltd (South Africa)	Ashanti Goldfields (Ghana)	Gold Ores	\$1.5
2004	Sinergy (Brazil)	Avianca (Columbia)	Air Transportation	\$0.4
2004	YTL Power (Malaysia)	Jawa Power (Indonesia)	Electric Services	\$0.2

SELECTED ANNOUNCED OIL AND GAS DEALS BY SOUTHERN MULTINATIONALS (DEALS NOT NECESSARILY ACTUALIZED)

Year	Purchasing Company (Country)	Seller Company (Country)	Location of the Acquired Asset	Value (\$ billion)
2005	Sinopec Group (China) 50% and ONGC (India) 20%	National Iranian Oil Company	Yadavaran Oil Fields (Iran)	\$70-100 (over 30 years)
2005	Andes Petroleum (China)	EnCana (Canada)	Ecuador	\$1.42
2005	CNPC (China)	Petro Kazakh (Canada)	Mainly in Kazakhstan	\$4.18
2004	Gazprom (Russia)	Lietuvos (Lithuania)	Lithuania	\$0.05

Source: UNCTAD (2005), Goldstein (2005) and World Bank staff

that started over two decades ago. A confluence of factors – increasing wealth, loosening capital controls, trade liberalization, and regional integration – have led to many developing countries becoming a significant source of FDI, particularly to other developing countries. In fact, according to rough estimates, South-South FDI flows increased from \$15 billion in 1995 to \$46 billion in 2003, accounting for about 35 percent of total FDI flows in developing countries. At the same time, high income Organisation for Economic Co-operation and Development (OECD) member countries received \$16 billion of FDI from developing countries (South-North FDI) in 2001, up from \$1 billion in 1995. South-North FDI flows amounted to \$7 billion in 2003. Although data is not available for 2004 and 2005, recently finalized and announced M&A deals suggest that Southern multinationals continue to expand globally (Table 1, above).

Substantial emerging market FDI flows on a regional basis

In their search for new opportunities, Southern multinationals tend to invest close to their home country and where they have acquired a certain familiarity through trade, or ethnic and cultural ties. As a result, there is a significant regional aspect to most South-South FDI flows (Table 2, following page). Following trade liberalization in Latin America, multinationals from Chile, Brazil, and Argentina expanded their operations mainly in other developing countries in the region. Russian investments abroad have primarily been in the countries of the former Soviet Union. Turkey has also been actively investing regionally, particularly in West and Central Asia, and Russia. Further, South African investments in other developing countries are almost completely in the Southern part

¹ This note was prepared for the conference "Southern Multinationals: A Rising Force in the World Economy," 9 & 10 November, 2005, Mumbai, India. It is a product of the staff of the World Bank. The findings, interpretations, and conclusions expressed herein do not necessarily reflect the views of the Board of Executive Directors of the World Bank or the governments they represent.

Table 2: Regional flows by Southern Multinationals (% of total outflows/country)

COUNTRY	% REGIONAL (SOUTH-SOUTH)
Brazil	10.4
China	20.7
India	25.4
Hungary	75.1
Thailand	58.8
Turkey	32.0
Russia	37.0

Source: Goldstein (2006)

of Africa, and companies from India and China have been particularly active in Asian countries.

There is also some indication that strong economic and cultural ties play a role when these companies invest in developed countries. For example, almost all FDI outflows from Latin America to high-income OECD countries went to the US and Spain. Major investment destinations for East Asian investors are Korea and Australia. Further, the UK receives 40 percent of African – mainly South African – investments to high-income OECD countries.

Tax haven countries are as popular destinations for many Southern MNCs as for Northern MNCs. Cayman Islands, Bermuda and Cyprus are main destinations for Brazilian, Indian and Russian FDI. Hong Kong plays an important role for Chinese companies, as a base from which to expand overseas.

However, there are indications that Southern MNCs are increasingly venturing beyond their immediate region. Latin American and Asian investments are finding their way into Africa, Asian investments are entering Latin America, and Latin American investments are entering Asia. More recently, Chinese and Indian firms have acquired high value assets in the US and EU countries.

Concentration in the infrastructure and extractive sectors

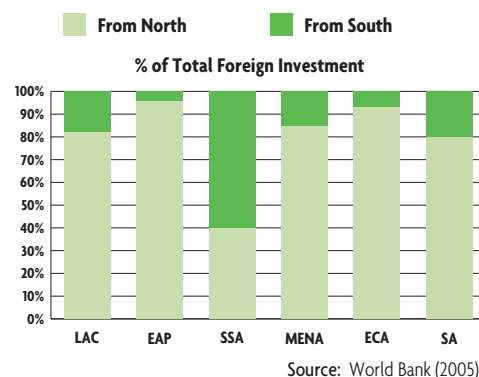
South-South FDI flows are highly concentrated in the infrastructure and extractive sectors, mostly in the form of large M&A and privatization deals. In the late 1990s, global infrastructure companies began to withdraw from the South because of less than expected returns and the global downturn in the sector. The resulting void was in part being filled by those emerging Southern companies, particularly in the telecom sector that had gained experience through their partnerships with global players over the years. They wanted to leverage their experience dealing with the political economy aspects of infra-

structure investments. Between 1998 and 2003, Southern MNCs contributed almost \$30 billion in infrastructure projects in developing countries. Their participation was particularly significant in telecom and in infrastructure projects (Figure 1, right) in Africa. Since 2003, Southern expansion in the telecom sector has continued as Mexico's America Movil, Egypt's Orascom Telecom and various Russian telecom firms acquired assets in other developing countries (Table 1, previous page).

The extractive sector has also attracted a large amount of FDI from Southern MNCs because of three factors. First, national oil companies from the South are leading players in the market because of their exclusive access to oil reserves; almost 70 percent of oil production takes place in developing countries. As these state-owned enterprises have expanded their operations globally both in upstream markets to diversify their portfolio and downstream markets to reach consumers directly, other developing countries have been their main destinations particularly for upstream investments. Thus, South-South FDI flows have been prominent in the oil and gas sectors (Table 3, below). Second, most of the population and economic growth is taking place in the developing world. To secure access to additional resources and ensure their long-term supply, countries try to acquire assets in other countries. State-owned oil companies in China and India have been particularly forceful in recent acquisitions of oil- and gas-related assets. The two countries have started to cooperate, rather than compete, for some of those assets. They are already shareholders in Sudan's Nile project, and will be partners again if the exploration and development project in Iran's Yadavaran oil field is actualized. Finally, some southern oil and gas multinationals such as Petrobras and Petronas leverage their advanced technical capacity, such as deep-water exploration, in order to gain global presence in the sector.

The large investments in the extractive and infrastructure sectors mask smaller scale South-South FDI flows in other sectors. Many Southern MNCs in various sectors such as banking, brewery, pharmaceuticals, retailing, textile, and tourism have investments in other developing countries. For example, UralAZ, a Russian automobile manufacturer, has plants in China, Egypt, and India, and announced plans to open assembly units in Ethiopia and Brazil. Angola's largest non-oil FDI comes from Odebrecht, a Brazilian engineering and construction company. Haier, a Chinese

Figure 1: Total foreign investment in infrastructure sector in developing countries, 1998-2003



white goods producer, has two manufacturing plants in India and one in Thailand, and announced plans for an R&D center in India. A few South-North investments outside the extractive and infrastructure sectors have been comparatively large; Ambev in Canada, CEMEX in the UK, Lenovo in the US, and TCL in France have positioned those Southern MNCs to play in the big league.

Southern MNC outward FDI drivers are similar to those of Northern counterparts

Three factors have driven outward FDI from emerging market countries (EMCs): access to resources, access to markets, and access to strategic assets. Efficiency-seeking has not been a major driver.

Access to resources

Experiencing sustained high economic growth in recent years, a few EMCs are under pressure to secure raw materials, including oil and gas. They often seek to diversify their sources from a wide range of countries, including those where there is no strong presence of OECD-based MNCs. China and India are two cases in point, with growing investment in energy and mining in Sub-Saharan Africa, Central Asia, and Latin America. Of the deals in the extractive sector that China's state-owned enterprises are making worldwide, about half of China's outward FDI went to natural resources projects in Latin America in

Table 3: Selected State-Owned Southern Multinationals in oil and gas sector

CORPORATION (HOME COUNTRY)	COUNTRIES IN WHICH COMPANY OPERATES
CNPC (China)	Sudan, Venezuela, Kazakhstan, Myanmar, Ecuador, Mauritania, Canada
Indian Oil Corp.	Libya, Iran
Lukoil (Russia)	Iraq, Romania, Ukraine, Bulgaria, Canada, Uzbekistan
PDVSA (Venezuela)	Brazil, Argentina, Chile, Paraguay, USA (CITGO), Germany, Belgium
Petrobras (Brazil)	Mexico, Nigeria, Tanzania, Libya

Source: Aykut (2006)



2004. Similarly, India's Oil and Natural Gas Corporation closed deals in the Russian Federation and in Angola. The search for new sources of raw materials has also taken Southern MNCs to developed countries such as Australia and Canada.

Access to markets

Access to markets is the second most important driver of outward FDI from EMCs. Southern MNCs, similar to those from the North, search for higher returns and lower risks through portfolio diversification. Using the experience acquired in their home market, and taking advantage of globalization and trade liberalization, particularly regional integration, a large number of firms in EMCs are venturing into foreign markets, often close to home, but increasingly beyond. They exploit a number of assets that they have developed at home: products and production processes appropriate to EMC markets; the ability to manage regulatory processes, particularly in infrastructure; ability to network in neighboring countries; knowledge of cultures and markets; and low cost structures.

For example, MNCs in the IT and telecommunication sectors from India, South Africa, Mexico, Malaysia, and China have expanded their market abroad. Both sectors are growing globally, and in both cases Southern firms have developed a strong base at home. In the case of telecommunication, they have also developed the ability to efficiently manage the regulatory process, particularly in their neighboring countries.

In market segments where the level of competition has increased domestically and profit margins have diminished, firms have also sought growth abroad. Chinese firms in consumer electronics and home appliances have seen the domestic market approaching saturation and have invested in Asia and beyond, including in developed markets. For similar reasons, Indian firms in carbon black and steel, and Malaysian firms in utilities are also seeking investment opportunities abroad.

Access to strategic assets

In their quest to expand internationally, many Southern MNCs have invested abroad to acquire strategic assets. With very few internationally recognized brand names of their own, Chinese firms such as Lenovo and TCL have acquired well-known Western brand names such as Tompson, RCA, and IBM. Haier's attempt to buy Maytag was not only for its brand name, but also for its distribution channel. Compared to other Southern MNCs, Chinese MNCs seem to have made more attempts to acquire well-known brand names. This strategy was not followed by Japanese and Korean budding MNCs that developed their own brand names in the second half of last century.

A small but increasing number of investments, mainly from Asia, are being made in R&D to tap technology in a wide range of sectors in developed countries. Almost all Indian IT firms have such an investment in developed countries including the US. China has 37 R&D operations abroad in a variety of sectors including engineering and IT. Twenty six of those operations are in developed economies. South Korea has over 60 R&D firms overseas. Mexican firms have invested in biotechnology in the US. It is interesting to note that a fair proportion of R&D investment from Southern MNCs in developing countries has gone to other developing countries. In addition to an increasing number of R&D projects from high-income OECD-based MNCs, China and India are among the largest recipients of Southern R&D FDI, with investment from one another and from South Korea, Malaysia, and Thailand.

Southern MNCs expect an investment-friendly investment climate in host countries

Whether Northern or Southern, MNCs look for an investment-friendly business environment. A good investment climate entails not only a certain level of macro-economic stability, but also micro-economic policies and practices that offer a regulatory environment with a reduced level of bureaucratic burden and costs, and a high level of transparency and predictability. Overall, physical safety, adequate protection by the law, and quality of life are important to investors.

Challenges in their own home countries

Compared to their Northern counterparts, Southern MNCs face challenges in their home countries, as many developing countries do not have policies and an institutional infrastructure to support outward FDI. China, India, South Africa, among others have various levels of capital controls, requiring additional regulatory burden to access foreign exchange. Such countries lack the level of financial market development, and options and sophistication of financial instruments that exist in the North. For example, in addition to burdensome and less than transparent capital control procedures, China's regulations require its MNCs, whether state-owned or not, to submit to three separate agencies a whole set of documents, including certificate of establishment of the firm in China, contracts or agreements relating to the overseas project, various elements of a project feasibility study,² assessment of the project made by the Chinese embassy in the host country, and audited financial reports and bank statements. Investors are also required to report annually on their investment to the Ministry of Commerce. Those factors have discouraged or even prevented many small- and medium-size firms from investing in China. They have instead pushed larger firms to use offshore platforms, like Hong Kong, for their foreign investment.

Developing countries lack the institutional infrastructure for the support services found in developed countries. Access to knowledgeable consulting firms, business associations, banks, and other sources of information about overseas markets and practices is more difficult to obtain. Unlike in developed economies, outward investment promotion services are non-existent or in their infancy in most EMCs. These handicaps have affected the development and operations of overseas projects, particularly for EMCs relatively new to outward FDI.


Operational challenges of investing abroad

If there is a generalization to the comparative advantages of Southern MNCs vis-à-vis their Northern counterparts, it would be a lower cost structure; an ability, developed in their domestic market, to cope with uncertainties in the business environment of host countries; and offering products and services often more suitable to host countries' markets. However, most Southern MNCs do face serious operational challenges.

Business operations issues vary substantially, mainly according to the level of experience of a Southern MNC as a foreign investor, and to some extent to the business environment in their home country. Many MNCs in Brazil, India, South Africa and Turkey have already advanced on their learning curve, and are capable of formulating and implementing their global or regional strategies, and developing and implementing investment projects. Others, with less experience in FDI, find it more difficult to formulate their strategy and package their domestically developed comparative advantages into projects that fit in with the culture, market characteristics, and regulatory environment of foreign countries. Many such MNCs saw their comparative advantages quickly eroding, and re-assessed their strategy and projects in light of their lessons learned. Observers including banks in developed countries believe that MNCs in EMCs have tended to overbid for assets due to their lack of experience and narrower sets of strategic options available to them at this stage of their quest for globalization. This is not an unusual phenomenon: U.S. and Japanese firms experienced similar challenges when they started to venture abroad after World War II, and in the 1970s and 1980s. The question is how to take advantage of past experience and the services provided by various institutions, including multilateral ones, to minimize the "entry fees" of Southern MNCs in the global market.

A summer 2005 survey of 150 Chinese firms operating abroad shows that about fifty percent of respondents said that they have faced important or very important challenges in understanding the host country's culture, monitoring and reacting quickly to changes on the ground, and accessing project financing. With the exception of quality-price ratio, the list of advantages listed by those firms in their domestic market shrunk substantially when applied to their overseas operations. This list included brand name, technology, human resources, access

² In October 2004, the Ministry of Commerce issued a regulation exempting outward investors from submitting a project feasibility study. Other relevant agencies continue to require the submission of many elements of a feasibility study.



to market information, knowledge of policies and distribution channels. Access to finance has been a particularly challenging exercise for those firms. While aware of political risks, firms did not buy insurance to cover them, or take other adequate measures to hedge them.

The impact of the growing phenomenon of Southern MNCs on developing countries

The emergence of the South as a substantial source of FDI for developing countries has important implications for their economic development. First, South-South FDI represents an opportunity for low-income countries. Apart from the extractive sector, Northern MNCs are less likely to invest in small market economies, whereas Southern MNCs tend to invest in other neighboring developing countries with a similar or lower level of development than their home country. South-South FDI flows, however small, may be significant to many poor countries. For example, Lesotho, Mongolia, and Nepal have attracted FDI from their neighbors. India (in hotels and manufacturing) and China (in manufacturing) account for more than half of the FDI coming to Nepal. Most FDI in Mongolia originates from China and Russia.

Second, Southern MNCs tend to use resources, technologies, products, and services more suitable to the markets and the level of economic development of developing countries. For example, TCL produces \$50 television sets in Vietnam and Maruti Suzuki produces a \$2,000 car in India. Narrower technological gaps between Southern MNCs and host economies, compared to their Northern counterparts, may foster positive spillovers to developing countries.

Finally, in recent years, South-South FDI played an important role in sustaining FDI flows to developing countries in light of the significant decline in investments coming from the North. 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.

Compared to their Northern counterparts, many Southern MNCs have some comparative advantages when investing in 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. The relative success of MTN, the South African telecommunications company in Uganda, compared to its competitors from developed countries, is traceable to its in-house expertise in managing pertinent economic and political risks. Southern MNCs are playing a critical role of bridging the North and developing countries. Southern MNCs are

smoothing the entry of their Northern counterparts in developing countries. For example, Northern investors partnering with Chilean companies to invest in Latin America earned higher rate of return to their investments. Furthermore, like Carrefour investing in Egypt from Dubai, Northern MNCs use their operations in the South as a base to expand their business in neighboring developing countries.

South-South FDI may not always be favorable for the host economy. Over the years, many Northern MNCs have participated in initiatives to improve their transparency, environmental and labor standards while investing abroad. However, these initiatives are yet to be implemented by most Southern companies that tend to have lower environmental and labor standards. Any distorting measures granted by home country governments, often to their state-owned enterprises, are likely to have negative effects on host country economies. Geographic and cultural proximity do not always guarantee better relationships. Historical factors or the behavior of investors may cause further skepticism in the host economy toward foreign investors. Of course, it remains the host country's responsibility to improve its business environment and regulatory system in order to realize the development potential of FDI, while taking necessary precautions to minimize the negative impacts of FDI that are independent of the source country.

The impact of outward FDI on home economies of developing countries has not yet been assessed. It will depend on a range of factors, including the sectors and particular operations of MNCs, whether outward FDI is complementary or substitute to domestic production, and the absorptive capacity of home countries for new technologies and know-how acquired abroad. When outward FDI is complementary, as Southern firms increase their profits by expanding and diversifying their markets, the home economy gains from increased economic activities and employment related to FDI projects, and tax revenues. If in the future it becomes a substitute to domestic investment, the impact would not be clear. The vast literature on Northern MNCs is inconclusive on the issue. Although there are studies indicating that FDI outflows in manufacturing may reduce employment and suppress wage rates, other studies show a positive impact on skilled worker employment or no impact at all.

Since a major part of Southern investment abroad has been in extractive and infrastructure, indications of the negative impact on their home economies have been limited. As Southern MNCs continue to evolve and expand their global operation, particularly in secondary and tertiary sectors, and consequently adjust their domestic production, the impact on their domestic economy will be more strongly felt. They are certainly bound to introduce a higher level of management systems and know-how, and contribute to the capacity-building of their home country, crucial elements in economic and social development. That said, for Northern MNCs, global

production systems are becoming a must rather than a choice for Southern MNCs due to increased competition at home and abroad.

Learn more about this phenomenon

Ten years from now, how would Southern MNCs affect the global economy, and the development of developing countries – their own and others? Would we see major differences in strategies and behavior among Southern MNCs, and if so, would they be driven by nationalities, sectors, or other factors? For now, much of the growing effort of learning about this phenomenon has been to attempt to map it out – find out who is doing what, where, and test a few hypotheses here and there. This initial effort has been challenged by the lack of data. In general, complete and reliable inward FDI data from developing countries is hard to find, and even more so for their outward FDI. This new and growing phenomenon is bound to affect the economic development of developing countries, home and host to FDI. It is in the interest of those countries to learn more about it and deal with it, and for that they need to enhance their FDI data collection and management systems.

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