Emerging-market multinationals

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A new breed of multinational company has emerged

WHEN Ford Motor Company bought Jaguar in 1989 and Land Rover 11 years later, it marked a low point for Britain's ailing industrial heritage. Last year Ford concluded that it could not make money from the illustrious British marques—equally a sign of its waning fortunes. The two firms shortlisted to take the prize come from India. Their ambition and confidence is a sign of something new in global business: the arrival in force of emerging-market multinationals.

Tata Motors, the carmaking bit of Tata Group, India's biggest industrial conglomerate, has edged ahead of Mahindra & Mahindra, a sprawling group that makes tractors and off-road vehicles, to become the preferred bidder. Ford told Jaguar workers this month that it was “in substantive discussions” with Tata. The future of these two grand old badges will be shaped not in Coventry, cradle of the British motor industry, but in Pune, home of Tata Motors.

Another indication of this newcomer's growing strength was the unveiling this week of the revolutionary, cheap “one lakh” car, which will sell in India and South-East Asia for the equivalent of $2,500. Thus the Indian company, which launched its first saloon car barely ten years ago, is beating the industry's established giants in a new market segment in which sales will surely grow fast.

Tata is certainly not the only company from an emerging economy striding onto the global stage. A study by Boston Consulting Group (BCG) found 100 companies from emerging markets with total assets in 2006 of $520 billion, more than the world's top 20 car companies. By 2004 the UN Conference on Trade and Development (UNCTAD) even noted that five companies from emerging Asia had made it into the list of the world's 100 biggest multinationals measured by overseas assets; ten more emerging-economy firms made it into the top 200.
By 2006 foreign direct investment (including mergers and acquisitions) from developing economies had reached $174 billion, 14% of the world's total, giving such countries a 13% share (worth $1.6 trillion) of the stock of global FDI. In 1990 emerging economies accounted for just 5% of the flow (see chart 1) and 8% of the stock. Their slice of global cross-border M&A has been climbing. It reached 14% in value terms in 2006 (chart 2). That year they spent $123 billion in more than 1,000 cross-border deals.

Since UNCTAD's first analysis in the early 1970s there has been concern about the power wielded by companies from rich countries in poorer ones. Developed countries have had their bouts of anxiety too. In the 1960s the French fretted about le défi américain, as IBM, Ford, General Motors, Dow Chemical and ITT spread their tentacles across Europe; in the 1980s it was America's turn to squirm as Japanese firms bought up Hollywood and Manhattan.

The latest trend reflects a new, fundamental shift. In a more open world, emerging economies are spawning their own giants. UNCTAD is turning its attention to the new shape of global business: investment now flows increasingly from south to north and south to south, as emerging economies invest both in the rich world and in less developed countries.

**Meet the new boys**

The rest of the world has woken up to the newcomers in the past couple of years thanks to some huge cross-border deals. In early 2006 Arcelor, a steelmaker of French, Luxembourgeois and Spanish extraction and Europe's biggest, faced a bid from Mittal, an international steel group largely owned by the family of Lakshmi Mittal, an expatriate Indian based in London. Mr Mittal and his son, Aditya, had cooked up the deal two days before Christmas 2005, during their annual skiing holiday in St Moritz. When the French government heard about the deal in January, recalls Mr Mittal, ministers wondered whether his company was Indian or American. Arcelor turned to another emerging-economy steelmaker, Russia's Severstal, as a possible white knight, before eventually succumbing to Mittal six months later. Thus was born Arcelor Mittal, the first steel company with an annual output of more than 100m tonnes.

The confusion over Mittal's origins among French government ministers reflects the novelty of the group. Unable to expand the family's steel business in stuffy, over-regulated India, Mr Mittal took off to lead an international wing, with a steel mill in Indonesia, which soon prospered "under the noses of the Japanese" as he gleefully recalls. His reputation there led to a contract to turn around the state-owned steel industry in Trinidad, which he later acquired. Next was Mexico, where he bought steel plants in the country's 1990s privatisation wave, before buying Inland Steel and International Steel in America, as traditional steelmakers there wilted in the rust-belt meltdown. Then he snapped up old state steel firms in eastern Europe.

Even before Mr Mittal bought Arcelor, Corus, an Anglo-Dutch steel firm, had approached Ratan Tata, head of Tata Group, about joining forces with Tata Steel, which owned plants in Singapore and
elsewhere in South-East Asia as well as in India. Months of discussion led to the conclusion that the only efficient way to combine would be for the Indian firm to take over Corus (most Tata group companies are separately quoted, with the holding company having about 20% of the shares). This agreement led to another dramatic demonstration of power: a bidding war for Corus between Tata Steel and Brazil’s CSN group, which broke out in late 2006. Tata eventually secured its prize in an all-night auction organised by the takeover panel in London a year ago.

Besides the companies making such big deals, a whole squad of well-known new multinationals from developing countries have been growing organically and through smaller deals. The Indian trio of Wipro, Infosys and Tata Consultancy Services (TCS) have built an IT outsourcing industry that has moved upmarket, has gone global and is chasing rich-country leaders such as Accenture and IBM. China has Lenovo, which bought IBM’s PC business, the Haier and Hisense groups in domestic appliances and consumer electronics, and BYD, the world’s largest maker of nickel-cadmium batteries.

Others now being watched by western analysts include Chery Automobile, China’s leading car exporter, which aims to build plants in eastern Europe, the Middle East and South America. Johnson Electric, of Hong Kong, has cornered half the world’s market for tiny electric motors. Cemex, a Mexican cement company, has already taken over a big British group, RMC. Embraer of Brazil has become the world’s third-largest aircraft company, specialising in regional jets. Half the sales of Sadia and Perdigão, two Brazilian food companies, which amount to around $6 billion combined, are exports.

India’s Bharat Forge, now the world’s second-largest forging company and a leading supplier to the motor industry around the world, recently tied up with a French company to get close to PSA Peugeot Citroën. Indian private-equity groups have been eyeing this tactic and aim to take over small European car-parts companies. Their motivation is not to own assets in France or Germany, but to acquire relationships with manufacturers. “We are not really buying factories,” says such an investor. “We are buying orders, which we can eventually fulfil with cheaper supplies from India.”

The rationale

According to BCG, thousands of companies like these are expanding sales and production internationally. Their home markets offer several advantages. Rapid growth gives companies scale and spare cash to invest abroad. Costs are low. The difficulties of operating in an emerging market may make managers adaptable and resilient. Finally, gradual liberalisation in their home markets—as in India since the early 1990s—has exposed them to competition from multinationals. The threat to their domestic dominance has encouraged their managers to hone their skills, exposed them to best international practice and spurred them to seek growth abroad to compensate for lost market share at home.

Ratan Tata spent his first ten years at the helm of the family company tidying up its rambling and often decrepit Indian businesses before turning his attention to foreign markets in the late 1990s. When the Indian market opened up, he recalls, Indian companies thought they would all have to merge with each other, because years of protection had made them too weak to face the new foreign competition. That soon passed as other industries saw the success of Indian IT and outsourcing, textile and pharmaceutical companies; Ranbaxy was on the way to becoming one of the world’s leading makers of generic drugs, just as the boom in such products was taking off in the mid-1990s.

While Tata’s IT business, TCS, was cutting a swathe through North America, Mr Tata was planning other international moves. He bought Tetley Tea, an English brand, and NatSteel Asia, based in Singapore, whose rolling mills could use the slab steel produced in Tata’s Indian plants. He also bought Daewoo trucks, after the stricken South Korean chaebol had to be broken up. Mr Tata says that he looks beyond sheer size in search of a strategic fit when he acquires companies.

The new brigades are fanning out around the world using a selection of five strategies, according to BCG. The first is taking brands from local to global. China’s Hisense, a $3.3 billion consumer-electronics group, is a prime example. With over 10% of the market for TV sets at home, it has turned its attention to the wider world with a product range that includes air conditioners, PCs and telecoms equipment. It manufactures in Algeria, Hungary, Iran, Pakistan and South Africa. It now sells over 10m TVs and 3m...
air conditioners a year in more than 40 countries. Hisense owns the best-selling brand of flat-screen TVs in France. The home Chinese market gives the company a vast, cheap manufacturing base, to which it adds other advantages such as stylish design and a world-class R&D centre.

Bajaj Auto, based like Tata Motors in Pune, is another developing-country brand going global. It is India's biggest maker of two- and three-wheeled vehicles. Its sales have more than doubled since 2000, to $2.3 billion. Under the former boss, Rahul Bajaj, the company was typical of a stratum of Indian entrepreneurs, known as the Bombay club, who wanted to keep foreign competition at bay with tariff walls and domestic mergers. Now, under Rahul's son, Rajiv, Bajaj has taken its own first steps onto the global stage with organic growth of exports, mostly to South-East Asia.

A second strategy is to turn local engineering excellence into innovation on a global scale, as Embraer has done. Supported by the Brazilian government and later largely privatised, Embraer has overtaken Canada's Bombardier to become the world's leading maker of regional jets. It has timed its push to take advantage of regional airlines' desire to replace traditional, noisy turbo-prop aircraft with sleeker, faster small jets. By 2006 over 95% of its $3.8 billion sales were outside Brazil. It is one of Brazil's biggest exporters, combining low-cost manufacturing with advanced R&D. In addition, Embraer has a joint venture with China Aviation Industry Corporation II. In this it was even ahead of Boeing and Airbus, both now scrambling to transform themselves from rich-world exporters into global producers, with long, difficult-to-manage supply chains spanning the world.

The third path to international success is going for global leadership in a narrow product category. Two Chinese companies are notable for taking this route. One is BYD, the battery-maker. It uses a more labour-intensive production system than the Japanese firms it competes with to take advantage of low labour costs. The other is Johnson Electric, which though based in Hong Kong now produces chiefly in mainland China. It makes tiny electric motors for products such as cameras or cars. A BMW 5 series, for instance, has over 100 tiny motors (of less than one horsepower) to move the wing mirrors, adjust the seats, open the sun roof and so on. Johnson churns out 3m a day, most of them for export. Manufacturers prefer to have them designed to their specifications than to buy them off the shelf. Johnson has landed its half-share of the market by catering to these requirements.

In this way an industry that used to be in the hands of American or European companies, with factories in the Midwest, the English Midlands or Germany's industrial heartland, has moved to China. That said, Johnson has built its strength partly through well-timed acquisitions (including parts of America's Lear and ArvinMeritor) in target markets to get closer to customers. It now has plants in America and western Europe and R&D centres in Israel, Italy, Japan and America.

Brazil's Sadia and Perdigão exemplify the fourth strategy: taking advantage of natural resources at home, and boosting them with first-class marketing and distribution. They have built sales organisations around the world to make the most of the abundant resources for producing pork, poultry and grain in Brazil, complemented by ideal growing conditions and low labour costs. Another Brazilian firm, Vale, has exploited its home country's huge, cheap sources of iron ore to become one of the world's leading suppliers.

The fifth strategy is to have a new or better business model to roll out to many different markets. This is the approach of Mexico's Cemex, one of the world's biggest suppliers of ready-mixed concrete. Its annual sales topped $18 billion in 2006.

Industries such as cement and other building materials are usually considered “territorial goods”, meaning they are bulky, basic and too expensive to transport long distances. But now this wisdom is being stood on its head: though it may not be worth shipping cement from Mexico to Europe, know-how and investment can be swiftly poured into any market. Whereas rich-world companies, such as Lafarge and Saint-Gobain, are investing in developing countries to increase sales of their cement and building products, Cemex is showing that the same thing can flow in reverse.

Few in Europe had taken much note of Cemex until it swooped to buy RMC in 2005. But by that time four-fifths of its revenue was already coming from beyond Mexico's borders. It had bought or built businesses in Colombia, Panama, Venezuela, Indonesia, the Philippines, Thailand and the United States before it set its sights on Europe.
The secret of the company's success is the rigorous development of its own style of managing acquisitions, which it calls "the Cemex way". A British manager who left RMC, somewhat discomfited, shortly after its purchase by the Mexicans nevertheless praises their approach. "They have their own systems, very heavily dependent on standardised procedures built around highly developed IT systems," he concedes.

The new multinationals have some distinct advantages in their sprint to the fore of global business. They are often family-owned or family-controlled (even when they are public companies), which helps them to make decisions quickly. They often enjoy cheap finance from state banks. But they also face particular problems, because they are trying to break into a world economy in which globalisation is already well advanced.

When rich-world companies were going international, everything moved at a slower pace. Now, as Gordon Orr, who works in McKinsey's Shanghai office points out, the prizes go to the top few firms in any industry. Organic growth is generally too slow to turn companies into winners.

Tariffs and anti-dumping actions can also prevent developing-country companies from getting into the rich world. Firms may be ignorant of the markets they are entering. Their brands, though well established at home, are unknown in Europe or America. They may lack the necessary management talent. Pay structures are hard to devise when middle managers in rich-world subsidiaries expect to earn more than their seniors in head office.

**The future is Mittalic**

But the new boys have often leapt these hurdles impressively. TCL, a Chinese consumer-electronics company, broke into Europe by buying the French Thomson TV brand. Cemex started investing in America when its cement exports were hit by anti-dumping suits: it became the market leader. Lenovo bought IBM's PC business partly to acquire management talent, and went on to create a firm that blended the best of the two businesses. Sunil Kakkad of LG, a London-based business-law firm, says that Indian multinationals are reversing the usual brain-drain by sucking non-resident Indians back from branch offices in America and Europe, where they have gained experience that could be useful at the centre.

Possibly, more newcomers will not build out from home markets but will amass businesses in all parts of the world, as Mr Mittal's group has done. He likes to point out that having a strong base in both developing and rich countries gives his company a balanced portfolio. "I see plenty of scope for growth in developing countries and plenty of opportunities for consolidation in developed countries," he beams in his office overlooking London's Berkeley Square.

Success in one developing country led Mr Mittal to opportunities on the other side of the world. Family ownership helped with quick decisions to outsmart competitors. There will be more Mittals: not just Tatas or Cherys, emerging from giant, booming domestic markets; but new creatures, bursting out of nowhere to take the world by storm.