



Economic Views

Emerging Multinationals

The rise of new multinational companies from emerging economies

PRICEWATERHOUSECOOPERS 

Executive summary

Companies from emerging nations are facing increasing competition in their home marketplaces and are venturing abroad in a bid both to secure resources and to better service foreign demand.

These new multinationals are expected to become more prominent in the future, providing a host of opportunities for infrastructure and business service firms in developed economies. Some will become international powerhouses of the future requiring high levels of support services around the world – IT and telecoms services, for example.

In this report PwC Macro Consulting uses econometric techniques to project the number of new multinationals that will arise from a representative sample of 15 emerging economies over the next 15 years. We define a firm as a 'new multinational' the first time it establishes a physical presence in a foreign country.

The countries analysed were Argentina, Brazil, Chile, China, Hungary, India, Malaysia, Mexico, Poland, Romania, Russia, Singapore, South Korea, Ukraine and Vietnam.

Our projections yield three key results. Of the countries we focused on:

1. India is expected to produce the most new multinational companies, overtaking China as potentially the emerging world's largest source of new multinationals;
2. the South American countries in the sample (Argentina, Brazil, Chile and Mexico) are expected to be a relatively smaller source of new multinational companies; and
3. the export orientated South East Asian countries (Malaysia and Singapore), oil- rich Russia and newly-industrialised South Korea are expected to continue to produce large numbers of new multinationals.

The data also provides an insight into the changing behaviour of new multinationals, both in terms of destination countries and the sectors in which they operate. In the future, we expect to observe:

- a shift away from intra-regional investment in other emerging nations and towards a greater share of new multinationals going direct to developed markets; and
- a fall in the total number of new multinationals operating in industries focused on natural resource extraction, but an increase in those operating in the business services and high value manufacturing sectors.

Introduction

Globalisation has accelerated in the last 15 years. During a period of relatively strong economic growth, world exports as a share of GDP increased from under 20% in 1994 to over 32% in 2008 and whilst global trade fell back in 2009, as a result of the global slowdown, it has already been bouncing back in recent months.

It is a testament to the interconnected nature of the world economy that a crisis emanating in Western financial markets led to a worldwide recession, with world GDP falling by over 1% in 2009¹. Some of the world's key emerging economies have suffered sharp recessions during 2009, whilst others, notably India and China, were able to maintain strong growth.

There has been more to globalisation than just a rise in world trade. There has also been a significant increase in foreign direct investment (FDI) by companies over the last 15 years. This increase has been especially strong in emerging nations, which are the focus of this report. The advance of globalisation has also been reflected in the number of companies establishing a presence in other nations, directly competing in the overseas market. Some evidence suggests that common factors such as the easing of trade barriers and tariffs and the ICT revolution have made these aspects of globalisation easier than before².

We are now seeing companies based in emerging nations increasingly punch their weight in the global marketplace. The Fortune Global 500, an annual ranking of the world's largest corporations by revenue, has seen the number of Fortune Global 500 companies based in Brazil, Russia, India or China (BRIC) more than double from 27 to 58 in the last five years. The highest placed BRIC firm in this list is Chinese oil giant Sinopec which has risen to 9th in the overall standings in 2009 from 31st in 2003.

In addition to internationally recognised multinational companies, emerging nations have seen a steady increase in the number of new multinational companies over the last five years. We define a firm as a 'new multinational' the first time it establishes a physical presence abroad³. An intensely competitive global marketplace and less restrictive capital and trade barriers have led to increasing numbers of emerging economy companies setting up operations in foreign countries.

This rise of new multinationals from emerging economies could open up a whole host of opportunities for companies that provide business-to-business services, such as telecoms and IT companies. The setting up of offices and manufacturing facilities around the globe is likely to result in significant demand for local services and infrastructure by new multinational companies.

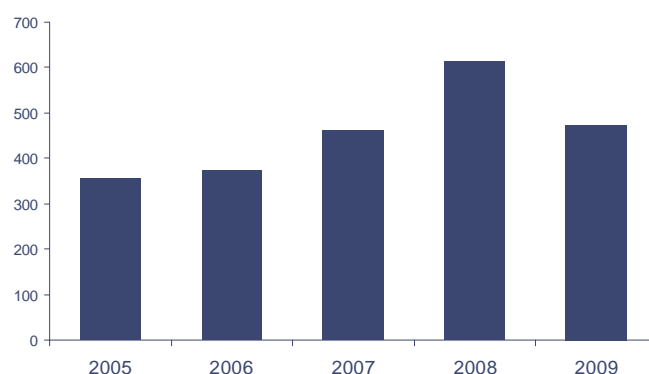
In the next section of this report we present estimates of the number of new multinationals that have emerged from our sample in the last 5 years. In the following section we use econometric techniques to project the number of new multinationals from emerging economies in the next 15 years. We then examine the characteristics of these 'new multinationals', in terms of the sectors they operate in and the regions they chose to expand into.

New multinationals from emerging economies

This report analyses data on multinationals from 15 emerging economies. The countries chosen were Argentina, Brazil, Chile, China, Hungary, India, Malaysia, Mexico, Poland, Romania, Russia, Singapore, South Korea, Ukraine and Vietnam. These economies are geographically dispersed and cover a range of sizes and levels of economic development. They were chosen to make up a representative sample of emerging economies.

We estimate that the total number of new multinationals from these 15 key emerging economies rose significantly in the years preceding the global economic downturn (see Chart 1 below). There were 352 new multinational companies which emerged in 2005, rising to 613 in 2008, before decelerating to 470 during the global economic recession.

Chart 1 – New multinationals from 15 selected emerging economies



Source: FDI Intelligence from the Financial Times Ltd, PwC analysis

Of the countries we analysed, we estimate that China produced the most new multinationals between 2005 and 2009, rising from 54 in 2005 to 141 in 2009. This came against a backdrop of extremely strong export as well as overall economic growth in China during which its share of the world economy rose from 9.5% to 12.1%⁴.

Overall the number of new multinationals from emerging markets decelerated significantly in 2009. There were three exceptions to this out of the 15 countries studied. These were China, Mexico and Hungary which all produced more new multinationals in 2009 than in 2008. As discussed, the growth seen in China mirrors its relatively strong economic performance throughout this period. The same cannot be said of Hungary and Mexico, however, whose economies both experienced a severe recession in 2009.

Focusing on country level data reveals that the number of new multinationals varied significantly across our sample. Chart 2 below shows our estimates of new multinationals by host country. We present 2008 data as a reference year in this chart as we believe it provides a more representative snapshot than 2009.

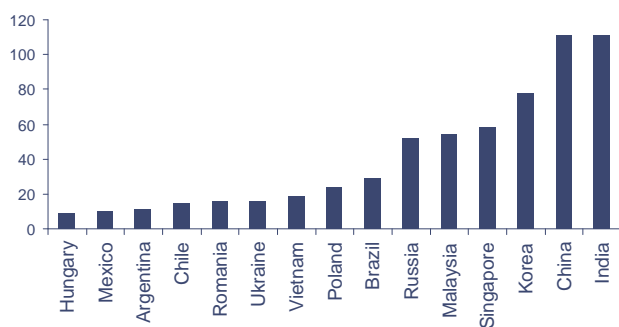
¹ Global GDP at PPP rates.

² See Goldstein and Pusterla, 2008.

³ See Annex for the methodology used to estimate the number of new multinationals.

⁴ Using PPP exchange rates.

Chart 2 –New multinationals, 2008, by country



Source: FDI Intelligence from the Financial Times Ltd, PwC analysis

There is a substantial range in the number of new multinationals across our sample. Hungary had the least, with only nine in 2008; China and India produced the most new multinationals with 111 each.

The ranking demonstrates that size matters; the countries with the largest economies in the sample are China, India and Korea. These countries also produced the most new multinationals. But trade openness also matters; Singapore and Malaysia outstrip Brazil and Russia in the number of new multinationals they produce, but have much smaller economies. For example, Brazil's GDP is nearly seven times larger than that of Malaysia, but there were 25 fewer new multinationals in Brazil than in Malaysia in 2008.

Projections for the future

We used econometric techniques to attempt to identify and quantify the factors driving the differences in the number of new multinationals across countries and over time. The model with the most predictive power included measures of home market size (measured as real GDP), investment intensity (measured as the investment to GDP ratio) and trade openness (measured as the exports to GDP ratio). We used this model to project the number of new multinationals from our sample of emerging economies in the future.

We have already seen that the total number of new multinationals created fell sharply in 2009. Our projections suggest the numbers will recover only slowly, such that it will take until 2015 for the 2008 peak to be surpassed. However, by 2024 we expect that the number of new multinationals from our sample of emerging nations each year will be 40% higher than in 2008.

In the countries studied in our sample the landscape is still dominated by India and China – together they are projected to account for 42% of the total number of new multinationals arising over the next 15 years. In 2009, China was the largest source of new multinationals in our sample. By 2018, however, we expect India to overtake China, with India projected to see 20% more new multinationals than China by 2024. Our projections for GDP growth over the same period in China and India dwarf the rest of the sample, both averaging over 7.5% per annum, with growth in China somewhat higher than that in India. The reason that India edges out China in terms of our projections of new multinationals, despite slower forecast growth, is its likely relative increase in both investment intensity and openness, which our modelling has found to be key drivers of the creation of new multinationals. In contrast, China's current level of investment intensity is unlikely to be

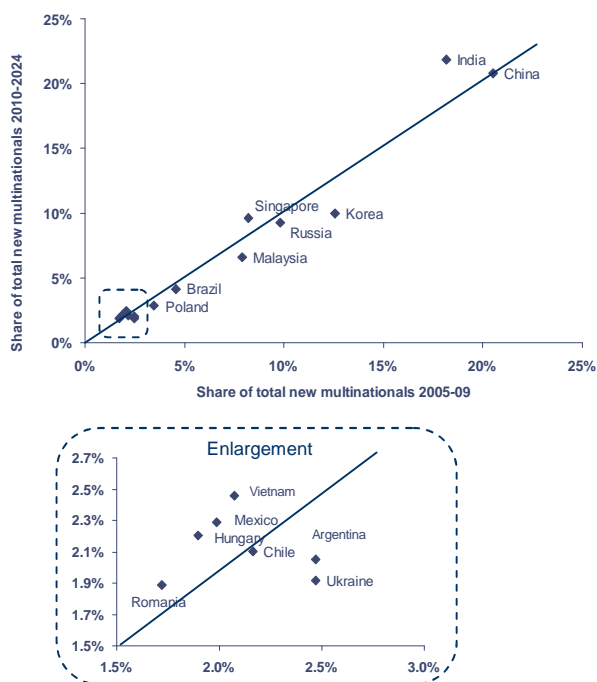
sustainable in the long term, while growing domestic demand is expected to help hold down the trade openness of the economy.

Looking at our results in terms of geographic groupings, in the Asia contingent of our sample there is an interesting contrast between Korea and Singapore. Both countries are relatively developed and have grown rapidly on the back of integration with the world economy. However, Singapore is expected to see more growth in new multinationals between the base (2005-09) and the projection period. This is driven by a large increase in openness that occurred half way through the base period. We predict this change to be permanent across the projection period, implying that the last 5 years have understated potential of the Singaporean economy to produce new multinationals. The Korean economy by contrast is expected to see little growth in trade openness. Korea also saw investment peak in the 1990s, on account of being more developed than most of the sample. Vietnam is a big mover in the sample, second only to India in expected percentage growth in new multinationals, but still only produces 2.5% of all new multinationals in the projection period in our sample. Its new multinationals growth is driven by strong GDP growth and increasing openness and investment intensity. Malaysia's relative position in the group of Asian countries falls, as it takes time to recover from the large drop in new multinationals observed in 2009.

Russia and the Ukraine had the most severe recessions in the sample, but have different outcomes when considering the projected number of multinationals. Russia falls slightly in importance, but is still the fifth largest source of multinationals in the projection period primarily due to the strong bounce back in GDP growth and expected investment expansion. The Ukraine's GDP growth recovery is expected to be more muted and consequently it is projected to lose share of total new multinationals between the base and projection periods. Romania and Hungary are expected to see growth in trade openness and investment intensity over the projection period and hence growth in new multinationals, but the absolute numbers of new multinationals are restrained by the sizes of their economies.

Chart 3 (on the next page) shows the share of the total number of new multinationals from each emerging nation in the sample. It compares the share of each country in the 2005-2009 period to its share in the 2010-2024 projection period. A country that is on the 45 degree line on the chart is expected to have the same share of total new multinationals in the projection period as in our historical estimates. Those above the line are projected to increase their shares of the new multinationals from our sample and those below it are expected to see their shares fall.

Chart 3 – Current and projected share of new multinationals



Source: FDI Intelligence from the Financial Times Ltd, PwC analysis

The chart shows the countries are bunched into three sections. India and China are the largest sources of new multinationals by some margin. The combination of Korea, Malaysia, Russia and Singapore should not be overlooked however, as together they represent 36% of all new multinationals in the projection period. The rest of the sample all fall below the 5% mark in both the base and projection periods, including all four South American countries.

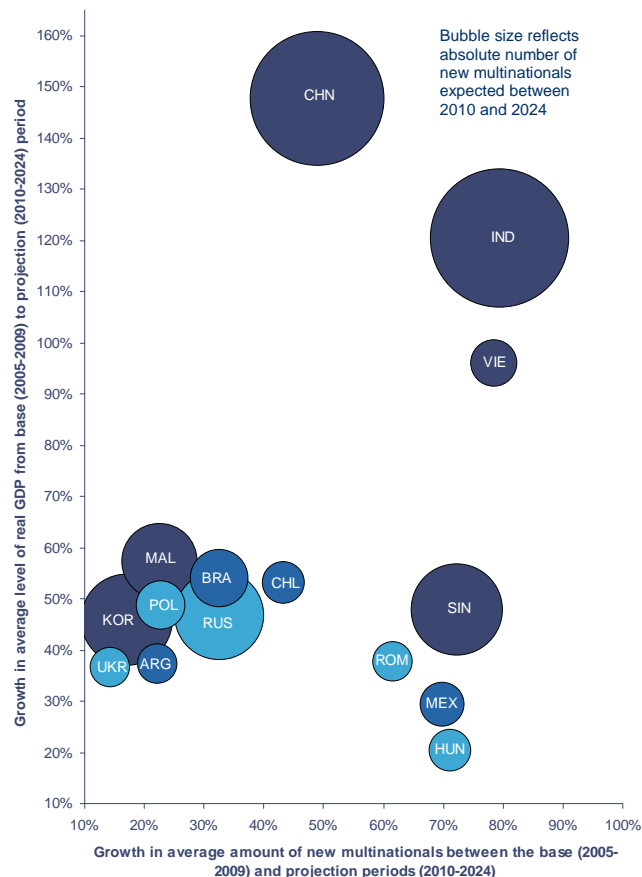
The graph also shows the countries that are projected to gain and lose most shares of total new multinationals. The big gainers in the sample are India, Vietnam and Singapore. The biggest losers in the sample are Korea and the Ukraine.

Brazil and the other major Latin American emerging economies have relatively low numbers of new multinationals in both the base and projection periods. The size of the Latin American economies does not seem to translate into corresponding numbers of new multinationals. Our projections do not take into account the size of the new multinationals however, so it could be that only larger firms from South American countries venture abroad. We cannot ascertain from this analysis whether Latin American countries will continue to produce giant multinationals that compete on the international stage, such as Mexican Cement company Cemex. We can only predict that they will not produce a number of new multinationals to rival their Asian emerging nation counterparts.

Charting the expected growth in the number of new multinationals against expected growth in the economy provides further insights. To take into account both the historical data and projections we have computed the average level of GDP and new multinationals in both the base and projection periods. Chart 4 shows the growth in the average level of GDP (y-axis) and new multinationals (x-axis) between

the base and projection periods⁵. The area of the bubbles is scaled to represent the total number of new multinationals expected from each country between 2010 and 2024.

Chart 4 - Projected growth - new multinationals vs. GDP



Source: FDI Intelligence from the Financial Times Ltd, PwC analysis

This chart demonstrates that there is more driving the expected growth in new multinationals than GDP growth, as there is not a clear relationship between the two variables. The country projected to have the largest percentage increase in the number of new multinationals is India. It also has the bubble with the largest area so is expected to be the biggest source of new multinationals in absolute terms.

One surprise from the graph is the growth in multinationals between the base and projection periods in Mexico. Mexico produced very few multinationals between 2005 and 2006, which gave it a very low average level of new multinationals in the base period and causes the growth rate between the base period and projection period to be relatively high.

New multinationals are changing over time

The pattern of where multinationals choose to expand and in which sectors they focus has evolved over time. In this section we evaluate these trends – focussing on new multinationals from Russia and China in 2005 and 2009 as examples.

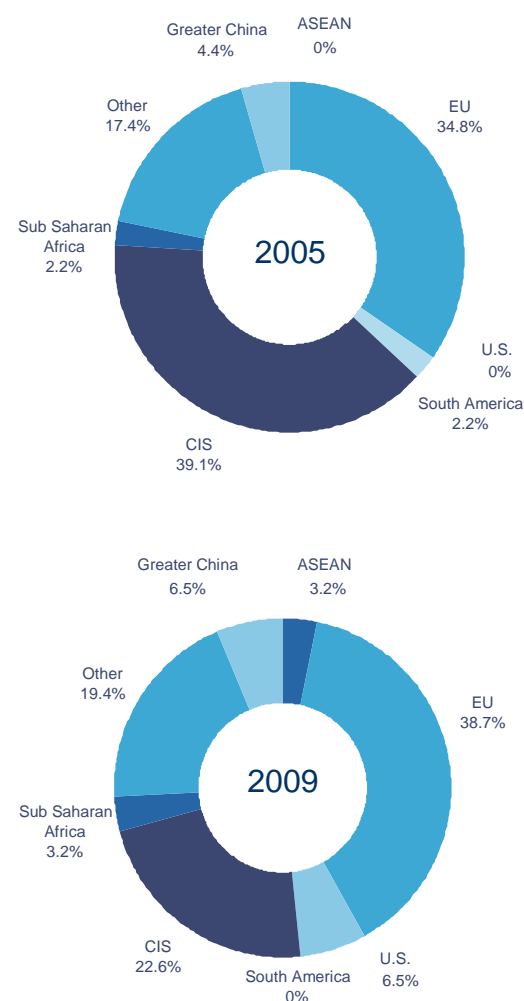
At the start of this period roughly 20% of the total FDI flows into emerging economies came from other emerging economies. Intra-regional investment has been found to be a

⁵ For example, a value of 100% would mean we expect the average level to be twice as high in the projection period.

common starting point for a new multinational company undertaking FDI⁶. This trend for investment in neighbouring emerging economies is mirrored by the initial destination countries of new multinational companies.

However, over time firms have become more inclined to expand into developed markets straight away. Chart 5 below shows where new multinationals from Russia set up their first foreign operations in 2005 and in 2009. In the short time between the two periods there has been a shift away from setting up operations in neighbouring Commonwealth of Independent States and into the relatively wealthier EU and US economies.

Chart 5 – Destination countries of new Russian multinationals



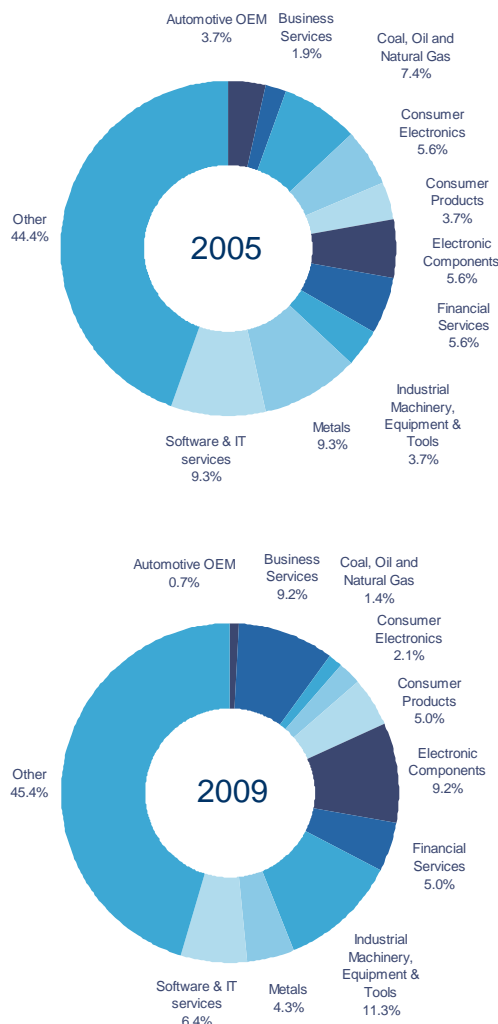
Source: FDI Intelligence from the Financial Times Ltd, PwC analysis

The changes in destination country we have observed in Russia could represent the changing motives of new multinationals over time. In turning their attention to the EU and US economies Russian multinationals are more likely to be market-seeking. This involves setting up operations abroad better to service existing foreign demand and to increase the potential customer base for their products.

The second pattern observed in the data is that new multinationals have moved away from resource extracting industries and into the business services and high value

manufacturing sectors. This is a further indication of the change in motives of new multinationals over time, but it also reflects the changing composition of the domestic economy. Chart 6 below shows how the sectors in which new Chinese multinationals operate have evolved over time.

Chart 6 – Sectoral breakdown of new Chinese multinationals



Source: FDI Intelligence from the Financial Times Ltd, PwC analysis

A substantially reduced percentage of new multinationals operated in industries such as coal, oil and natural gas and metals in 2009, with a boost in the proportion of new multinationals focused on business services, electronic components and industrial machinery, equipment and tools.

We would expect the patterns observed over the period to continue into the projection period. The next 15 years could therefore see more new multinationals from emerging economies expanding directly into developed countries. These companies are also increasingly likely to be market-seeking firms in the services or high value manufacturing sectors.

Conclusions

The number of new multinationals from emerging nations is expected to rise in the next fifteen years. This is further evidence that companies from emerging markets will play an important role in the post recession global economy. Companies from the emerging world have had to adjust to the fiercely competitive global marketplace and have ventured

⁶ See Aykut and Goldstein, 2006.

abroad in greater numbers than ever before. This trend looks set to intensify and we project the next fifteen years will see the rise of a large generation of new multinationals from emerging countries.

We used an econometric model to project how the emerging markets new multinationals landscape would evolve over the next 15 years. The three main results of our projections are that, of the countries in our sample, we expect:

- India to replace China as the largest source of new multinationals in the emerging world from 2018 onwards;
- the South American countries in the sample to be a relatively smaller source of new multinationals; and
- Malaysia, Russia, Singapore and South Korea also to supply high numbers of new multinationals to the world economy.

The changing patterns of companies setting up operations abroad for the first time are expected to continue into the future. We therefore expect to observe a shift away from expansion into other neighbouring emerging economies and towards moving straight into developed markets. These new multinationals are also increasingly likely to operate in the higher value-add business services or manufacturing sectors and not in the more basic natural resource extraction sectors.

These companies should provide enormous opportunities for business-to-business suppliers in the host countries, in the infrastructure and business services sectors in particular, as the new multinationals are likely to require services all around the world, for example in order to support their IT and telecoms needs.

Annex – Econometric approach

This section outlines the model we developed to project the number of new multinationals arising each year across a sample of emerging economies.

We used data from the FT FDI Intelligence database to estimate the number of new multinationals arising from each country in our sample historically in the last 5 years. We have classified a firm as becoming a 'new multinational' the first time it undertakes green field investment abroad. We define a green field investment as when a parent company sets up a physical presence in a foreign country. This could be through renting a property, purchasing premises or building an operating facility from the ground up. This excludes portfolio investment (i.e. a firm purchasing a stake in an existing foreign company). Repeat investments made by the same firm have been excluded, so as to best capture only the new multinationals -- firms investing beyond their home market for the first time.

The academic literature on multinational companies from emerging economies was consulted to help ascertain factors which may drive firms to venture abroad. A list of some of the papers we consulted is contained in the References section (see right). The papers did not contain econometric modelling, but provided a range of variables that might influence the number of new multinationals from emerging economies, such as; size of the economy, level of development, regulatory and competitive conditions, natural resource abundance, the level of trade liberalisation, distance from the host country, the level of capital controls, government policy and cultural or ethnic ties to the host country.

The variables we tested as part of our econometric work included the size of economy (as measured by real GDP), level of development (as measured by GDP per capita), level of trade openness (as measured by the exports to GDP ratio), investment intensity (as measured by the investment to GDP ratio), exchange rate changes, economic growth (as measured by real GDP growth) in both home and potential destination countries. We also tested two variables aimed at proxying the strength of the domestic corporate sector, namely the number of patent applications and number of companies on the domestic stock exchange.

The econometric model we used was a random effects panel data model, as it allowed us to investigate both the differences across countries and the changes over time. The variables included in the final model were those that we found to have the highest positive predictive power of the number of new multinationals. These were the home economy's size, investment intensity, and trade openness.

The macro-economic forecasts to project the number of new multinationals were developed by PwC Macro Consulting.

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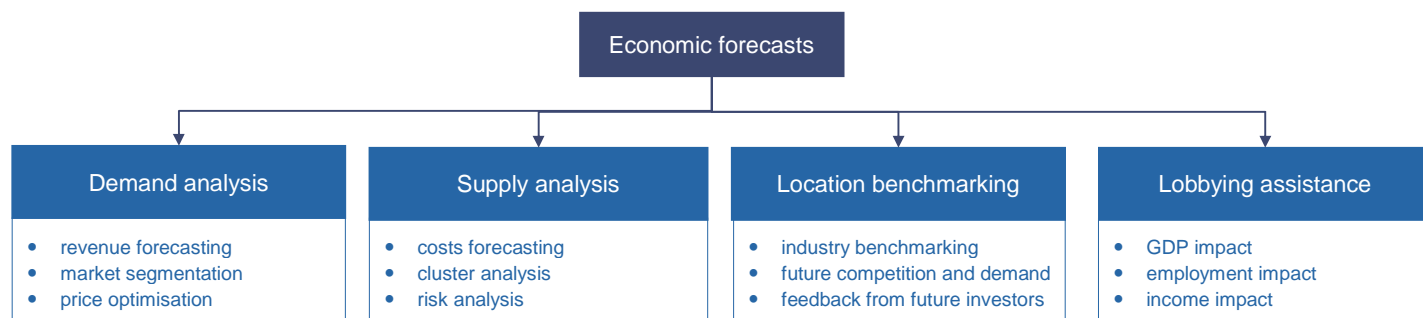
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