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CHAPTER 5

International Capital Movements

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International
Capital Movements

Financial globalization has taken place thanks to the proliferation of international financial flows. Although trade liberalization is generally acknowledged as beneficial by the various theoretical schools of thought, there are conflicting opinions on the effects of the free international circulation of capital.

The economist Stanley Fisher is among those who feel that financial globalization enables capital to be allocated more efficiently, and that it is vital for low income countries. It is emerging countries that would in principle benefit from financial globalization, as they have less capital.

According to the opposite school of thought, led by the economist Joseph Stiglitz, Nobel Laureate for Economics in 2001, among others, the free flow of capital without any restrictions is detrimental to international financial stability. Furthermore, Stiglitz maintains that the crisis on Wall Street clearly shows that the model of free market fundamentalism does not work, and he is critical of the complexity of the financial products that caused the crisis, as well as the incentives for risk in the payment scheme for senior executives.

In the current circumstances, in the midst of collapsed markets and bankrupt businesses, the developed countries are being accused of having failed to establish sufficient checks in order to prevent a speculative bubble. Capital surpluses, which in many cases come from emerging countries, fueled the speculation by investing in complex financial products which hid the risks of subprime mortgages, among other hazards. The spread of these products was encouraged by the AAA rating assigned to them by the rating companies. That is why "conservative" investors were affected by the collapse in the markets as to the same extent as "bold" investors. The rest is history.

The financial crisis has focused the spotlight on the regulatory services and rating companies. The Future Trends Forum experts believe that "the rating companies had a great deal of power, but the problem was not a lack of regulation, but rather that the regulation in place was poor." As a result, it is crucial to deal with this new complexity by means of effective risk management in companies, and greater financial and political coordination on an international level.

A crisis of confidence in the markets arose at the same time as the financial crisis, but more importantly, the conduct and morality of executives is being called into question. During his inaugural speech, President Obama himself did not hesitate to point to the "greed and irresponsibility on the part of some" as one of the causes of the crisis. He referred to "greed and arrogance on Wall Street," and has even described the payment of bonuses amounting to billions of

dollars to senior staff in financial institutions which remained solvent thanks to the help of taxpayers' money as "shameful."

Ángel Cabrera Izquierdo, president of the Thunderbird School of Global Management in Arizona and a Future Trends Forum expert, recently emphasized the need to define a new ethical code for capitalism: "The time has come for business managers to adopt their own Hippocratic oath of business. We must define the obligations and rights of managers as regards society."¹⁰¹ Behind this proposal lies the criticism that companies focused more on increasing financial yields to their investors than on generating employment, value for customers, their suppliers, new technologies and other factors.

Indeed, innovation in financial products was the main factor responsible for the tremendous economic growth of recent years and also for many of the losses in the global economy. It is now vital to restore confidence in the markets and ensure that they are transparent. There are growing calls for more regulation, but if this is not established properly, protectionism may rear its ugly head, with the resulting influence on how the markets function and the efficient allocation of resources.

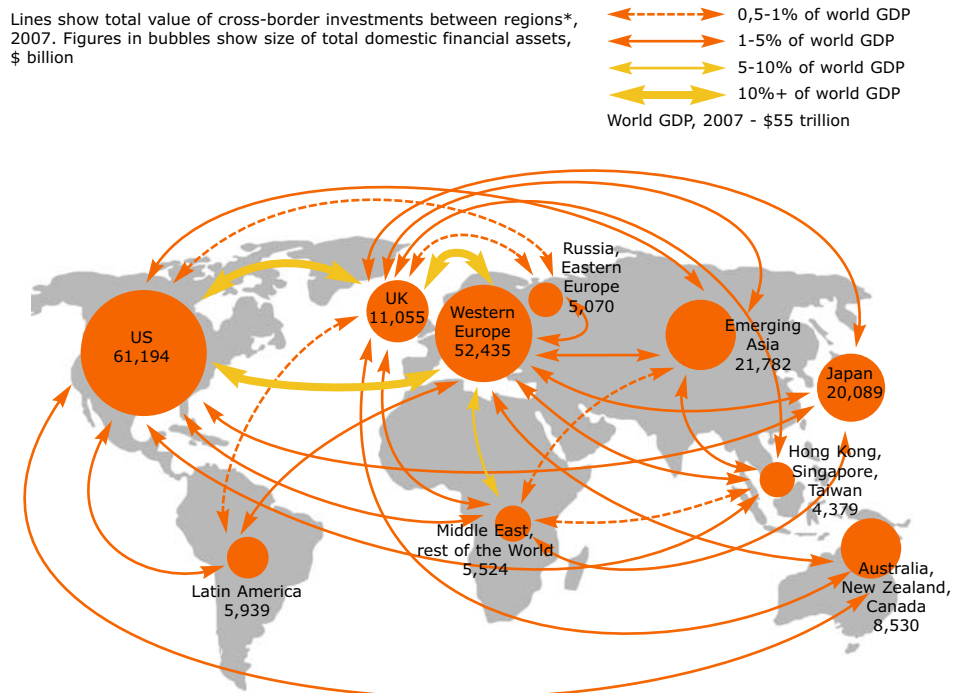
During an interview at the World Economic Forum in Davos in early 2009, Gordon Brown warned of the danger of a rapprochement between the international economy and financial protectionism: "What you are seeing is the withdrawal of banks from a number of emerging-market countries with a pretty weak domestic banking system [...]. What you've got then is a form of financial mercantilism. What you've got is people retreating to their home-based banking systems. It's the first stage of a financial protectionism that will lead eventually to the kind of trade protectionism that we've seen in the past if we are not prepared to do anything about it."

These barriers would halt the great progress made in the flow of international capital. The speed with which the crisis spread and the lack of confidence it created in the banking sector are unprecedented. The closely linked nature of the international financial markets was apparent. This trend toward the multipolar globalization of capital has become apparent in recent years. What is most important is that whereas some years ago, investments originated almost exclusively in developed economies, investments from emerging countries are now increasingly common. These investments are being made in both developed countries and other emerging countries (see Figure 31).

¹⁰¹ «Un nuevo código ético para el capitalismo», *El País*, 02/03/2009.

Did you know?

Between 1996 and 2006, subprime mortgages in the United States increased from 9% of the total to more than 20%.



*Includes total value of cross-border investment in equity and debt securities, lending and deposits, and foreign direct investment.

Figure 31. International cross-border investments. Source: McKinsey Global Institute analysis.

Countries with large foreign capital reserves or low levels of debt will be in a better position to face the future. However, those that are most dependent on international capital flows will have the highest levels of exposure to fluctuations in capital markets, as is now apparent in the countries of eastern Europe. If they do not pay back the debt they have incurred with other European countries, they may endanger the financial systems of the lending states. Iceland's situation at the end of last year, when it was on the verge of bankruptcy, is well known. In the US, the states of California (the world's 8th-largest economy in its own right) and Kansas are also on the verge of bankruptcy, due to their excessive financial leverage and abuse of debt. As a result, the trend will be toward a reduction of debt by both countries and the companies within them.

Flows from Developed Countries to Emerging Countries

Approximately 30% of international direct investment flows from developed countries toward emerging countries. Asia is now more integrated within the international capital markets, and attracts around 40% of the net private capital heading for emerging markets. Foreign direct investment accounts for two thirds

of the private capital going to Asia. These capital inflows, and the region's current account surplus, have led to a significant build-up of reserves.

However, these investments have gradually been withdrawn during the financial crisis. There is some evidence of an incipient financial protectionism which would make countries give priority to injections of capital within their frontiers to deal with the lack of liquidity. The supply of capital to emerging countries is declining as a result (see Figure 32).

Since the outbreak of the worldwide credit crisis, investors have progressively withdrawn their capital from Asian stock markets.
(Net equity flows, million dollars)

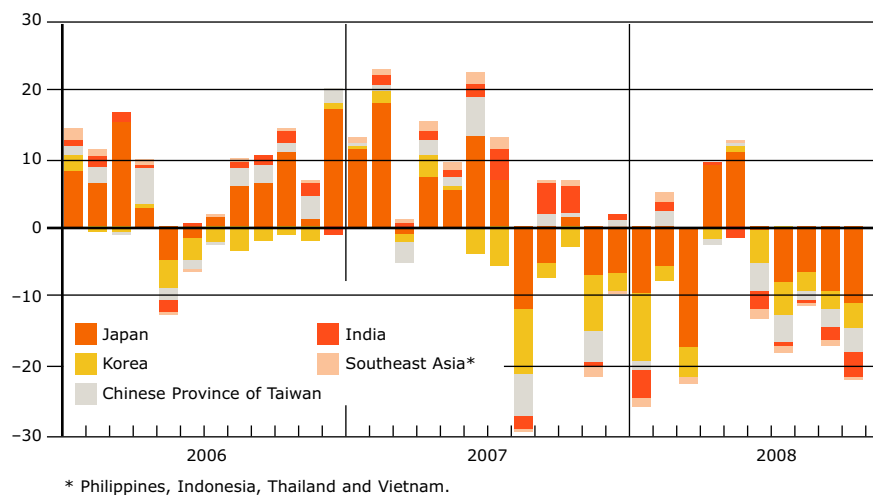


Figure 32. The flight of foreign capital.
Source: Bloomberg.

The flow of capital from rich countries toward developing countries—in the form of remittances sent by immigrant workers—is also being affected by the financial crisis. As all the sectors in the economy of the countries in recession become involved, this group's income will decline, and these capital flows will fall even further as a result. The estimated figure for remittances sent to developing countries in 2008 was 283 billion dollars,¹⁰² with a decline in the second half of the year, followed by a sharp fall in 2009.

The Future Trends Forum experts found that this trend is becoming apparent in various Latin American countries, such as Mexico. Many Mexican immigrants who used to work in the construction sector in the United States are now unemployed, and this will have a profound effect on the volume of remittances.

¹⁰² *Global Economic Prospects 2009*, The World Bank.

The reduction of the flow of remittances will have an effect on the GDP of developing countries. The scale of the decline will also depend on exchange rate fluctuations, which will become particularly important in the near future.

Capital from Emerging Countries to Developed Countries

The tables have turned, as the enormous power of investments from emerging economies looking for sectors in weak situations in developed countries becomes apparent. It is therefore obvious that in a globalized and multipolar world, the so-called "rich" countries also need investments from "poor" countries, which means that the distinction between them is becoming increasingly vague.

The spectacular growth in the foreign currency reserves of countries with emerging economies, and especially those in Asia (see Figure 33), is explained by what Ben Bernanke, President of the Federal Reserve, calls a "saving glut." The high savings rate in these countries is a result of their comparative advantage in labor costs and other inputs compared to the countries that provide these currencies. According to experts at Wharton, the United States, the world's richest country, now finances its trade deficit by borrowing from poorer countries.¹⁰³

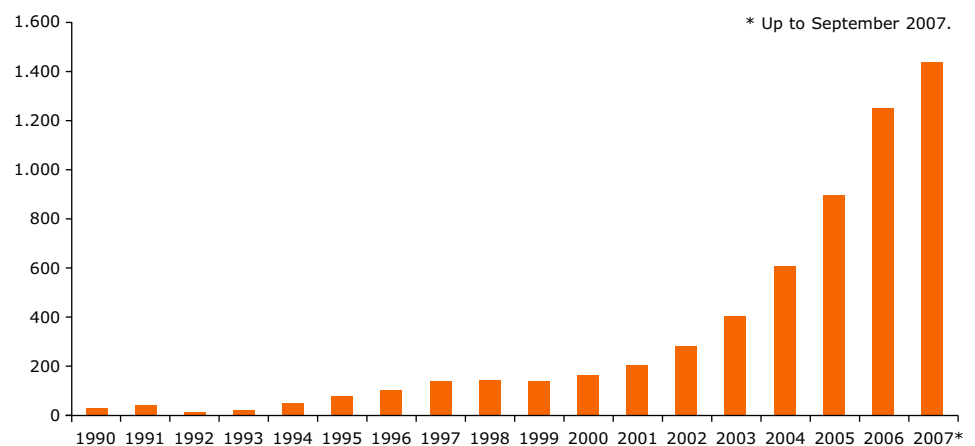


Figure 33. China's foreign currency reserves (at the end of the year, in billions of dollars).

Source: *The Rise of the Emerging-Market Multinational*, page 13, Accenture (2008).

Furthermore, investments in United States Treasury bonds are no longer attractive to Asian countries, due to their low yield. As a result, they are seeking new foreign investment formulas. It is increasingly common to hear on the news of attempts by Asian businesses to merge with and takeover European and North American companies on the news. These are a source of some controversy—does this mean that the emerging countries are taking power in business? These

¹⁰³ «Huge Reserves, Emerging Market 'Challengers' and Other Forces Are Changing Global Finance», *Knowledge@Wharton* (15/10/2008).

strategic operations are carried out through sovereign wealth investment funds that can lead to alterations in many businesses' capital structures (see Figures 34 and 35).



Note: Numbers do not add up due to rounding
 * Estimated based on change in price of common stock from first day of month when transaction took place and June 2, 2008; in the case of Blackstone, change in price from IPO to June 2, 2008.
 ** Pr denotes private companies that do not trade in public markets. OMX AB went private due to transaction.

Figure 34. Sovereign wealth funds invested 59 billion dollars in Western financial institutions.
 Source: Dealogic; Datastream; press reports; McKinsey Global analysis.

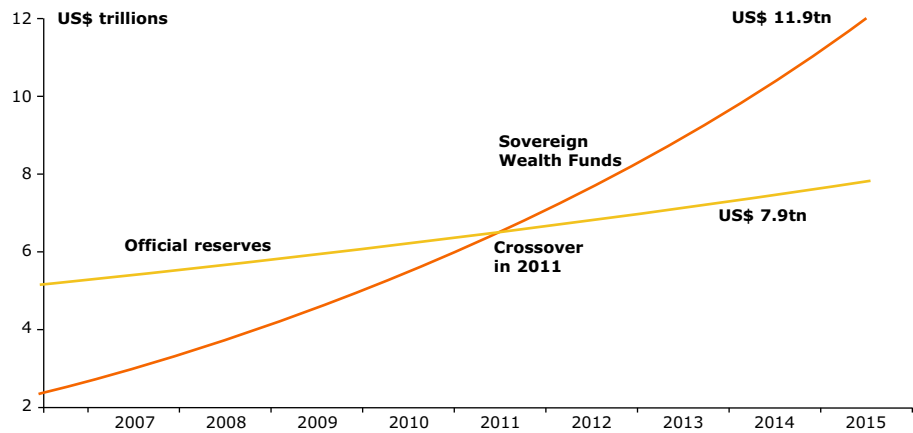


Figure 35. Forecasts for sovereign wealth fund growth.
 Source: Rankia Comunidad Financiera.

The appearance and growth of these sovereign funds is a change in the world economy. The financial players in emerging economies are now on equal terms with their counterparts in developed economies. The position of new financial centers such as Singapore, Dubai and Shanghai, which operate independently from the traditional centers, has been strengthened. Estimates suggest that sovereign wealth funds will continue to grow and become the key players in financial development. In the coming decades, 10% of the sovereign wealth funds' portfolios will be located in emerging and developing economies.

The Future Trends Forum experts believe that in the near future, developed countries must prepare to attract and compete for investments by sovereign wealth funds, in order to overcome their current liquidity crisis.

Capital Flows Between Emerging Countries

Figures for foreign direct investments are difficult to obtain, due to problems with the statistical systems in many countries, the flight of capital to evade taxes or regulation, and the offshore location of financial centers that do not report flows of foreign direct investment (FDI) in other countries. An example is Cyprus, which has become an off-shore platform for a large proportion of Russian capital outside the country, and is now the main source of foreign direct investment in Russia.¹⁰⁴

Despite these difficulties, estimates suggest that since 2003, the growth rate of FDI in developing countries has been higher than that of flows coming from developed countries. According to the United Nations Conference on Trade and Development (UNCTAD), developing countries accounted for 17% of international FDI in 2005. The usual scenario is that emerging country multinationals invest first in neighboring countries due to cultural similarities and existing commercial links. Examples are China and India, which concentrate their investments in other Asian countries.

In China, the trend among sovereign wealth funds seems to be reversing, with interest focused on purchasing shares in Chinese banks on the open market. Meanwhile, the China Development Bank, which is still state owned, is negotiating to take control of the Shenzhen Development Bank, one of the few foreign-controlled financial institutions.¹⁰⁵ Indeed, just at the point when the results of the privatization of state-owned companies became apparent, the recession has led to the rise of precisely the opposite trend. China Eastern Airlines received a capital injection of 7 billion yen (approximately one billion dollars) from the Chinese government, as well as tax deductions on oil.¹⁰⁶ With events like these, is the process of adopting capitalism in China finally coming to a halt?

A study published in late 2008 (*Sovereign development funds: Key financial actors of the shifting wealth of nations*, OECD Development Centre Emerging Markets Network Working Paper, 2008), forecasts a combination of two significant movements in sovereign wealth funds in emerging countries: more invest-

¹⁰⁴ "Las Multinacionales en Países Emergentes" ("Multinationals in Emerging Countries"), Andrea Goldstein and Zenaida Hernández (9/17/2008), a blog about US foreign policy, the emergence of the New International Powers and the shift in the International System.

¹⁰⁵ «So Much for Capitalism», *The Economist* (5/03/2009).

¹⁰⁶ «China Eastern Airlines suffers \$2.2 billion loss», *Google News* (16/04/2009).

ments in their domestic bases and more investments in emerging economies. On one hand, the sovereign wealth funds are suffering from domestic pressure to bring liquidity back to their national and regional bases. On the other, the current recession has showed them that there are no catch-all solutions for investments.¹⁰⁷

Meanwhile, Latin American multinationals are expanding in their own region in order to take up the position left vacant by the withdrawal of other multinationals in sectors such mobile communications, oil and gas. The exceptions are CEMEX and the Brazilian minerals giant CVRD, which completed its takeover of Canada's Inco in October 2006.¹⁰⁸ South African businesses are also investing in neighboring countries such as Mozambique, and emerging countries like Turkey are undertaking FDI, particularly in Central Asia.

The Post-Crisis Capital Market

In conclusion, what is clear is that the capital market has undergone a profound change. The growing range of sources of capital, such as hedge funds, venture capital investments and sovereign wealth funds, have led to a shift in the balance of the global financial system. There are a number of fresh challenges in this new environment. First, addressing the problem of a lack of effective regulation and transparency for new forms of investment. Second, there needs to be increased cooperation in the supervision of large international banking groups. Finally, there must be greater intervention in the brokerage and non-banking institutions market.

According to Joel Kurtzman, President of the Kurtzman Group, former editor of the *Harvard Business Review* and a Future Trends Forum expert, the "new capitalism" that we are starting to build will largely depend on the environment left behind after a severe crisis, which he compares to a great battle by referring to "victims of war:"

- The idea that the domestic market has disappeared, because the global financial system is interrelated and nobody is safe.
- The "portfolio theory" has failed because prudent investors with balanced portfolios suffered as much as those who took more risks.
- The existence of "black swans" in risk management has been confirmed by the crisis. These are events with a major impact that are difficult to predict and which cannot be anticipated by normal expectations.

Apart from the current economic situation, the study published by *The McKinsey Quarterly*, *Long-term trends in the global capital markets*, identifies a series of trends anticipated in the coming years:

- First, it expects the growth of international capital markets to continue as investors invest in equities, debt, deposits and other types of positions all over the world.

¹⁰⁷ http://www.elpais.com/articulo/semana/fondos/soberanos/crisis/elpepueconeg/20090208elpneglse_11/Tes.

¹⁰⁸ "Las Multinacionales en Países Emergentes" ("Multinationals in Emerging Countries"), Andrea Goldstein and Zenaida Hernández (9/17/2008), a blog about US foreign policy, the emergence of the New International Powers and the shift in the International System.

- Likewise, growth rates in emerging markets will continue to increase, and in Asia, China and other emerging countries will replace Japan in terms of financial influence. However, the link between emerging countries and developed countries will persist.
- Meanwhile, the euro area countries will increase their financial influence, and the importance of the euro in the international market will also grow.
- Finally, countries rich in oil will flourish as suppliers of capital and new financial centers will emerge—as mentioned above—in the Middle East, complementing the centers in London and Asia.

All these factors will encourage the transfer of financial power from the United States to other parts of the world.

5.1. Business Strategies for Positioning within International Capital Movements

The multipolar nature of the new world order is most apparent in the capital sphere. The trend toward global integration goes hand in hand with the increasingly intense battle for capital due to the growth of companies from developing economies. Not only is there more money flowing from emerging economies toward their stock markets, but their companies are also choosing to be listed on stock markets in developed economies in order to obtain greater access to capital.¹⁰⁹ In other words, emerging economies are both a destination and a source of foreign direct investment. The implications of this in business terms will depend on the ability of companies to consistently take advantage of where capital is coming from, where it is headed, and its inevitable scarcity.

In his book *The World Is Flat*, Thomas Friedman explains how the offshoring of factories to cut costs has been one of the main forces behind the “leveling” of the international economic playing field. These capital flows lead to direct investments in emerging countries, normally in search of lower costs or cheap labor.

The trend toward offshoring arises from companies’ inherent need to find new ways to produce their goods, optimizing costs and exploring new markets that are attractive and sustainable over time. In situations like the present, in which budgets are being cut, this option is winning converts.

Obviously, the recent crisis and the consequent loss of confidence in the capital market are also factors to take into consideration, in terms of both their negative effects and the opportunities that arise for more entrepreneurial spirits. So this raises the question: what are the main trends that are appearing as a consequence of the current economic-financial conditions and how can they be taken advantage of in investment terms?

¹⁰⁹ *The Rise of the Multipolar World*, Accenture (2008).

Did you know?

Global investments are expected to double ... to 300 trillion dollars in just a few years. 60% of this growth will come from new global markets, which will account for more than double that of mature and developed markets like the United States and Japan (Economist Intelligence Unit).

Companies in Developed Countries and International Capital Movements

The crisis that has battered the financial markets since 2007 has unbalanced the traditional models of debt and capital financing for companies in developed countries. Consequently, many of those companies are looking at emerging markets as a way of improving their financial situation.

Rule 1: Invest in BRICs

Yields on investments in emerging markets used to be below average. When they entered these markets, venture capital investors used to find economically and/or politically unstable situations, a lack of favorable agreements in the country concerned, and problems related to intellectual property laws and even to security. However, the outlook has changed because the perception of emerging markets among foreign investors has improved, due to structural macroeconomic reforms such as privatization, lower taxes, deregulation in markets and integration in international trade. These factors have led to an increase in the yield on investments in emerging markets, and a spectacular decline in inflation rates.

In short, high rates of economic growth, the opening up of their stock markets and the increasing globalization of investors are making emerging markets a more attractive investment. Furthermore, competition in the Europe and United States makes obtaining higher rates of return more difficult, so businesses from these regions must improve their access to capital and diversify risk. Thirteen BRIC investment funds were traded by seven financial institutions in Spain in 2007. These accounted for total assets of 645 billion euros, according to Spain's national securities commission (CNMV). These institutions take their customers' financial resources and invest them on the major stock exchanges in Brazil, Russia, India and China. This means that the yield for the customer is higher than the average offered by more conservative types of investment. The advantage is that they are accessible to small investors. However, the disadvantage is that despite offering higher yields, they are "high" or "very high" risk, meaning that real yields can vary across a very wide spectrum. This spectrum is influenced by the likelihood of Brazil, Russia, India and China being able to become strong and stable economies.

One way that developed countries invest in BRIC capital is by means of strategic alliances and joint ventures. Obstacles to investment abroad can be overcome, and access to the advantages of new markets and international expansion thus becomes possible. Japan is an example of a country that can no longer depend solely on its domestic market. According to an article published in November 2008, its companies were spending more than a trillion dollars a week on merger and takeover operations.¹¹⁰ Among their BRIC investments is Nomura Holding's outlay of 2 billion dollars for the Asian and European operations of Lehman Brothers, and the buyout by Daiichi Sankyo of Ranbaxy Laboratories, India's largest generic pharmaceutical company, which was valued at 4.6 billion dollars.

¹¹⁰ «The one big buyer», *Newsweek* (15/11/2008).

A recent survey by the United Nations Conference on Trade and Development (UNCTAD) showed that East, South and Southeast Asia remained the preferred regions for foreign direct investment (FDI), followed by the European Union, North America and the emerging European markets. It also predicted that FDI in 2009 will remain at acceptable levels, although countries like China are now much more selective in their investments and give priority to internal projects.¹¹¹

Finally, there is the “Bangladesh Paradox,” a term coined by the World Bank. Bangladesh was named “the least developed nation” in the world by the United Nations in 2003. However, banks such as Citigroup, Goldman Sachs, J.P. Morgan and Merrill Lynch consider the country to be a “key investment opportunity” because the Dhaka Stock Exchange Index rose by 66% in 2008, making Bangladesh the country with the highest yield after China, and even ahead of India. The sustained 7% growth of its GDP strongly suggests it will soon be an “Asian tiger.”¹¹²

Rule 2: Attract BRIC Capital

The rise of sovereign wealth funds as a means for emerging countries to invest in companies in developed countries has been discussed throughout this report. Sources of capital in emerging markets are a great opportunity for multinationals in developed countries to improve their poor financial situation. In this respect, Accenture¹¹³ feels that “Developed-market multinationals need to recognize the emergence of a new cast of players in global capital markets—not only emerging market multinationals but also private equity, hedge funds and sovereign wealth funds, many of which also originate from emerging markets. Companies are therefore subject to an increasingly competitive market for corporate control, with corporate strategy and shareholder objectives in progressively closer alignment. This also means that developed-market companies face increasing competition for assets, thus potentially bidding up prices for acquisition targets.”

An example of governmental action to attract these funds occurred in the United States in December 2008, when steps were taken to facilitate the entry of Chinese financial institutions attempting to invest in the country. The United States aims to encourage foreign investment via bilateral agreements in order to gain access to credit markets that have been “frozen” by the crisis. The sovereign wealth fund China Investment Corp. alone has lost 6 billion dollars since mid-2007 with its purchase of shares in Morgan Stanley and Blackstone Group.¹¹⁴ The US government therefore wants to encourage investments by Chinese sovereign wealth funds at all costs, and especially commercial investments.

Siemens, the German engineering group, met investors from sovereign wealth funds from the Gulf and Russia in the summer of 2008 in order to enlarge its long-term investor base. By doing so, the company would be entering markets with rapid growth, which would provide it with potential profits. However, the trend

¹¹¹ http://www.unctad.org/en/docs/wesp2009_en.pdf.

¹¹² «Buoyant Bangladesh: An Emerging Investment Destination», *DinarStandard* (3/03/2008).

¹¹³ *El auge de las multinacionales de países emergentes*, Accenture.

¹¹⁴ «US to speed investment from China banks, state fund», *Qatar Tribune* (12/12/2008).

toward protectionism is once again a threat, as Germany had announced its intention to approve a law allowing investments in German businesses with more than a 25% shareholding by non-members of the EU to be blocked. At the opposite extreme, Barclays in the United Kingdom preferred to accept capital investment from Qatar rather than from the British government, despite the Qatari sovereign wealth fund increasing its shareholding to 15.5%.¹¹⁵ In March 2009, Daimler AG justified selling its shares to Aabar, an investment fund controlled by the Abu Dhabi government, by citing its need to guarantee funds that enabled it to maintain its current levels of spending on R&D, and to prepare the company for the (long) transition from today's internal combustion engines to new technologies.¹¹⁶ In early 2009, Abu Dhabi and Kuwait jointly controlled 16% of the German automobile group. Despite this, companies such as Barclays and Daimler are choosing opportunities for growth and capitalization, rather than worrying about a decline in strategic and operational capacity.

Although sovereign wealth funds have existed for decades, their appeal increased considerably with the onset of the credit crisis. International Finance Services London (IFSL) has calculated that the annual average growth in assets managed by sovereign wealth funds in the last three years was 18% (see Figure 36). Although this growth rate probably will be affected by the crisis, the IFSL projections suggest that they will double their total amount to 8 billion dollars in 2015.

¹¹⁵ «Barclays looks to Gulf for \$12 billion capital raise», *The Guardian* (1/11/2008).

¹¹⁶ «Dinero de Abu Dhabi para consumir menos petróleo», *El Mundo* (24/03/2009).

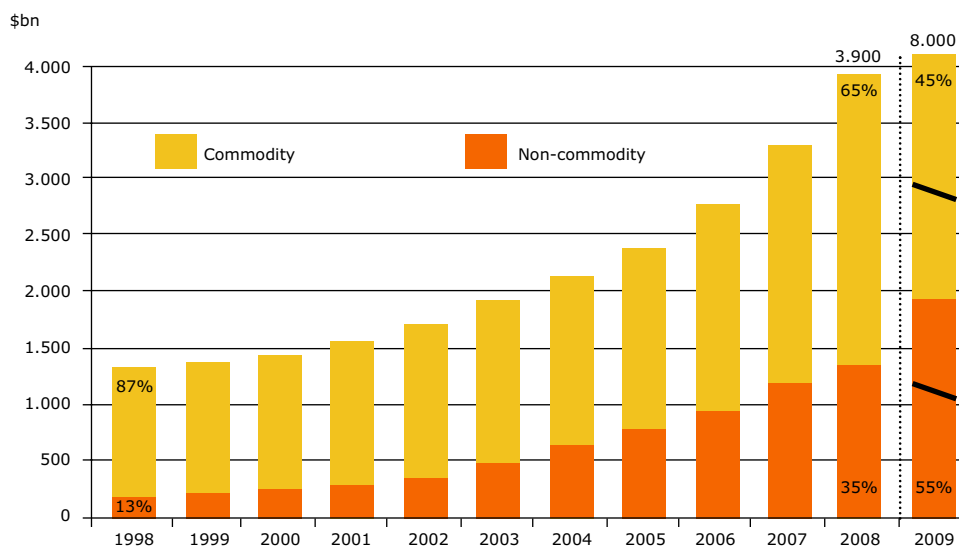


Figure 36. Sovereign wealth fund assets.
Source: IFSL.

Rule 3: Consider the Various Investment Formulas

The emerging market for foreign direct investment (FDI) has business models with assets with low costs and high productivity rates. The competition in emerging markets forces multinationals from developed economies wanting to invest there to adopt more flexible and innovative business models. Despite all the difficulties involved in crossing frontiers, companies are particularly willing to increase their investments abroad. They overcome some of the barriers to doing so by means of strategies such as opening new offices in foreign markets, investing in businesses with a local presence or creating strategic alliances with firms established in the region.

As far as direct investment is concerned, while India is the star of outsourcing, China is the leading player in offshoring. The world's largest communist country also receives the most foreign capital for the production and preparation of products from thousands of companies seeking quality and low manufacturing costs. While outsourcing consists of taking some of a company's work and subcontracting it to someone somewhere else, offshoring "is when a company takes one of its factories that it is operating in Canton, Ohio, and moves the whole factory offshore to Canton, China. There it produces the very same product in the very same way, only with cheaper labor, lower taxes, subsidized energy, and lower health-care costs."¹¹⁷

The possibility of using mergers/takeovers and joint ventures as a means of investment has already been discussed. These operations are all over the news, and involve some of the world's leading companies. It has also become apparent that, to an increasing extent, one of the parties involved is a company from an emerging country. For example, General Electric joined forces with Mubadala, a financial arm of the Abu Dhabi government, to invest in a "carbon dioxide-free" city as a pilot experience for the company's *ecomagination* clean-energy program. This agreement shows that even an investment between a private company and the public sector in an emerging country can lead to expectations of investments totaling 40 billion dollars, like those anticipated of the present and future projects by this partnership. This case is related to the so-called greenfield investments, which are a means of foreign direct investment in which a parent company builds up an industry's installations "from scratch," creating employment in the target country. Multinationals in developed countries see this investment as a way to penetrate the market in emerging countries, where governments even offer tax breaks, subsidies and other incentives in exchange for these projects being carried out. Indeed, China has encouraged foreign companies to invest in its economy in this manner, rather than by purchasing existing Chinese companies directly. Some examples of greenfield investment are the construction of tourist resorts and golf courses in Croatia with public and private capital.

¹¹⁷ <http://www.luismaturen.com/2008/10/sexta-aplanador-traslado-de-fbricas.html>.

Rule 4: Take Advantage of Adversity

Times of crisis also lead to the appearance of investment products that can lead to profits. In this case, a new one, known as distressed debt, has risen out of the ashes of the crisis. These are debts owed by companies and/or countries that find it difficult to meet payments, and which are probably going to fail in the near future. Why would investors—in most cases venture capital companies—be interested in bonds that seem unlikely to be paid? Like many attractive investments, the greater the risk, the higher the potential yield. The strategy consists in becoming the largest creditor of businesses at risk of bankruptcy, by buying bonds at a very low price. If the company is wound up, its investors take priority for payment over the owners of assets, and recover their investment, or at least make a small profit on it. However, the best result is when the company is restructured and bankruptcy is avoided. The investor companies then write off the target company's debt in exchange for shares. Companies such as Goldman Sachs are already planning to invest their surplus funds—in this case 15 billion dollars—in distressed debt.¹¹⁸

Another effect of the crisis experienced by the banking sector in recent months is that the banks appear to be determined to go back to basics in order to survive, rather than maintaining their aspirations toward international expansion. In a survey by the Economist Intelligence Unit,¹¹⁹ almost two thirds of those surveyed expressed their intention to focus mainly on domestic markets and curtail their product lines. Alpha Bank, the second largest bank in Greece, is promoting its All-In-One campaign, which consolidates customers' entire debt in a single account to help them meet interest payments. Despite the campaign being launched in 2006, the bank feels that the current situation could not be better in terms of offering this product.

Rule 5: Invest in "Green," Commodities and Emerging Consumption

The energy and environment sectors have been identified as those that will attract the most investments in the coming years, due to the international problem of the lack of natural resources. Venture capital companies will also seek out opportunities to overcome the global lack of food and energy in industries such as biotechnology. In many cases, it is a question of developing techniques that genetically alter crops to increase production. In the energy field, the never-ending search goes on for alternative sources that are sufficiently lucrative to make investment in research worthwhile. Government support for RDI projects is a major incentive for businesses—especially in the pharmaceutical and biotechnology sector. Barack Obama aims to allocate part of the national budget to supporting a legal means of approving the generic versions of biotechnological medication. In March this year, the German pharmaceutical company Merck also announced its intention to finance a venture capital fund of 40 million euros specializing in biotechnology in emerging countries over the next five years.¹²⁰ This would focus on the therapeutic areas of neurodegenerative, autoimmune and inflammatory diseases, as well as oncology.

¹¹⁸ «Goldman fund eyes distressed debt market», *Financial Times.com* (16/03/2009).

¹¹⁹ «Beyond the home market, the future of crossborder banking», Economist Intelligence Unit.

¹²⁰ «Merck launches biotech venture capital fund», *International Herald Tribune* (23/03/2009).

At the same time, international demand for commodities is on the rise, meaning that some investors will want to take advantage of their climbing prices. Despite having to withstand possible initial losses, there are favorable factors, such as strong demand for agricultural material in emerging countries and the weakness of the dollar, which lowers the transaction costs—i.e., transport—on which the prices of these products depend. The demand for gold also reached a record high of 32 billion dollars between July and September 2008.¹²¹ Gold is chosen by investors in times of crisis, or periods of inflation, or when there is concern over the volatility of currencies. However, Jeremy Siegel, professor of Finances at Wharton School, says in his book *Stocks for the Long Run*¹²² that gold is not a good long-term investment. “A dollar invested in gold in 1801 would have grown to just \$1.95 at the end of 2006, while a dollar put into a basket of stocks reflecting the entire market would have grown to more than 755,000 dollars.”

Another type of investment that has become very important entails finding countries with a sharp increase in their middle class, such as China or Brazil, and focusing on the housing sector and retail trade. This investment usually prioritizes long-term operations, and is not attempted without the participation of a local partner. We all know “someone” who invested in construction in Eastern Europe. However, other destinations, such as Brazil, are starting to become popular. With 320 days of sun a year, long stretches of beaches, fiscal stability and massive growth in tourism (as well as having been named the host of the 2014 World Cup), the country has become one of the main targets for investment. Equity International, a specialized private investment company that focuses on businesses related to assets located outside the United States, announced its purchase of approximately 20 million shares of the Brazilian company Construtora Tenda in March 2009, just four months after another investment of 46 million dollars in the Shanghai Yupei Company, a Shanghai-based industrial property company owned by private capital. With this investment, the company began operations in the Chinese logistics and storage sector.

Companies from Emerging Countries Regarding International Capital Movements

As liberalization and technological breakthroughs lead to increased integration in the international capital markets, investors from emerging markets are becoming increasingly important, and account for growing proportions of both foreign direct investment and portfolio investment.¹²³

The Future Trends Forum experts were asked the question “Which of the following factors will be most important for companies in emerging economies in the next three years?” They felt that the priority will be the search for capital (see Figure 37). Emerging countries are subject to serious capital pressure, due to the decline in demand for their exports, the slowdown in the rate of investments and the refusal to provide loans across frontiers. Considering that most large banks belong to developed economies, the fragmentation of the capital market has a direct impact on emerging countries, as it is more difficult

¹²¹ World Gold Council.

¹²² «Gold May Glitter, but It Doesn't Stack up as a Long-term Investment», *Knowledge@Wharton* (30/04/2009).

¹²³ *El auge de las multinacionales de países emergentes*, Accenture.

for them to obtain the loans that they have been depending on to boost their growth. All the BRIC countries have suffered from the results of the crisis in Western markets, but this is especially true of Russia, which has also been affected by the fall in its oil and gas income.

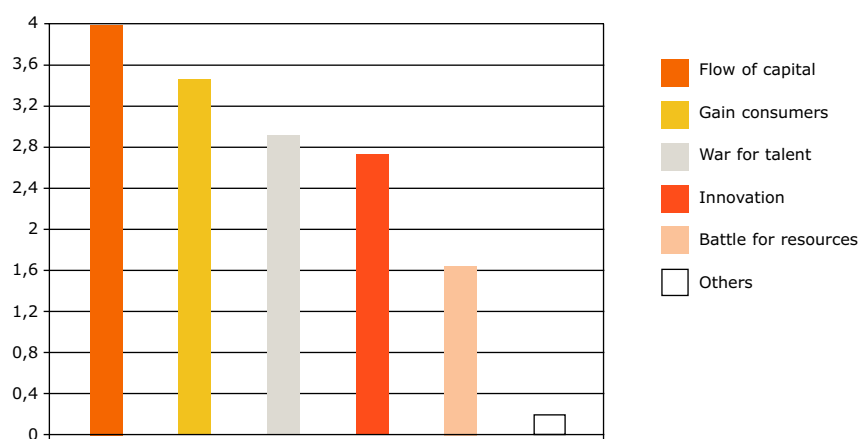


Figure 37. Main factors for companies in emerging economies in the next three years.

Source: Drawn from the conclusions within the Future Trends Forum.

Some of the trends that will govern the strategies of companies in emerging countries in terms of international capital flows are set out below.

Rule 1: Begin to Expand Internationally in other Emerging Countries

Competition from companies in emerging countries is an international fact of life. After a period in which they cornered their domestic markets by buying up the assets left behind by businesses from developed countries, they began their internationalization process after the crisis of the late 1990s. However, the trend among multinationals from emerging economies appears to be focused on expansion by means of E2E investments: "emerging to emerging." The figures show that over 96% of the flows of foreign direct investment from the four BRIC countries go to other emerging economies¹²⁴ (see Figure 38). Accenture believes that this is due to a variety of factors, such as the existence of regions that are rich in resources and consumers, the lack of services and cheap labor. E2E investments put these countries on the path toward international expansion, but also enable them to gain experience in more familiar markets and to refine their business models before expanding further.

¹²⁴ «El auge de los mercados emergentes», Accenture (2008); data from Economist Intelligence Unit; analysis by Accenture.

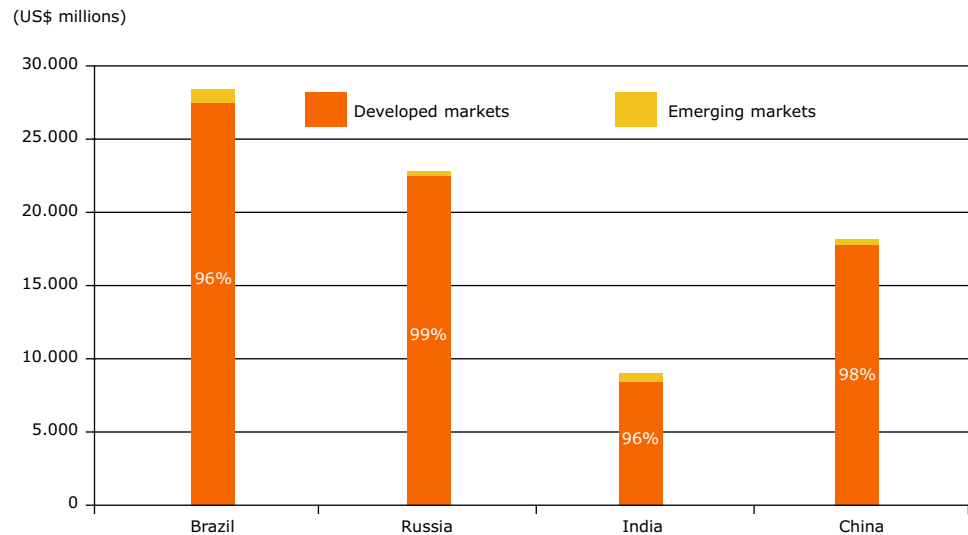


Figure 38. Destination of foreign direct investment from BRIC economies (2006).

Source: Economist Intelligence Unit; analysis by Accenture.

Huawei, a Chinese manufacturer of networking devices, used its experience in Southeast Asia during its subsequent expansion to South Africa, Latin America and Eastern Europe. According to the company itself, “we have established a global network, placing great importance on localization. We try to be as close as possible to our customers. We believe that to really understand customers’ needs, we need to be right there with them, working hand in hand in their own location. That way we can always be sure of providing our customers with the finest global technology tailored perfectly to their local needs.”¹²⁵ After initially expanding in geographical areas that are more familiar due to the limitations on infrastructures and income levels, the company is continuing its growth by penetrating similar regional markets all over the world.

Indeed, the limited infrastructure in emerging countries—or even the lack of infrastructure—is an attractive investment opportunity. The trend toward multi-channel banking in developed countries is a way of cutting costs on physical offices, as well as enabling a larger market to be reached by means of the Internet, automatic cash machines and mobile phones (see Figure 39). Banque Libano-Française (BLF) says that the Internet has given it a competitive advantage in its domestic market of Lebanon and in foreign markets such as Switzerland, France, Syria and Cyprus.

¹²⁵ <http://www.huawei.com>.



Figure 39. Which of the following multichannel banking areas will be your bank's main focus in foreign markets in the next three years?

Source: The Economist Intelligence Unit, 2009.

Another example of an emerging country that chooses other emerging countries for its investments is China's projects in Africa. An article by *The Economist* stated, "according to a recent study by the Institute for Public Policy in London, China has become the third-largest trading partner behind the United States and France."¹²⁶ China is present in 48 African countries, most notably in Sudan, followed by Algeria and Zambia. The telecommunications industry in Africa was dominated by British Vodafone, France Telecom, Vodacom and MTN (the latter two are South African). However, Chinese public companies such as Equipments Company Limited (ZTE) and Huawei, the private multinational mentioned above, have established themselves in the arena, and have bid for telecommunications operations in Nigeria, Niger and Zambia. CNOOC also acquired a 45% holding in Offshore Oil-Mining License (OML) in Nigeria in early 2006. The China National Petroleum Corporation is the largest foreign oil producer in Sudan.¹²⁷ It is also involved in infrastructure construction projects in numerous African countries in the road and railway transport sectors, and other post-war reconstruction work.

In short, Africa has been a place for China to gain experience, encouraged by trade agreements and the fact that there is a market niche in which Chinese businesses can manufacture products at a price that African consumers can afford. Some examples are refrigerators that are smaller than the standard size, produced by Haier, and Lenovo's laptops for small and medium enterprises.¹²⁸ Oddly enough, the African mobile phone operator MTA operates in countries in the Middle East such as Iran, Afghanistan, Syria and Yemen, as well as in Africa. This is another symptom of a multipolar world in which the new players come from all over the planet, and in which they are also interrelated to a greater extent than ever before.

Rule 2: Take on the Global Market

Despite the first step toward international expansion by multinationals from emerging countries usually taking place in other emerging countries, many are deciding to expand globally. A few years ago, nobody would have imagined that CEMEX, a company from Monterrey (Mexico), would become the leading cement

¹²⁶ «¿Realismo mágico? China e India en América Latina y África», Javier Santiso <http://www.oecd.org/dataoecd/37/55/38447180.pdf>

¹²⁷ «China Advises Sudan Not to Let Darfur Crisis Worsen», *Bloomberg.com* (18/03/2009).

¹²⁸ «China's Emerging Multinationals in Africa», *The Africa Journal*.

producer in United States by taking over several competitors, nor that Thailand's CP group would be the largest foreign investor in China. It would also have been difficult to believe that as well as having a significant presence in north Africa, Iraq and Bangladesh, the Egyptian telecommunications company Orascom would organize Europe's largest leveraged buyout to acquire the operator Wind in Italy. These days it is hard to find an edition of any international financial newspaper that does not contain news of another operation carried out by an emerging multinational. One example of this is the dispute between an Indian and a Brazilian company over the purchase of Corus, the giant iron and steel company formed by the merger of British Steel with a Dutch rival.¹²⁹

Multinationals from emerging countries became a topic of discussion 25 years ago. At that time, a small group of developing economies were starting to become a source of foreign direct investment: Argentina, Brazil, Korea, Hong Kong, India, Singapore and Taiwan. Since the late 1980s, other emerging countries, including Chile, China, Egypt, Malaysia, Mexico, Russia, South Africa, Thailand and Turkey have joined them as significant sources of foreign direct investment.

Most of the flows of these investments from emerging countries are to Asia. Indeed, the largest emerging multinational is Hutchinson Whampoa, a Hong Kong conglomerate that is very active in telecommunications and logistics services, and is 17th in the ranking of the world's largest multinationals published by UNCTAD. The top 100 also includes a Korean company (Samsung Electronics), one from Singapore (SingTel), one from Malaysia (Petronas) and one from China (CITIC).

The expansion of foreign direct investment from emerging countries is also a reflection of the rise in flows of capital toward these countries as the sophistication and size of their businesses increases. Globalization raises the levels of competition faced by businesses in emerging countries, in terms of sales, access to resources and strategic assets. Emerging multinationals therefore have no alternative other than to become international in order to strengthen their competitive advantages. Unlike traditional multinationals, their emerging country counterparts do not usually have resources such as their own technology, established brands, access to financing and management teams with international experience. They generally expand slowly, with frequent changes in direction as lessons are learned through experimentation.¹³⁰

Investment operations by emerging multinationals are leading to complex and highly diverse businesses. For example, the headquarters of Mittal Steel, one of the world's largest steel producers, which recently took over Arcelor in Europe, is in the Netherlands, it is controlled by an Indian citizen who lives in London and its executives are mostly Indian. The South African multinationals, such as SABMiller, which are listed on the Johannesburg and London stock markets, with two leading shareholders that are an American group and a Colombian family, are another complex case. Another example is the acquisition of OECD companies' assets by emerging multinationals in exchange for a significant stake in

¹²⁹ <http://www.mobbingargentina.com.ar/Files/RRII/Las%20multinationales%20de%20los%20pa%C3%ADses%20emergentes.pdf>.

¹³⁰ <http://www.mobbingargentina.com.ar/Files/RRII/Las%20multinationales%20de%20los%20pa%C3%ADses%20emergentes.pdf>.

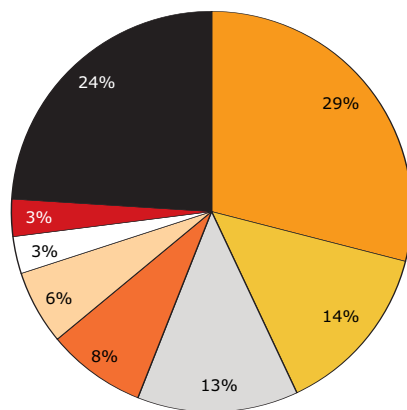
their capital, as occurred with the Chinese company Lenovo's purchase of IBM's personal computer division.

Rule 3: Use Mergers and Takeovers to Overcome Frontiers

News of merger and takeover operations are featured in the media every day. Companies from emerging markets have recently been participating in these agreements to an increasing extent. According to A.T. Kearney,¹³¹ companies in India, Malaysia and China were responsible for 56% of this type of agreement between 2002 and 2007 (see Figure 40). In previous chapters, we discussed the increasing number of sovereign wealth funds that are accumulating international assets on an exponential basis. According to the same publication, these assets were valued at a total of 2.5 billion dollars in 2007, but this figure will have reached 12 billion dollars in 2015.

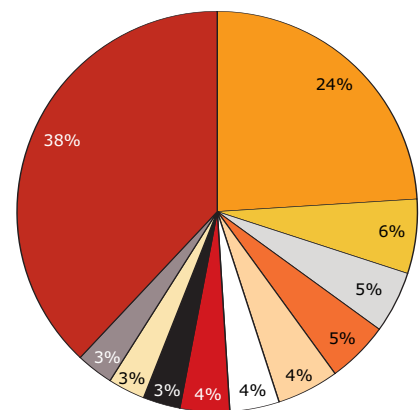
¹³¹ «The Rise of Emerging Markets in Mergers and Acquisitions», A.T. Kearney (2008).

Acquirers from developing countries



- India
- Malaysia
- China
- South Africa
- Russia
- Mexico
- United Arab Emirates
- Other

Countries targeted by companies from developed countries



- China
- India
- Poland
- Brazil
- Mexico
- Russia
- Czech Republic
- Hungary
- Romania
- Malaysia
- Other

* Porcentajes entre 2002 y 2007

Figure 40. China, India and Malaysia led the way in mergers and takeovers between 2002 and 2007.

Source: "The Rise of Emerging Markets in Mergers and Acquisitions." A.T. Kearney (2008).

Although the objective behind the merger and takeover strategies in developed countries is to cut costs and obtain competitive advantages, companies from emerging economies want to improve their access to production and new technologies. For example, Tata Motors took over the British crown jewels Jaguar and Land Rover in early 2008. It has so far only produced compact and cheap models, but the takeover gives it access to technology, means of production and distribution channels, which are very important in its expansion to Western markets, as well as changing the perception of the brand.

The strategy of carrying out mergers and takeovers enables companies from emerging markets to penetrate markets with more sophisticated consumers, to take advantage of synergies with businesses on the international scene, and to acquire transparent corporate governance habits. As the saying has it, "when in Rome, do as the Romans do." When international expansion strategies are undertaken and interaction with global players begins, it is necessary to operate within a regulatory framework with regional and international laws that affect trade, investment, the environment and even specific sectors such as banking.

India's ICICI bank began its European operations in 2003 by establishing itself in the United Kingdom, largely because of the country's population of 1.3 million Indians, 200,000 of whom are ICICI customers. Its objective of becoming a "community bank for Indians" in all the countries where it operates has been a success, because it chose the right partner when embarking on its path toward internationalization.

Despite mergers and takeovers being a very wise strategy for emerging countries, KPMG published a study in March 2009 which said that the number of companies in emerging economies that merged or took over others in developed economies fell by 28% in the second half of 2008.¹³² The recession undoubtedly has a great deal to do with this decline. India remained the leader in takeovers of companies from developed economies.

Finally, the inevitable question is: why are there hardly any joint ventures between companies from emerging economies and developed economies when mergers and takeovers have become the norm? According to an article in *The McKinsey Quarterly*,¹³³ the answer lies in the difficulty in overcoming the vast differences between them in order to successfully establish an alliance. Among the differences mentioned are size, financial capacity, structure, business objectives, culture and the different management teams. The alliance must have a common objective and strategy, and the company from the emerging country will not be able to tackle them in the same way as the developed country company, for obvious reasons. The article gives an example of a leading multinational company in the perishable consumer goods sector and an Indian company. They formed an alliance that tripled their market share in four years, and became the third-largest competitor in the sector. However, the multinational wanted to add more capacity and make the Indian company the regional supplier for Asia and Africa. The Indian company would have had to make an investment estimated at

¹³² «M&A Deals In Emerging-Markets Hit Multi-Year Lows», KPMG (2/03/2009).

¹³³ «Emerging Market Alliances: Must They Be Win-Lose», *The McKinsey Quarterly*.

17 million dollars, or a quarter of its annual turnover. In the end, when the Indian company refused to invest, the multinational took it over.

Rule 4: Adapt Financial Practices to Local Conditions

In their analysis of financial practices in emerging countries, the Future Trends Forum experts came to the conclusion that they do not currently meet the needs of the population. The main characteristics of these countries that should be taken into account when designing financial products for them are: their large populations (a large proportion of which lives just above the poverty line), the informal nature of their labor market and their banking mediation channels, and their lack of infrastructure in terms of networks, communications and public services. Another very important aspect is the high level of self-employment, due to individuals' need to improve their financial situation. These microenterprises are their only means of improving their living standards, but they lack financing in most cases. They normally depend on informal groups of moneylenders, kinship networks and family members to meet over half their financing needs (see Figure 41). Experts believe that this problem could aggravate the income divide between rich and poor countries, as well as social problems.

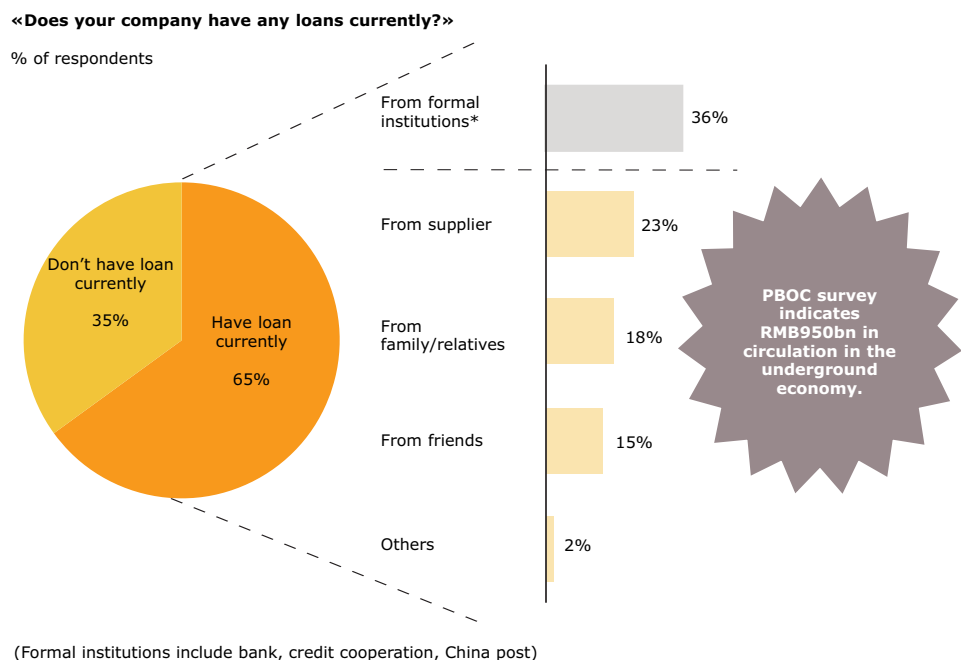


Figure 41. Financing sources for companies in China.
 Source: 2004 Survey by the People's Bank of China on informal financing, Team Analysis, August 2007.

The good news for local financial companies is that this area has yet to be examined in depth by global companies (see Figure 42). Furthermore, despite the expansion by these local and global companies, access to financial services in emerging markets is still low level and uneven, meaning that there is a clear business opportunity in this area.

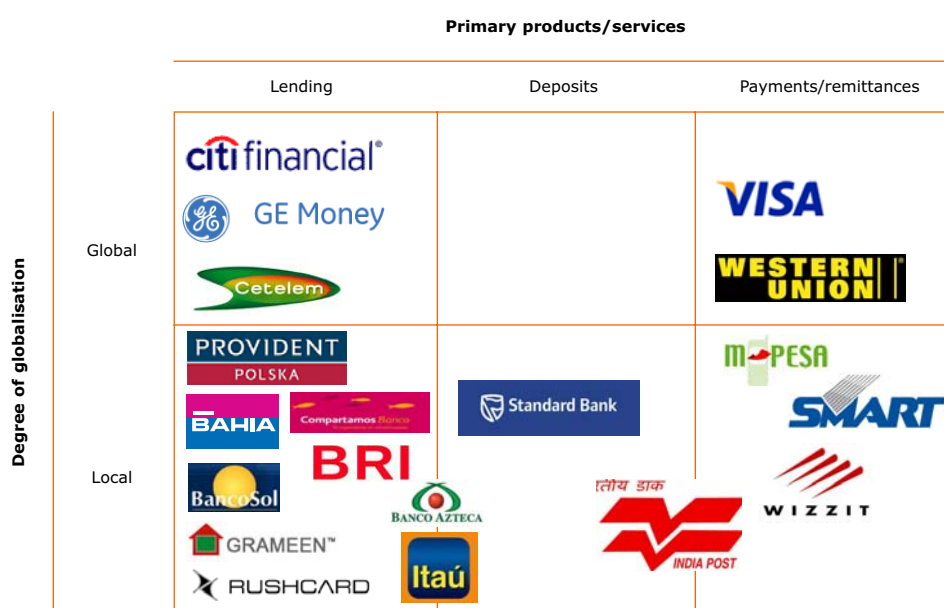


Figure 42. The competitive landscape in China’s financial-services sector.
Source: Fullerton Financial Holdings.

For the experts, if companies that want to serve consumers (businesses or individuals) in emerging countries are to be successful, they must innovate in terms of their business models in order to adapt to these conditions. Bearing this in mind, the financial-services company Singapore Fullerton bases its business model on in-depth knowledge of the customer, extensive investment in research and commercial relations at the most basic levels.

This has led to a network of offices that is fully integrated into local life. In Indonesia, for example, they have extended their sales network to the *Pasar*, or local market. They also recruit sales staff from the communities in which they operate, taking advantage of their knowledge of local customs, dialects and customers. At the same time, a commitment to the communities they serve is part of the company’s mission, and one of the reasons for its success.

In this type of market, optimization of costs is vital because the operating margins are very narrow. Some measures for achieving this include designing

variable payment schemes for employees, optimizing the size of the sales network and exploiting new technologies.

There are many opportunities in this market. According to Bain & Co.,¹³⁴ the Vietnamese government liberalized the financial services sector in 2006 as a result of the World Trade Organization's regulations concerning global competition. This was a great opportunity to enter a market of 85 million people in which only 6% have a current account and only 2% have asked a bank for a loan.

There are precedents, such as the Indian bank ICICI mentioned above, the country's second largest, which uses a combination of technology and local partners to reach customers in rural India. The bank has provided low-cost premises to rural sales staff for them to offer loans, insurance and investment products to the inhabitants of the region. Among these are farmers who need loans to cover the period between the last crop sale and buying seeds for the next season. The bank charges an annual interest rate of 9%-11%, compared to the monthly rate of 2% charged by local moneylenders, who also charge an additional commission on sales.

Rule 5: Consider the Possibility of Obtaining Liquidity from Venture Capital

In the vast desert of liquidity surrounding the market, venture capital has become one of the few oases where cash is still available. The crisis is forcing entrepreneurs to be more willing to accept venture capital funds when financing their projects. This means that good operations that did not take place in the past due to the entrepreneur's indecision are now more common.¹³⁵

Another factor is the difficulty in completing the transaction due to the venture capital funds' unwillingness to invest when they see a target company that previously presented a good track record, with sales and performance which were attractive in 2006 and 2007, but with results that decline significantly during the investment process and after analysis of the most recent financial statements for 2008. This makes future plans more difficult and less credible.¹³⁶

In any event, increasing numbers of investors are starting to feel that investing during this downward cycle could be a good move if the investment is made with a view to recovering it in five years' time, when the situation has improved. This is despite the uncertainty involved in the "lean years" of 2009 and early 2010.

For example, notwithstanding the crisis, the business conglomerate Anil Ambani will invest a billion dollars in a venture capital fund in India. Its aim is to invest between 75 and 100 million dollars in Indian logistics, communications and cosmetics companies which are expanding internationally.

A recent study by KPMG¹³⁷ showed that venture capital investors in China are willing to enter the consumer products and services, retail sales and production sectors (see Figure 43). Thirty-five percent of the investors surveyed said that

¹³⁴ «Lessons from India for banks in Vietnam», *Bain&Co. Newsletter* (09/10/07).

¹³⁵ «Lessons from India for banks in Vietnam», *Bain&Co. Newsletter* (09/10/07).

¹³⁶ <http://www.onetoone.es/index.php/blog-de-ramon-requeni/195-consecuencias-del-entorno-de-crisis-para-el-capital-riesgo>.

¹³⁷ <http://www.kpmg.com/SiteCollectionDocuments/Private-equity-China-market-sentiment.pdf>.

the consumer sector will be the most attractive in the future. The Chinese companies operating in these sectors will be able to assess the possibility of obtaining financing by means of this type of operation.

In any event, the plentiful liquidity available from venture capital has a darker side: the customers that provided it could decide to recoup their money before it is invested.

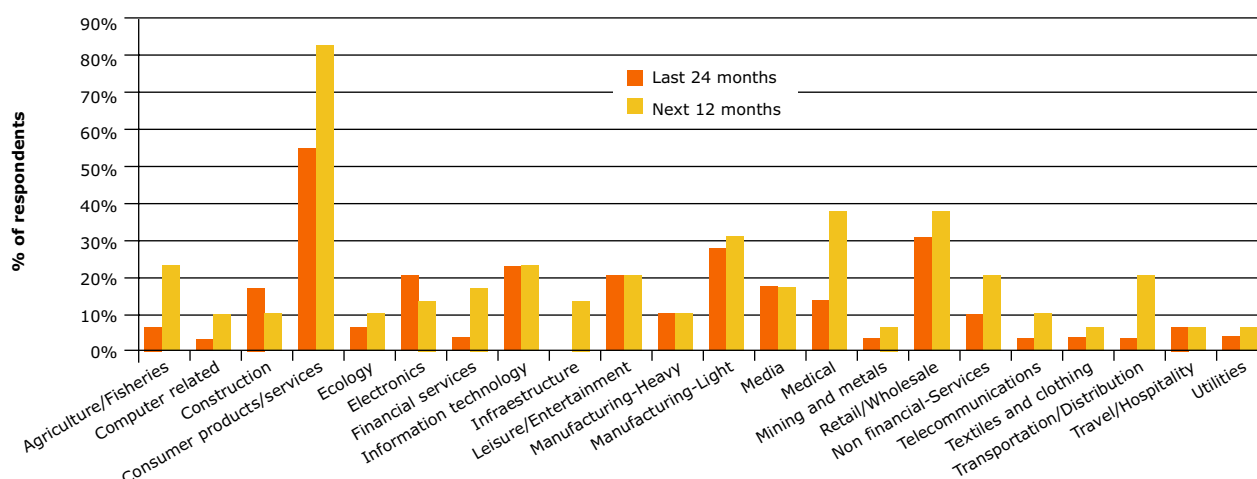


Figure 43. Which industries have you invested in over the last two years, and which do you anticipate investing in over the next dozen years?

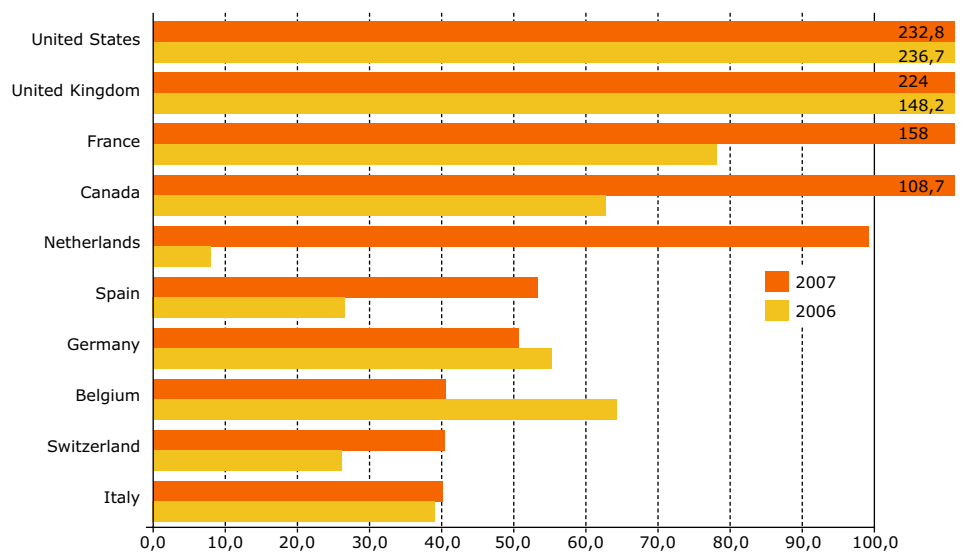
Source: *Private equity in China*, KPMG.

5.2. The Situation of the Spanish Economy and International Capital Movements

Capital flows are increasingly multidirectional, due to the new multipolar world order. Emerging countries are becoming increasingly attractive destinations for investment. These countries are in turn increasing their capital in the rest of the world. Changes in the source and destination of capital are therefore further evidence of a change in the international order.

In this context, in the mid-1990s Spain ceased to be a country that was a net recipient of investments, and become a source. It is now consolidated as the fifth-largest direct international investor in overall terms, behind the United States, the United Kingdom, France and Germany, ahead of technological and business powerhouses such as Japan, Sweden and Italy. Spanish companies continued to expand internationally in 2007, with 4% of the world's foreign direct investment, while the Spanish economy accounts for barely 2% of international GDP. However, its activity as an issuer country has remained at satis-

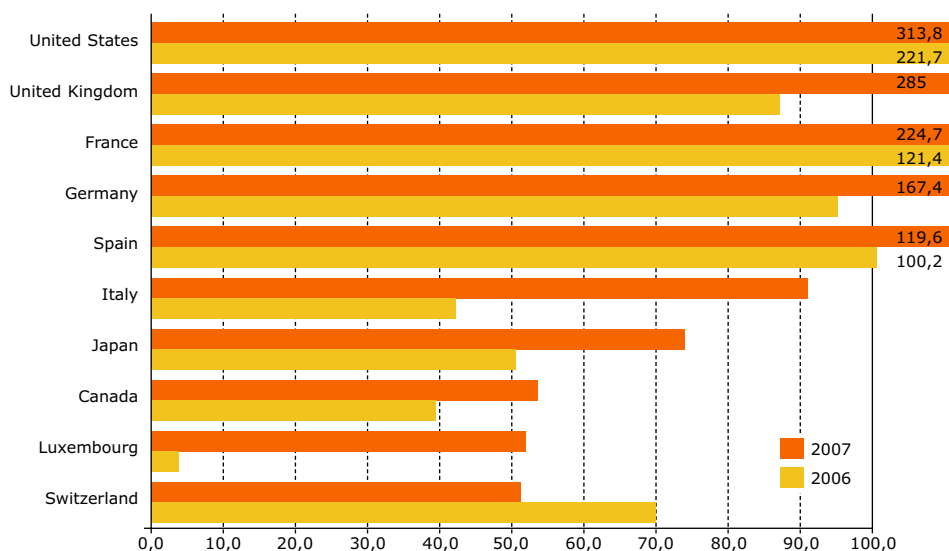
factory levels. The flow of foreign direct investment increased by 7.3% in 2008, according to initial estimates by the United Nations Conference on Trade and Development (UNCTAD). Spain received 57 billion dollars in 2008, compared to 53.4 billion dollars in the previous year, making it the world's sixth-largest recipient of FDI and the third largest in the European Union (see Figures 44 and 45).



Note: Classified according to the extent of the incomings of FDI in 2007.

Figure 44. Developed countries: 10 leading FDI recipients, 2006-2007 (figures in billions of dollars).

Source: *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, UNCTAD.



Note: Classified according to the extent of the incomings of FDI in 2007.

Figure 45. Developed countries: ten leading FDI sources, 2006-2007 (figures in billions of dollars).

Source: *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge*, UNCTAD.

Credit difficulties and the economic downturn will undoubtedly have a negative short-term effect on the figures for Spanish direct investment. Spanish companies have become more indebted than those in other countries in recent years and the lack of credit will affect their investment plans to a greater extent as a result. It will therefore be crucial for not only the large multinationals, but also medium-sized businesses to have the necessary financial resources to operate internationally and carry out their investment plans. It should be borne in mind that these investments increase exports and therefore employment.

Spanish investments have so far been mainly in the Euro area. Latin America has been another key destination since the 1990s. However, rapidly growing markets, especially in East Asia, have played a minor role in their exportation targets. Spain's limited presence in terms of trade and investment in Asia is striking not only because of the continent's increasing importance in the world economy, but also because of the current level of internationalization in the Spanish economy, for which a more global profile would be anticipated. In 2007, Asia only received 1.5% of Spanish investment abroad. China is a particularly noteworthy example, as it has become Spain's trading partner par excellence in this economic area. The central role assumed by China in Spain's trade with Asia has increased in tandem with the Spanish trade deficit with the Asian giant. The Spanish trade balance with other Asian countries like India and Japan has also deteriorated.¹³⁸

¹³⁸ *España y la nueva arquitectura económica y financiera internacional. El desafío del G-8*, Fundación de Estudios Financieros.

According to a study by KPMG,¹³⁹ the trend seems to suggest that Brazil and China will be the main focuses for investment by Spanish companies in the next 12 months (see Figure 46). Spanish investors are planning to make direct investments in Brazil, while in China companies are more inclined to invest in joint ventures. In the United States, Spanish investors do not participate in joint ventures and prefer direct investment or takeovers of established companies.

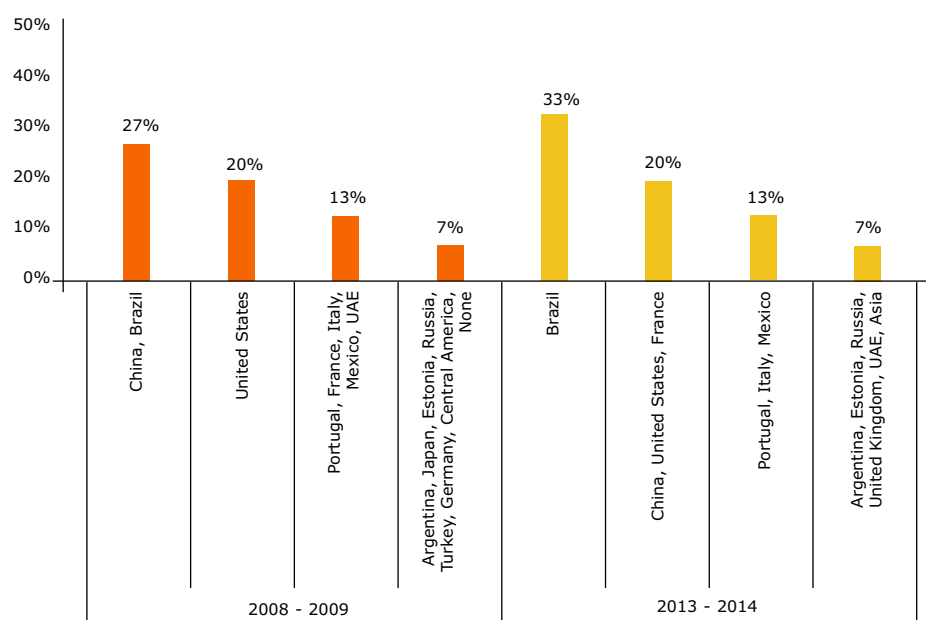


Figure 46. Spanish corporate investment plans.
Source: *Global Corporate Capital Flows, 2008/9 a 2013/14*, KPMG International.

If Spain wants to take advantage of the opportunities in the new multipolar order, it seems reasonable to suggest that it should increase its volume of exports to Asia, while simultaneously increasing Asia's share of total exports. According to the conclusions of a study by the Fundación de Estudios Financieros, "achieving this objective only appears to be possible if direct investments in the area by Spanish companies are encouraged. This in turn appears to be difficult, due to the minimal level of investment in Asia in Spanish investment policy abroad. The fact is that Spanish companies find Asia very difficult, which explains the weakness of their investment in the region." The role of Spanish companies in these countries will be analyzed below.

¹³⁹ *Global Corporate Capital Flows, 2008/9 to 2013/14*, KPMG International (June 2008).

The internationalization of the Spanish economy toward unexplored areas is therefore an opportunity. Cuba is an attractive target for investment. Spain has

some trading experience in Cuba, which may be a competitive advantage in the event of entry becoming possible in the near future.

Meanwhile, foreign investment in Spain has been a driving force behind the country's growth for decades. Foreign investment in Spain in 2008 totaled 37.55 billion euros, 0.4% more than the previous year. The financial crisis has led to some stagnation, but the larger fall in investments in the world as a whole meant that the Spanish share increased to around 4.5%.¹⁴⁰ However, at a time like the present, when internal demand is weak, it is vital to attract foreign capital oriented toward exportation, which is what generates employment in the country. However, for this to happen, the appeal of investing in Spain must be increased by increasing the Spanish economy's productivity. If this does not happen, the flows will continue to head toward more competitive economies, such as the United States or the emerging countries.

On this subject, the economists and Future Trends Forum experts F. Guillén and Emilio Ontiveros said in the newspaper *El País*: "What is most important, however, is not the total amount of investments but rather the proportion of them that will be focused on creating new jobs rather than taking control of the most attractive Spanish infrastructures and services companies."¹⁴¹

Nevertheless, sovereign wealth funds from emerging countries are playing an important role in injecting liquidity into developed countries during this crisis. Late last year, Spain offered public debt to sovereign wealth funds in the Arab countries to give the financial system more liquidity. In an interview with Reuters, Miguel Sebastián, the Minister for Industry, Tourism and Trade, declared: "Spain is a very attractive country for investment, and that is why we are offering these sovereign wealth funds the opportunity to buy Spanish bonds, not only in Spanish companies but also in Spanish public debt."

This type of measure has been praised by those who see protectionism as the greatest threat to overcoming the crisis. The OECD General Secretary Ángel Gurría recently highlighted what he saw as the correct response by the Spanish Government, one that was far removed from the protectionist urges in other countries that have been revived by the economic crisis, such as the Buy American clause in the United States, and he encouraged his audience to resist them as much as possible.¹⁴²

As mentioned above, in the near future countries will have to compete internationally to attract capital from emerging countries that have high levels of savings. In this respect, the lowering of Spain's credit rating from AAA to AA+ by Standard & Poor's will not only make State financing more expensive, but will also restrict the number of potential investors in Spanish public debt. Many sovereign wealth funds, central banks, pension plans, insurance companies and investment funds have strict internal regulations that oblige them to invest a specific percentage of their assets in bonds with the highest rating (AAA). Furthermore, in some cases, this restriction is complete, and institutional in-

¹⁴⁰ «La inversión extranjera en España se estancó el pasado año», *CincoDías.com*, (24/03/2009).

¹⁴¹ «Globalización en crisis», *El País*, (28/09/08).

¹⁴² <http://www.noticias.com/noticia/espana-logra-situarse-septimo-puesto-ranking-competitividad-ocde-di9.html>.

vestors are prohibited from investing in assets without a AAA rating. For this reason, the lowering of Spain's rating will not only prevent them from buying Spanish debt, but will also force them to sell the debt they already have.

These investments by emerging countries in developed countries are viewed with misgivings in the rest of Europe. French President Nicolas Sarkozy recently proposed that the European Union countries create their own sovereign wealth funds and coordinate them in order to invest in EU companies, in order to prevent them from being taken over by foreign capital, at a time when their stock market prices were at record lows due to the financial crisis.

However, in this race to attract foreign capital, most of the large economies in the European Union have decided to make formalities easier for multinationals deciding to establish themselves in the country. With that objective in mind, several countries have applied the directive that waives the requirement for dual accounting in cases where in the group's parent company resident in another country has already prepared them elsewhere. As a result, there has been some concern at the Spanish government's decision to oblige multinationals to produce and audit consolidated financial statements for their Spanish-based holding companies, despite these also being produced and audited for the group's parent company in its country of origin.

At the same time, the current trend for sovereign wealth funds to invest in their own countries or in other emerging countries could also favor businesses from the OECD area with a strong presence and operations in emerging markets. With this in mind, Spanish companies have some advantages, as many of them—such as banks (BBVA, Santander), telecommunications operators (Telefónica) or the energy sector (Iberdrola, Gas Natural, Endesa, etc.)—have strong commitments in emerging markets, mainly in Latin America. As well as being able to become potential investments for sovereign wealth funds from the Gulf, these companies could also take advantage of their presence and unique knowledge of the region to promote or encourage interest in Latin America. Forums such as Latibex could also become a showcase for attracting these potential investors, from both the Middle East and Asia. Similarly, companies from the Gulf could also be partners in joint investments in the Middle East and North Africa, as suggested by the agreement signed in 2008 between Iberdrola and the Abu Dhabi National Energy Co. (Taqa).¹⁴³

¹⁴³ http://www.elpais.com/articulo/semana/fondos/soberanos/crisis/elpepueconeg/20090208elpneglse_11/Tes.

The Future Trends Forum experts concluded that the best opportunities for investment in Spain in the next three years will be in the fields of renewable energies and tourism (see Figure 47).

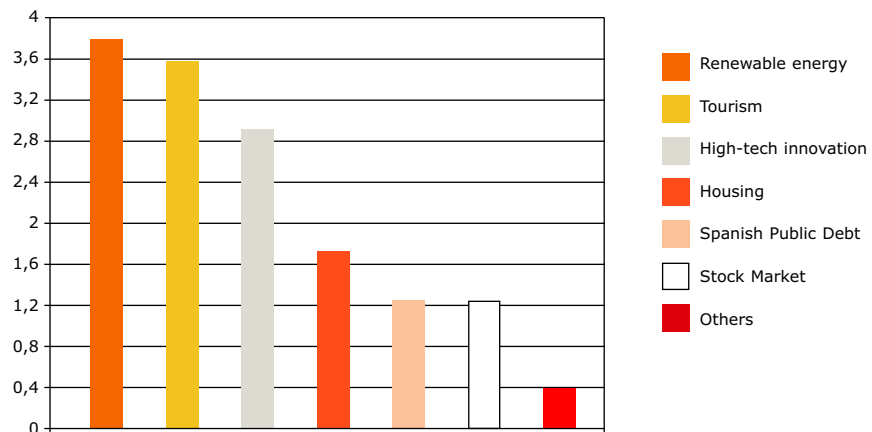


Figure 47. The most attractive investment opportunities in Spain in the next three years.

Source: Drawn from the conclusions within the Future Trends Forum.

In conclusion, Spain is facing the same difficulties as other nearby countries. It is an economy that is fully integrated and open to the world, with a dynamic business sector. However, Spanish companies are much more heavily leveraged than their competitors, and their capacity for attracting foreign investments is undermined by slow growth in productivity and by the inflation differential. In this situation, sustainable growth will be possible if the investment flows in both directions increase.¹⁴⁴ For this to happen, the structural problems that weaken the Spanish economy's competitiveness and dynamism must be solved.

5.3. International Capital Movements and Strategies for Spanish Companies

In recent years, Spain has become the world's seventh-largest international investor, after the United States, the United Kingdom, France, Germany, China and the Netherlands.¹⁴⁵ From a geographical standpoint, Spain started as an investor focusing on emerging countries in Latin America and increasingly concentrated on rechanneling its companies' investments toward countries with higher levels of economic and technological development. The internationalization of Spanish companies has entailed a strategic shift to a more long-term approach, with foreign direct investments and subsidiaries established abroad, instead of mere export sales. In general, this leads to higher levels of debt among Spanish companies. In the current economic and financial situation, this debt is an added risk for companies. Despite these difficulties, some of the investment trends followed by Spanish companies abroad are listed below, together with an analysis of Spain as a recipient of investments from foreign companies.

¹⁴⁴ «Globalización en crisis», *El País*, (28/09/08).

¹⁴⁵ «La Expansión de la Multinacional Española: Estrategias y Cambios Organizativos», Observatorio de la Empresa Multinacional Española (OEME).

Rule 1: Use Internationalization to Soften the Impact of the Crisis¹⁴⁶

The internationalization process among Spanish companies is a topic of debate now that it is time to analyze the effects of the world recession, consider the next steps that should be taken to overcome instability, and meet the challenges of the future, while taking advantage of the opportunities that have been created. As the Future Trends Forum experts pointed out, "recessions are not just about problems, they also create opportunities." As such, many companies will have to restructure their debt and even sell off some assets. Meanwhile, as in all recessions, the price of assets falls, which may make them attractive to those wanting to seize the moment to make investments. This is added to the fact that "if the Spanish economy enters a phase of much lower growth than in recent years, having an international profile due to exports or foreign investment is a cushion, and a way of diversifying geographically."

The infrastructures sector in China is first on the list of investment targets for Spain mentioned by María Jesús Valdemoros, Director of the Economics department of the Entrepreneurs' Circle, and Mauro F. Guillén, Director of the Lauder Institute at the Wharton School and a Future Trends Forum expert. The 4-trillion-yuan stimulus plan (464 billion euros) presented to the National Assembly in early 2009 is an opportunity, because according to the experts, Chinese businesses have neither the experience nor the knowledge necessary to undertake the projects which the Government wants to use to stimulate the economy. Second, despite the effects of the recession, everything suggests that India and Brazil will continue to grow and are therefore attractive countries for investment. Of course, there is also the United States, where asset prices are very low and the euro is still holding strong against the dollar, despite a slight fall. In short, Spain must take up positions in markets where there are expectations for high growth.

The trend in Spain has been to carry out operations abroad and new frontiers have recently been opening up with lower levels of activity in comparison to other countries. The Eat Out Group, a subsidiary of the Catalan company Agrolimen, works in the hostelry business with ten restaurant brands, including Pans & Company, Bocatta and Dehesa Santa María. In 2007, it opened four Pans & Company outlets in Saudi Arabia and will have at least 80 within 10 years.¹⁴⁷ Efforts have been made to adapt the menu to local tastes with softer bread, the addition of local sauces and spices and the replacement of pork for beef, and all the meat is halal, due to the requirements of the Muslim diet. According to the manager, Ignasi Ferrer, new technologies have been an essential tool in this expansion. "Before we started opening in other countries, we computerized our entire business. It is important that all information can be accessed from anywhere."

The Netherlands have been another target for Spanish geographic and sectoral diversification, accounting for 28.6% of the total. This was basically due to the acquisition of the Dutch bank ABN-AMRO. The next country on the list is the

¹⁴⁶ Interview in *Knowledge@Wharton* with María Jesús Valdemoros, Director of the department of economics at the Círculo Empresarios, and Mauro F. Guillén, Director of the Lauder Institute at the Wharton School (11/26/2008).

¹⁴⁷ «Bocadillos en el país del petróleo», *ElPaís.com*, (15/07/2007).

United Kingdom, with 23.9%. The OECD countries as a whole accounted for 95.2% of gross Spanish investment, and the 27-country European Union accounted for 75.5%.¹⁴⁸ Iberglobal's Spanish Foreign Investment Valuation Index contains assesses the investment conditions in 23 countries or regions of particular importance for Spanish companies. According to the study, the most highly rated region in the world by Spanish companies is the European Union, followed by Canada and United States, although China and India also appear in eight and ninth place respectively. The Indian model is attractive due to legal factors and the strength of its institutions, while the Chinese model's appeal lies in its political stability and economic strength.

International operations by Spanish companies have become more significant since the start of the recession. For example, around 90% of the revenues of Acerinox—which has plants in the United States and South Africa—in first six months of 2008 were generated abroad. For Cintra, this figure is over 70%, while for Abengoa, Telefónica, Ferrovial and Santander it exceeds 60%, and for Repsol YPF and Iberdrola, it is over 50% (see Figure 48). Sales in Inditex's international outlets accounted for 65.2% of its total. The group's eight retail formats opened 249 stores all over the world between February 1 and July 31, and began trading in two new markets: Ukraine and South Korea. The proportion of total sales in shops in Asia and Eastern Europe has increased from 11% to 17% in the last two years.¹⁴⁹

¹⁴⁸ Interview in *Knowledge@Wharton* with María Jesús Valdemoros, director of the department of economics at the Círculo Empresarios, and Mauro F. Guillén, director of the Lauder Institute at the Wharton School (11/26/2008).

¹⁴⁹ «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI*, number 114/2008, Real Instituto Elcano.

Company	Sector	% of total
Acerinox	Steel	89.2
Grifols	Medical equipment and pharmaceutical products	71.8
Cintra	Management of toll highways and parking facilities	70.9
Inditex	Textile manufacturer and retailer	65.2
Abengoa	Biofuel, information technology and engineering	64.4
Técnicas Reunidas	Engineering	64.1
Telefónica	Telecommunications	63.3
Ferrovial	Infrastructure Operator, construction	63.2
Santander	Financial group	61.3
Iberia	Airline	59.6
Repsol YPF	Oil and natural gas	54.7
Gamesa	Wind turbines	52.5
Iberdrola Renovables	Renewable energy	52.2
Iberdola	Electricity	50.8
Abertis	Infrastructure management	49.4
Ibex 35	Main index of the Spanish Stock Exchange	48.9
Unión Fenosa	Electricity	48.4
BBVA	Financial group	47.9
OHL	Construction	46.5
Endesa	Electricity	44.7
FCC	Construction	39.5
Mapfre	Insurance	36.2
Gas Natural	Natural gas	35.2
Acciona	Energy, infrastructure, water	33.4
Indra	Information technology and defense systems	33.0
ACS	Construction	26.4
Sacyr Vallehermoso	Construction, concessions	18.5

Figure 48. Spanish companies and banks: percentage of total sales abroad (first six months of 2008).

Source: figures sent by the companies to the Spanish National Securities Market Commission.

Although there are numerous Spanish small and medium enterprises—many of which are not listed on the Stock Exchange—doing business abroad, most international business is done by about a dozen companies, all of which are listed on the IBEX 35 stock market index. The inherent risk here is that it makes the entire Spanish stock exchange vulnerable to recessions in the areas of the world where these companies do a significant part of their business, such as Latin America. This was particularly true a few years ago, although in the end there was no cause for alarm. Since then, there has been a diversification away from Latin America toward Europe and Asia, making important players, such as Santander, Telefónica and Repsol, less dependent on one particular region.¹⁵⁰

What has encouraged Spanish companies to expand abroad and toward foreign direct investment, which let us remind ourselves, increased by 7.3% in 2008? The main reasons are given in the report *The Expansion of Spanish Multinationals: Organizational Strategies and Changes* by the Spanish Multinational Company Observatory (OEME).¹⁵¹ First, companies in the textile, footwear and leather, and plastic sectors find the reduction in costs arising from moving their production plants abroad attractive. They can thereby sell under better conditions in the Spanish market. Second, alliances through joint ventures or by directly taking over foreign companies in advanced sectors enables technology and know-how to be acquired. Third, the search for economies of scale in larger markets leads to increased profits and a better position for competing in the global economy, especially among financial companies. Finally, the report describes how many companies in the public services sector—such as gas, electricity and water distributors—decided to seize the opportunity to purchase public companies that were privatized in the 1990s.

However, although the offshoring phenomenon is one of the opportunities available to Spanish companies to cut costs, it has many detractors, especially during a recession, as the decline in employment is directly attributed to it. However, its advocates believe that this is not true. They believe that transferring production to other countries can also have positive consequences due to the increase in employment and its impact on the level of development in the destination countries and in the countries of origin, such as Spain in this case. Among the arguments in favor of offshoring is the fall in the prices of industrial products internationally, as businesses save on many labor costs. Examples are the clothing, footwear and electronic sectors, in which prices have stabilized (or even fallen) in the last 20 years. Furthermore, savings on these articles leaves more money for consumption and enables jobs to be created in other activities (especially trade and tourism) which replace those lost in industry. For this reason, its advocates say, offshoring does not destroy jobs in developed countries, but instead replaces industrial employment with other jobs in the services sector. An example is Spain, where unemployment had not increased in the previous 10 years—in fact, quite the opposite. It also improves the living standards of the majority of the population in developed countries, which does not work in industry, and benefits from the fall in prices.¹⁵² Furthermore, offshoring does not in theory completely destroy any industrial sector, as the offshore factories specialize in

¹⁵⁰ «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI*, number 114/2008, Real Instituto Elcano.

¹⁵¹ Published in cooperation with Banesto, PricewaterhouseCoopers, ESADE Business School and ICEX.

¹⁵² <http://es.wikipedia.org/wiki/Deslocalizaci%C3%B3n>.

cheap low quality products, leaving European, Japanese and North American producers to manufacture expensive higher quality articles, which remain on the market and continue to be consumed by whoever wants them.

An example of offshoring in Spain—in Galicia to be specific—is described by several Galician economists in a book published by the Xunta, Galicia’s regional government.¹⁵³ The first part of this study of the impact of globalization on the Galician economy emphasizes that “rather than a calamity, offshoring of investment by Galician entrepreneurs would be evidence of dynamism.” The study found three types of offshoring in Galicia. A good example of the first type, sector offshoring, is in the shipping sector, with the decline of the Astano shipyard and the migration of work toward Japan, Korea and China. The second type is offshoring to increase demand, such as the opening of car part factories in northern Portugal, for example. This process is based on cheaper industrial installations (due to lower costs of land, licenses and taxes) and lower personnel costs. The offshoring of Citroën’s subsidiary businesses has led to the opening of ten large Galician-owned production factories in Portugal. Finally, the prototype for offshoring due to segmentation of the production process in Galicia is the closure of textile workshops and fish processing lines (tuna) for preserves. In the textile sector, the preparation workshops have been replaced by factories in the Third World; in the preserves industry, the Galician plants have seen losses in production and employment, which has been transferred to new factories in Morocco and Central America.

Rule 2: Exploit the Triad of Infrastructures, Construction and Renewable Energies

The triad of the infrastructures, construction and renewable energies sectors is Spain’s great hope for the future, because there is still room for these industries in emerging countries, and Spanish companies are in a good international position in these sectors.

In the construction sector, for example, Spain has extensive knowledge and the domestic standstill in the sector calls for a new strategy for overcoming the slump. Many experts have suggested taking the lead in expanding construction to targets in emerging countries. According to José Antonio Pérez, Real Estate Chair at the Instituto de Práctica Empresarial, it is necessary to analyze the needs for first homes of the social classes that are starting to have a constant income, especially in large cities. As regards second homes, it is necessary to invest in places with legal, economic, political and tourism safeguards that enable competition on an “all-inclusive” basis, with better quality/price relationships, based on journey times and climate. As regards real estate allocated to the tertiary sector, it is advisable to look for cities with an emerging middle class with purchasing power.¹⁵⁴

The potential for development in this sector to a large extent depends on the governmental measures that are approved to stimulate it. The Brazilian govern-

¹⁵³ http://www.elpais.com/articulo/Galicia/Deslocalizar/calamidad/dinamismo/elpepiatgal/20080526elppgal_4/Tes.

¹⁵⁴ «Los países emergentes entran en la escena inmobiliaria», *ElMundo.es* (24/10/2009).

Did you know?

Moscow is the world's second most expensive market for offices.¹⁵⁵

ment of Lula da Silva has made considerable investments in infrastructures and tourist development, and several Spanish companies have already taken up positions in Brazil, especially in the northeast. In Mexico, the government's state plan includes the construction of a million homes with sustainable criteria by 2012. The Indian government has announced the need to build 20 million homes in a short time, and its aim is for 30% of the financing to come from the private sector, by encouraging tax breaks. In other countries, such as Russia, the boost to the market is the result of the need to build higher quality homes, as the buildings there mostly date from the Communist era, and offices to meet the expansion requirements of the tertiary sector. In the Middle East, Spain can use its experience in holiday and timeshare complexes. In Africa, Spanish investors have focused on Morocco, but there is still an entire continent waiting to be discovered. The United States is also an opportunity for contracts for all types of infrastructures in the future. There is also the impetus in Portugal from the country's infrastructure plans, and the opening up of the United Arab Emirates and Libya.

The major Spanish construction companies are being forced to seek business abroad as the only way to compensate for the marked decline in their business at home. Companies such as ACS, FCC, Acciona and Sacyr ended 2008 with a new record in contracts for projects abroad, with a total volume that will reach 12 billion euros, 9% more than the previous year.¹⁵⁶ Furthermore, the opportunity involved in the Panama Canal enlargement project is also on the horizon, and ACS, FCC, Acciona and Sacyr are bidding through two consortiums. The four groups are pre-authorized to bid for what will be one of the world's largest engineering civil works, with an estimated budget of 3.8 billion euros.

The renewable energies sector will be analyzed in more detail in the chapter "The challenge of sustainable development," as the current scarcity and the threat of depletion of traditional energy sources means that it is a business opportunity for Spanish companies.

Finally, Spanish investment in properties abroad reached 2.937 billion euros by November, an increase of 43.7% compared to the previous year, according to figures from the Bank of Spain.

¹⁵⁵ Aviva Investors.

¹⁵⁶ <http://www.eldiadevalladolid.com/noticia.cfm/Econom%C3%ADa/20090118/grandes/constructoras/capean/crisis/obras/extranjero/E6416765-1A64-968D-593A2BE9D7BE4517>.

Country ranking	Company	Rank in the Fortune Global 500	Revenues (millions of euros)	City
1	Grupo Santander Central Hispano	58	89,295	Madrid
2	Telefónica	76	77,254	Madrid
3	Repsol YPF	92	67,006	Madrid
4	Banco Bilbao Vizcaya Argentaria	134	51,449	Bilbao
5	Endesa	258	30,018	Madrid
6	ACS	270	29,171	Madrid
7	Cepsa	313	25,853	Madrid
8	Iberdrola	339	23,910	Bilbao
9	Grupo Ferrovial	424	20,062	Madrid
10	Fomento de Construcciones y Contratas	440	19,267	Madrid
11	Grupo Mapfre	463	17,984	Majadahonda

Figure 49. Ranking of Spanish companies in the 2008 Global Fortune 500.

Rule 3: Attract Foreign Investment

The flow of foreign direct investment in Spain increased by 7.3% in 2008, according to initial estimates by the United Nations Conference on Trade and Development (UNCTAD). Spain received 57.3 billion dollars in 2008, compared to 53.4 billion in the previous year, making it the sixth-largest recipient in the world and the third largest in the European Union. It ranked eighth and fourth, respectively, in 2007.¹⁵⁷

Spain's appeal for any type of direct investment therefore persists, as can be seen by the figures for greenfield projects (new investments generating wealth and jobs) undertaken in 2008; 450 investment projects took place between January and November 2008, an increase of 14.6% compared to the same period in the previous year. Of particular note was the increase in this type of project in high added value sectors based on innovation, the knowledge society and RDI. At the same time, Spain saw major merger and takeover operations by foreign investors in 2008.¹⁵⁸

Opportunities for foreign companies have proliferated in the Spanish economy for some years. The automobile industry, for example, has been completely owned by multinationals since 1986, when the Spanish automaker SEAT, founded in 1950 with the help of Fiat, was sold to Volkswagen.¹⁵⁹ The multinationals also have a strong presence in the sectors of cement (Portland and Lafarge Asland), electrical household goods (Sony, Philips and Electrolux),

¹⁵⁷ <http://www.mityc.es/es-ES/GabinetePrensa/NotasPrensa/Paginas/npunctad.aspx>.

¹⁵⁸ <http://www.mityc.es/es-ES/GabinetePrensa/NotasPrensa/Paginas/npunctad.aspx>.

¹⁵⁹ http://www.realinstitutoelcano.org/wps/portal/rielcano/contenido?WCM_GLOBAL_CONTEXT=/Elcano_es/Zonas_es/DT47-2007#_ftn6%23_ftn6.

electronic parts (Siemens and Robert Bosch), electronics (Philips and Honeywell), information technologies (IBM and HP) and consumer products (Unilever and Procter & Gamble). Estimates suggest that foreign companies control half of the food producers, a third of the chemical companies and two thirds of the cement sector. Several foreign banks (Barclays, Citibank and Deutsche Bank) took over the networks of retail banks from the weakened Spanish banks, although their total market share remains small, and foreign companies control a significant part of the insurance market (Allianz, Axa, Aviva and Generali). The French groups Auchamp (known as Alcampo in Spain) and Carrefour led a revolution in the Spanish distribution sector, by opening hypermarkets on the outskirts of towns and attracting customers that until that point had normally used the shops in their neighborhood. Not even the wine sector has been immune to foreign takeovers: in 1994, Allied-Lyons purchased Pedro Domecq, Spain's leading liqueurs company, and in 2001 the newly renamed Allied Domecq took over Bodegas y Bebidas, the largest wine producer. Many of Spain's main product exporters are multinationals, especially in the automobile industry, which accounts for over 20% of total exports of goods (vehicles and parts).¹⁶⁰

These foreign investments have been vital to Spain's growth. The economist Juan Velarde Fuertes predicted that "if the flow of foreign capital stops, the Spanish economy would come to a standstill, there would be a suspension of payments."¹⁶¹ For this reason, the decision by Standard & Poor's on January 19, 2009, to lower the long-term rating of Spanish debt from the highest rating (AAA) to a lower rung (AA+), due to the "structural weakness" of the Spanish economy, was viewed with some concern. The State may not be the only party to suffer from the lowering of the credit rating. The market is now wondering whether S&P will lower the rating of Spanish companies. There is currently not a single company in Spain with a triple-A rating. Those with the highest rating are BBVA and Santander, with AA, the third level.¹⁶²

Juan Mascareñas, a professor at the Complutense University of Madrid and an expert in financial markets, says that "normally, no corporate debt has a better rating than sovereign debt, and if this sort of debt is downgraded, so is all the corporate debt, including debt from banks, which means that if [companies] want to finance themselves with outside money they will have to pay more for it. [...] Financial costs are getting higher for corporations, and if they want to compete—not simply by raising prices for their products and services—they will have no choice but to earn lower profits. Lower profitability leads to the flight of investors from these companies, and toward other companies that are similar but which are more profitable," he argues. In conclusion, he says, "our companies will be worth less."¹⁶³

Meanwhile, Sergio R. Torassa, a professor at Pompeu Fabra University, feels that there are two reasons behind the higher cost of financing companies after the drop in the Treasury rating. "First, the growing needs of governments will drive up investor returns. Second, the higher volume of public-sector issues, coming at a

¹⁶⁰ <http://www.investinspain.org/icex/cma/contentTypes/common/records/viewDocument/0,,,00.bin?doc=4061086>.

¹⁶¹ http://www.abcdesevilla.es/hemeroteca/historico-09-11-2007/sevilla/Economia/juan-velarde-teme-que-espa%C3%B1a-pueda-padecer-el-sindrome-argentino_1641315575285.html.

¹⁶² <http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1663>.

¹⁶³ <http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1663>.

time when liquidity is scarcer, will lead to a 'crowding out' effect. The private sector will have greater difficulty attracting financing, compared with the public sector," he explains.¹⁶⁴

Rule 4: Learn from Triangulation Experiences

Triangulation is described in a Casa Árabe publication as "Spain's role as a bridge between Asia and Latin America, taking into account the increasingly close relations between the two continents, on one hand, and the linguistic and business links between Spain and Latin America, on the other. Their involvement enables transaction costs such as trade barriers, transport times and costs, tax treatment and even linguistic and cultural differences to be minimized."¹⁶⁵ The study analyzes the opportunities for triangulation available in Spanish-Arab relations, and the cases of success among Spanish companies. It acknowledges that the Arab markets still account for a relatively small proportion of sales (around 8-10%) among the companies interviewed (they reach just 40% in LV Salamanca). However, the report says that the outlook for growth is significant because the rise in oil prices and the spending associated with it increase sales in Spanish companies, and the preference for up-market and advanced technology products. Some outstanding examples of the Spanish business presence in the Arab world are the latest generation video intercoms that Fermax sells in the Gulf, the sophisticated buses that Hispano Carrocera will present for public transportation tenders in Dubai and Abu Dhabi, and LV Salamanca's exportation of complex engineering, architecture and construction management services (see Figure 50).

¹⁶⁴ <http://www.wharton.universia.net/index.cfm?fa=viewArticle&ID=1663>.

¹⁶⁵ *La empresa española en los países árabes: experiencias de inversión y triangulación [The Spanish company in the Arab countries: experiences in investment and triangulation]*, Jacinto Soler Matutes, Casa Árabe. This publication explains that the concept of "triangulation" emerges as an embryonic idea from such Spanish diplomats and educators as Manuel Montobbio, Pablo Bustelo and José Ángel Sotillo. An approach to the theory of triangulation from a strictly economic perspective is Coase and Williamson's theory of transaction costs to explain the appearance of countries, cities or companies as "bridges" or intermediaries in global businesses.

LV Salamanca	Financial	Services provided to customers in the Gulf for their investments in Maghreb, Lebanon and Egypt.
	Corporate	The Dutch chain Makro commissioned LV to design supermarkets in Arab countries through its Spanish subsidiary.
Vivesa (Vanity Fair)	Commercial	Tunisia as the production hub for Europe, thanks to association agreements.
	Cultural	Attempts to use Tunisia as a platform for expansion in Maghreb and the Middle East, from commercial and production standpoints.
Fermax	Cultural	Indian manager of the Dubai subsidiary coordinating recent opening of factory in India.
	Logistics	Buffer warehouse in Dubai to serve Middle East (including Iran) and India.
	Commercial-financial	Management and collections for exports to Iran through Dubai.
Casademont	Cultural	Halal certification in France for selling to Middle East and Africa.
	Logistics-cultural	Lebanese distributor trading in Syria and Jordan.
Cemex España	Corporate	Spain as a natural market for enterprises and a bridge toward Arabian world.
	Fiscal	Dubai as the headquarters for enterprises of trading. Spain as the headquarters of a global holding.
	Logistics	Air connections from Spain to Mexico.
Hispano Carrocera	Corporate	Hispano-Tata alliance with Arab countries as the setting: exchange of market share (Tata in India and the Middle East, Hispano in Europe and Northern Africa).
	Cultural-corporate	Tata opens the door to the Middle East market thanks to its distributors and relationships with ruling families.
Aresbank	Financial	Libyan capital financing Spanish exports to the Arab world.
Mango	Cultural	Lebanese franchisees in the Gulf. Indian franchisees discover Mango in Dubai and take it to India and Southeast Asia.
	Cultural-financial	Saudi franchisee opens dedicated stores for the Mango brand in Algeria, Morocco and Jordan.
Premo	Commercial	Trading from Morocco to the United States thanks to free-trade agreement.

Figure 50. Summary of triangulation experiences.

Source: Spanish companies in Arab countries: investment and triangulation experiences, Jacinto Soler Matutes, Casa Árabe.

Some of Spain's advantages in the Arab world are clearly explained using the example of the Mexican company CEMEX, which uses its subsidiary CEMEX España as a regional management and coordination center for the whole region (Europe, the Middle East and Africa), as well as Asia. The reasons behind this are its use of the Spanish language, tax breaks, air links and direct contact apart from time differences.

Hispano Carrocera is an example of a strategic Spanish-Asian alliance with Arab countries as the main setting. With annual sales of around 40 million euros, the company specializes in the design and construction of accessories, and body-work decoration for buses. Its main customers are municipal transportation companies and scheduled or private passenger-transportation services. It also has extensive know-how in the safety area, such as in roll-protection systems. Today, Hispano Carrocera's international business is highly focused on Europe, from where it receives regular orders, as well as Northern Africa. In 2005, it signed an agreement with the Indian group Tata Motors to concentrate its sales efforts on the United Arab Emirates and Saudi Arabia. From Morocco, Hispano Carrocera will increase the sales of its lower-range products in nearby markets such as Algeria, Libya, Tunisia and sub-Saharan Africa. It is even considering the possibility of exploiting synergies with Tata in South Africa. As a result, Hispano Carrocera is a model of business cooperation between Spain and Asia, with the Arab countries as the backdrop and Latin America on the horizon.

Rule 5: An Exportable Banking Model¹⁶⁶

Santander, the euro area's leading bank in terms of market capitalization, and BBVA are two of the global banks that are riding out the crisis. Despite the turbulence on the markets, Santander made an attributed net profit of 8.876 billion euros in 2008, 2.03% less than the figure of 9.06 billion euros in the previous year, due to the bank making increased provisions to deal with the recession, which amounted to 10.16 billion euros. BBVA posted an attributable net profit of 5.02 billion euros in 2008, a fall of 18.1% compared to the previous financial year, although its core earnings remained stable and increased by 0.2% to 5.414 billion euros. These figures are in sharp contrast to the huge losses recorded by the top American banks. The difference is no coincidence, as both institutions focused on retail banking and avoided investments in toxic products, following instructions from the Bank of Spain.

Fifty-four percent of Santander's profits in 2008 came from continental Europe, while in 2004 this figure was 59% thanks its purchase of the British building society Abbey, the sixth-largest in the country. The United Kingdom generated 14% of its profits, while Latin America contributed 32%, Brazil 11%, Mexico 8% and Chile 6%.

At a dinner in London in July 2008, when *Euromoney* magazine named Santander as the world's best bank, its President, Emilio Botín, gave a slightly ironic speech (via a pre-recorded video) about basic banking principles, which the

¹⁶⁶ «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, ARI, number 114/2008, Real Instituto Elcano.

presidents of failed banks must bitterly regret not having taking into account. "If you don't fully understand an instrument, don't buy it. If you would not buy for yourself a specific product, don't try to sell it. If you don't know very well your customers, don't lend them any money," he said. "If you do these three things, you will be a better banker, my son." This advice has worked wonders for Santander.¹⁶⁷

While many banks were having difficulties dealing with the aftermath of the subprime crisis and other problems, Santander took on in the United Kingdom a new challenge in retail banking, a world it knows very well, and last July it reached an agreement to take over the then-troubled building society Alliance and Leicester (A&L) for not much more than its nominal value, after the value of the complex debt securities in the A&L treasury portfolio had fallen. Santander anticipates that this business will lead to a yield of 19% on its initial investment in three years. In September, Santander bought the distribution channels and retail deposits of Bradford and Bingley (B&B). Together with the acquisition of A&L, this enables it to achieve critical mass in the United Kingdom, increasing its estimated share of Personal Financial Services from 6% to around 10%. After these acquisitions, which provided 450 branches, the Abbey network will include 1,286 offices, which are distributed well in geographical terms. It is also an operation that involves no increase in credit risk, as all of B&B's client credits and treasury assets, including 41 billion pounds of mortgage assets, remain state owned.

In the United States, Santander paid 1.4 billion euros to acquire the remaining 75.6% of Sovereign Bancorp that it did not possess. That amounted to one tenth the amount it paid for a minority interest in the bank three years ago. Sovereign, badly hit by the increase in mortgage default, in September became the largest savings and loan bank in the United States after the collapse of Washington Mutual and its ensuing takeover by J.P. Morgan Chase.¹⁶⁸

Santander also strengthened its presence in Latin America as a result of its participation last year (with 19.8 billion euros) in the consortium led by the Royal Bank of Scotland which took control of the Dutch bank ABN-AMRO. By doing so, it also acquired Banco Real, AMRO's subsidiary in Brazil. The combination of Banespa, owned by Santander, and Banco Real created the second-largest bank in Brazil in terms of deposits, and the third in terms of network size (with a market share 12%). Santander's total market share in Latin America increased by between 10% and 15% in all its main products.

Meanwhile, BBVA's bank in Mexico—the largest in the country—generated 32% of its total profits (excluding extraordinary profits) in the first six months of 2008, while its banks in the United States accounted for 5.6% and those in South America accounted for 12%. While Santander has recently focused on Europe for its new acquisitions, BBVA increased its presence in Asia in June, when it agreed to pay 800 million euros to increase its stake in two units of Citic Group, a Chinese financial group. It practically doubled its stake in Citic Bank, China's

¹⁶⁷ «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI*, number 114/2008, Real Instituto Elcano.

¹⁶⁸ «Las multinacionales españolas cosechan los beneficios de sus estrategias», William Chislett, *ARI*, number 114/2008, Real Instituto Elcano.

seventh-largest credit institution in terms of assets—to almost 10%—and is maintaining its stake in Citic International Financial Holdings, a Citic Group subsidiary which is listed on the Hong Kong Stock Exchange.

However, the two banks are aware that 2009 is going to be a difficult year. At Santander, they insist that profits and dividends will remain stable. They both have large provisions available. However, the quality of credit is declining rapidly. Santander is exposed to two of Europe's most stressed economies—Spain and the United Kingdom—and the Brazilian economy, where it carries out major operations, is slowing down sharply.¹⁶⁹ Furthermore, the effects of its investment of 2.3 billion euros in funds managed by Bernard Madoff are being felt. In an attempt to limit the damage to its image, private-banking customers will be reimbursed 100% of their investment (“net [after deduction of] reimbursements”). Institutional clients, however, are not covered by this measure. The investments that Santander is to return amount to 1.38 billion euros.¹⁷⁰

¹⁶⁹ http://www.economist.com/finance/displaystory.cfm?story_id=13110701.

¹⁷⁰ <http://www.expansion.com/2009/01/27/inversion/1233095656.html>.

Meanwhile, BBVA will be largely dependent on the developments in Mexico, which is entering a recession. It also lost 300 million euros in the Madoff Case, having acted as a structurer for other organizations and institutional investors for products linked to funds that invested in Madoff's products.