

South-north FDI

Role reversal

Emerging-market firms are increasingly buying up rich-world ones

Sep 24th 2011 | from the Economist print edition

THE HALEWOOD CAR plant near Liverpool was once notorious for strife. In the 1970s its bolshie workforce frequently clashed with tetchy managers. In the peaceful interludes the plant turned out fleets of Ford Escorts, a popular family car.

The plant is now part of Jaguar Land Rover (JLR), owned by Tata Motors, the car division of an Indian conglomerate. These days it is a cheerful and contented place. At one end of the plant workers examine the body parts shaped by one of ten giant metal presses. At the other end, in the paint shop, a sprayer dressed in a protective suit squirts a mist of colour inside the back door of a car shell. Fork-lift buggies, owned by DHL, a logistics firm with an on-site operation, distribute parts from outside suppliers around the factory.

The reason for the activity and the good humour is that production has recently started on the new Land Rover Evoque, a mini sports-utility vehicle. Before the car had appeared in the showrooms, JLR had taken 18,000 orders for it and it was already for sale on eBay. Thanks to the contract for the Evoque, Halewood's workforce has doubled to 3,000 in the past year. Local suppliers will also benefit.

Two centuries ago the rise of the cotton trade in the mills around Manchester and the port of Liverpool spelled doom for India's textile industry. Today Indian firms own large chunks of Britain's old industrial north-west. The Stanlow oil refinery close to Halewood was bought earlier this year by Essar, an Indian conglomerate. Brunner Mond, a chemicals firm started in 1873 just a few miles from Quarry Bank Mill, was bought by Tata Chemicals in 2006. Blackburn Rovers, a founder member of England's professional football league in 1888, is owned by VH Group, an Indian poultry firm.

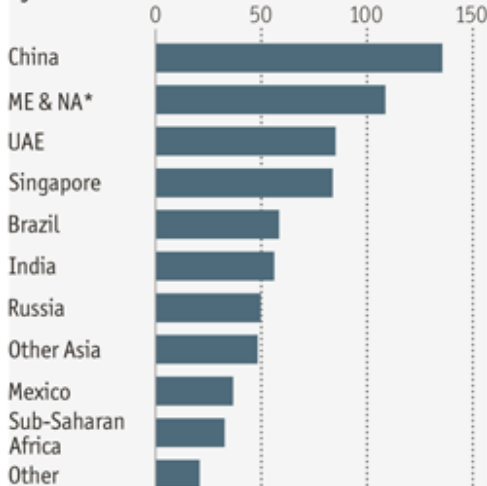
These Indian outposts are part of a broader shopping spree by emerging-market firms. Their share of cross-border mergers and acquisitions (M&A) rose to 17% in the seven years to 2010, up from just 4% in the previous seven years, according to a recent report by the World Bank. They are the source of more than a third of foreign direct investment (FDI) in other emerging markets. Typically this sort of FDI is "organic", which involves setting up a local factory or branch office. By contrast, direct investment by emerging-market firms in rich countries (so-called south-north FDI) tends to be "acquisitive", which means one company buying another.

Uphill rush

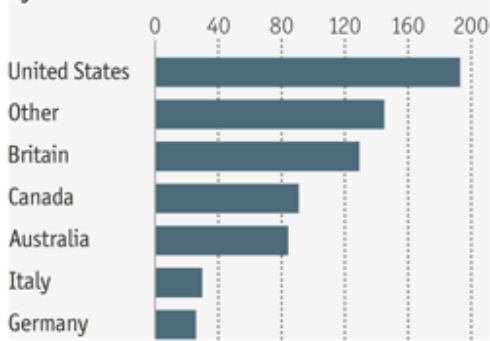
6

Cross-border M&A deals from emerging world to rich world
2000-10

By source



By destination



*Middle East & North Africa excluding United Arab Emirates (UAE)

Source: World Bank

The bulk of the emerging-markets' M&A in rich countries comes from five countries, led by China but also including India. America is the rich world's main recipient, with Britain not far behind, even though its economy is only around one-sixth America's size. Other big targets are commodity-rich Canada and Australia (see chart 6).

Firms from America and Europe are falling over themselves to invest in fast-growing emerging markets like China and India to escape sluggish economies at home. But why are emerging-market firms rushing in the other direction? The main reason is that, like rich-world multinationals, they seek access to new customers. "As a company you don't want to be confined to local growth," says Mansoor Dailami, one of the authors of the World Bank report. "You want to have the global economy as your market."

An acquisition is often the quickest (and sometimes the only) way to gain a foothold in a country. JBS Friboi, a big meat company based in Brazil, had no presence in the American market until it bought Swift, a struggling American rival, in 2007 (see [box](#)). Tata's purchase in 2000 of Tetley, a British tea firm, gave it instant access to consumers in North America, as well as in Britain.

Slow but steady

Emerging-market firms may also want to limit their exposure to their lively but often brittle home market. Growth in the rich world may be slow but the investment climate is often warmer. There are better regulations; the tax laws are easier to live with; the courts are less capricious.

Brands are a consideration too. Ratan Tata, the chairman of the Tata group, said the chance to own the Jaguar brand was "irresistible". Building a brand can take years and pots of money; buying an established one is often cheaper. Acquiring a rich-world company can also be a quick way to get hold of technology as well as the tacit know-how that comes with operating a firm in mature markets.

Moreover, a corporate presence in the rich world offers access to cheaper and more reliable financing. The World Bank study found that around two-thirds of emerging-market firms which were active in cross-border M&A had used some form of international financing to do so—a bank syndicate, a bond issue in foreign currency or a stockmarket listing in a rich country. Corporate bond markets in places like China and India are still underdeveloped, so a big, globally financed M&A deal paves the way for future capital-raising.

A deeper macroeconomic force behind south-north FDI is the need to put emerging-market savings to work. The three largest emerging-market buyers of rich-world firms, China, the United Arab Emirates and Singapore, all run large current-account surpluses and so acquire claims on foreigners. (Acquisitions by firms in Brazil and India are part of a more even two-way flow of capital with the rich world.) By contrast, America funds its current-account deficit by selling assets to foreigners. Much of the imbalance in savings between the rich world and the emerging markets is made up by the sale of government bonds. But emerging markets such as China already have their fill of low-yielding Treasuries and want to acquire assets with better prospective returns, including rich-world companies.

The pattern of developed-country deficits and emerging-market surpluses is likely to continue. Except for China, the developing world is mostly young, which means that its savings tend to be higher than those of the ageing rich world. If the commodities boom continues, it will leave the oil-rich Middle East with bulging trade surpluses. The up-and-coming economies may seek to emulate China's model, which relies on others to do the spending. The resulting balance of global saving will mean that emerging-market firms will spread themselves around the rich world and employ a growing share of its workforce.



Emerging-market buyers usually offer cash and tend to overpay. A study by Ole-Kristian Hope and Dushyantkumar Vyas, of the University of Toronto, and Wayne Thomas, of the University of Oklahoma, found that firms from developing countries generally bid higher than rich-world rivals to buy companies in developed markets, often for patriotic, social or political reasons. Tata's 2007 acquisition of Corus, an Anglo-Dutch steel firm, is a case in point. Yet although Tata may have paid over the odds, it got a big confidence boost out of it, as did India as a whole. "The psychological and cultural dimensions of the deal were enormous," says Shamik Dhar, who covers Asian economies for Aviva Investors, a London-based fund manager.

Apart from a good price, the targets of such acquisitions also get a welcome infusion of animal spirits and an appetite for investment that are frequently missing from rich-world boardrooms. Developing-country bidders have created a more vibrant market for the control of rich-world companies that keeps managers on their toes.

They often gain speedier access to emerging markets too. China is JLR's fastest-growing market and might soon be its biggest one. A few of the cars made at Halewood are shipped in kit form to India for assembly. That makes the cars cheaper for Indian consumers, as there is less import duty to pay. Carworkers at Halewood seem happy to be working for an emerging-market multinational. Above all, they are happy to be working.