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THE EMERGING MARKETS MULTINATIONALS REPORT (EMR) 2016[1]

THE CHINESE SURGE

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EXECUTIVE SUMMARY
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Emerging economies are one of the hallmarks of today's global economy, and the dramatic rise of their multinationals, also known as emerging market multinationals (or eMNCs), is a testimony to their growing weight and influence. The past fifteen years have seen the remarkable overseas expansion of such enterprises, a phenomenon that is bringing about profound changes in a wide array of areas, whether in terms of displaced trade and investment flows, new business models and the emergence of a new geography of global innovation for instance. This phenomenon is part and parcel of the reconfiguration of the new global economic and political landscape that we are witnessing in these early decades of the XXIst century. The Emerging Market Multinationals Report (EMR) series published by the Emerging Market Institute (EMI) aims at contributing to a better understanding of this phenomenon and its economic and societal implications. This first issue of the series sets the overall contours of the phenomenon and examines some characteristic of the eMNC expansion.

Emerging economies are the new heaveyweights

Emerging economies in this report are examined through the experience of the E20, a grouping of 20 top emerging economies – selected among emerging economies, based on the size of their GDP and population and of significant influence in global and regional trade and investment. The E20 includes countries from Africa, Asia, Latin America as well as Poland and Russia (see box).

Emerging economies display a number of features (demographic; economic; soft power attributes; as well as others related to technology, innovation and education) that have contributed to their new positioning globally. Accounting today for more than 50 % of the world's population, and almost half of the global GDP, the E20 countries occupy a major place on the world scene. Many emerging economies in the E20 have registered strong growth rates over the past twenty years, which explain their key contribution to global output today. They have developed innovation and technological capabilities and a number of them have become significant sources of innovation, with sometimes cutting-edge technologies in industries such as computer industry, energy, solar, transport or mobile services - to name a few. Developments in the area of global governance and international cooperation with, for instance, the creation of multilateral institutions such as the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB) are signs of their growing influence, enhancing their ability to exercise soft power on a global scale. The recently approved IMF quota and governance reforms that strengthen their representation in the IMF's governance structure also reflects the new dynamics of the global economy, and the growing key role of emerging economies.

Emerging economies are—and will remain—quite diverse. Vulnerability to external shocks and currency volatility has often characterized them. It would be unwise, to expect that the growth achieved by a number of them over the past fifteen years could be maintained in the future. There will be ups and downs, of a bigger or smaller order, depending on each situation. But, overall, their remarkable rise over the past decades has definitely challenged the status quo. A new global landscape has crystallized before our eyes. The impressive breakthrough of emerging economies as foreign investors and the spectacular blossoming of some of their firms as world champions, the topic of this report, is but one illustration of this profound transformation.

A radically different global FDI landscape has settled in

The global Foreign Direct Investment (FDI) landscape has gone through profound changes in the past two decades with the consolidation of emerging economies as key players both as recipients and sources of FDI. The E20 for instance accounted for 30% of global inward FDI flows on average over the past five years.

As regards to outward FDI, the rise of emerging economies as key outward investors started later but has been particularly impressive since the early 2000s, especially in the aftermath of the Global Financial Crisis: for instance, E20 economies account today for 20% of global OFDI flows; their share was 2% at the turn of the century. This trend was led by Asia whose flows have clearly outpaced those from Latin American emerging economies, especially after the Global Financial crisis. In 2015, two of the E20 countries (China and Korea) were among the top 15 investors in the world, with China in the third top position.

Differences between OFDI support policies partly explain this situation: for instance, in China and Korea—the two largest investors of the E20 in 2015—the internationalization of enterprises has become a strategic issue and OFDI support policies have been instrumental to achieve it. This has not been the case in Latin America where pro-active OFDI support policies have been very limited or non-existent. Even in Brazil - long unique in the region in this respect - support for OFDI, however limited, appears to have lost traction in recent years.

The geographical distribution of OFDI from emerging economies has also evolved, even if such FDI still remains largely South-South. While investors from emerging economies used to invest primarily in other emerging and developing economies, usually in their neighboring region, their natural market, a number of multinationals from emerging economies have ventured forcefully into more distant destinations in the past decade. For instance, the evolution of the OFDI stock of two major economies in the E20, Brazil and China, has increasingly shifted towards developed countries. There is also a notably growing presence of Asian investors (such as China and Korea) in Latin America and Africa, even though the reverse is not true.

Emerging Market Multinationals have made it to the top

Emerging market multinationals that are behind the radical change in the global FDI landscape have not only significantly increased their investment abroad, they have also made it to the top. This is illustrated for instance by the evolution of the Fortune Global 500 list, one of the oldest rankings by revenues of global companies. About 30% of the Fortune Global 500 enterprises for instance are from the E20 today; they were less than 10% ten years ago.

Here again, as in the case of OFDI flows, the Chinese lead the trend. However, although among emerging economies, enterprises from China dominate the ranking, a wide array of E20 countries are represented (14 in total), some of them with only one entry in the list. By decreasing order of importance, the new players are coming mostly from China, Korea, India, Brazil, Russia, Mexico and Indonesia.

While the Global Fortune 500 companies overall are from a diverse group of industries, those from the E20 are more concentrated: seven industries in particular (Petroleum refining; Mining, Crude Oil Product; Commercial and Savings Banks; Metals; Motor Vehicles and Parts; Energy; and Engineering and

Construction) are represented, accounting for more than 60% of all the E20 eMNCs. It is also interesting to note that there is a relatively marked "winner take all tendency" in emerging markets. For instance, the Fortune Global 500 top 10 companies of the E20 concentrate a large share of revenues and profits (respectively 29 and 40 % of the total revenues and profits of the largest 100 firms in the E20).

Not only has the presence of emerging market firms in the Global 500 substantially increased, another development has also progressively taken place: a change of guard at the very top. Indeed, a number of the new players have now become world industry leaders. If we consider, for instance, the five top leaders of eight industries (Banking, Logistics , Automobile , Telecom, Engineering & Construction, Petroleum Refining, Mining, Crude Oil Production and Metals), 40% of these leaders were firms from E20 countries in 2015 (largely dominated by China); there were none in 2004.

Remarkable inroads, but still some way to go

Emerging Market Multinationals have made remarkable inroads as global corporations, becoming world leaders as measured by revenues. In terms of profits, market capitalization and international presence, however, they still have some way to go compared to the more established western multinationals.

Overall, the average profit margins of eMNCs lag behind that of their US and Japanese counterparts for instance. Emerging Multinationals appear to be looking for growth in revenues rather than profit margins for the moment. The differences are relatively significant, whether one considers the E20 firms as a whole (27% of the eMNCs in the Fortune Global 500 achieve a profit margin above 5% versus 39% if one considers the whole Fortune Global 500) or at the industry level. There are, however, some notable exceptions such as Chinese firms in Banking and Korean ones in Automobiles.

As regards market capitalization, the gap between older/western and newer/emerging multinationals has become wider. While there are today twenty-seven eMNCs among the 100 largest firms by revenues, there are only seventeen by market capitalization. Emerging multinationals display a lower market capitalization on average than, for instance, US firms. Whether eMNCs will manage to close this gap remains to be seen because of the different financial cultures and contexts in which they operate. Indeed, while stock markets are the main source of corporate finance in, for instance, the United States, most eMNCs rely more on corporate debt than equity finance.

Regarding geographical expansion, Emerging Multinationals are not as international as leading American and Japanese companies for instance, but they are becoming increasingly so. European and American companies dominate the UNCTAD list of top 100 firms ranked by foreign assets but, if we consider the number of countries in which firms are present, the picture is different. For American companies, that number on average is triple that of Chinese firms; the difference is much less with the rest of Emerging Multinationals. In addition, the difference is also less marked between the very top US and Chinese multinationals. Overall, unlike what is quite commonly thought, the global footprint of Emerging multinationals is larger than expected and this will most likely continue to grow in the future.

China – An Emerging Global Acquirer

The emergence of China as a significant global acquirer is another distinctive feature of the new global FDI landscape; the surge was particularly marked after the Global Financial Crisis. While in

2000 China virtually had no outbound M&A, the value of its announced outbound M&As reached $138 billion in 2015, placing it in 5th position in the world between Singapore ($121 billion) and Netherlands ($171 billion), but still far behind the U.S. ($488 billion). This surge in M&A activity has been fueled, in particular, by technology and knowledge-driven acquisitions in developed markets, as well as natural resource driven acquisitions in Latin America and other parts of the world. The geographic distribution of Chinese outbound M&A, in fact, has shifted significantly towards Europe and Latin America in the post-financial crisis period. Not only has the overall amount of announced M&A transactions by China increased substantially, available information also suggests that the deals have been on average bigger and more expensive, with for instance Chinese firms willing to pay a premium on average higher since 2009 than in the pre-financial crisis period (2000-2008). Very recent developments suggest that the M&A drive of Chinese firms may be not be over soon.

The very top Chinese firms, such as the largest one in the Banking, Petroleum, Automotive and Metal industries for instance, have been quite active in overseas M&As. Interestingly, relative to their US counterparts, these firms, while still much younger and (directly or indirectly) state-controlled, are comparable in terms of total assets, revenues and market capitalization. Partly through increased M&A activity, they have acquired a global presence that is also on a par with top global MNCs in the United States.

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OECD contribution on "Expanding Business through Regional Integration in Asia"

Strengthening regional integration and economic community initiatives is essential to support growth and development. It increases market size, spurs innovation, investment and job creation and enhances macroeconomic stability through policy coordination.

Focusing on Southeast Asia, China and India, with a particular focus on the ASEAN Economic Community, the OECD contribution on "Expanding Business through Regional Integration in Asia" offers insights, and policy recommendations from the business sector, on the trade and investment implications of enhanced economic integration. It highlights that, even in the context of a Chinese slowdown, enhanced regional ties in Asia can still generate significant opportunities for private sector growth. The ASEAN Economic Community (AEC) in particular has the potential to support higher trade and investment in the region. This process can be particularly beneficial for multinational corporations from emerging Asia: due to geographical proximity and familiarity with the regional context, they have the potential to enjoy higher market penetration and lighter cost structure than their competitors from developed economies. Challenges however remain, in areas such as trade and non-tariff barriers, human resources development, infrastructure and connectivity. Although regional ties have been significantly enhanced in the region since the 1980s, additional policy efforts are required to fully achieve integration targets.