Business Across Borders

Leaving the nest: an overview of companies' international ventures

A series of articles written by The Economist Intelligence Unit

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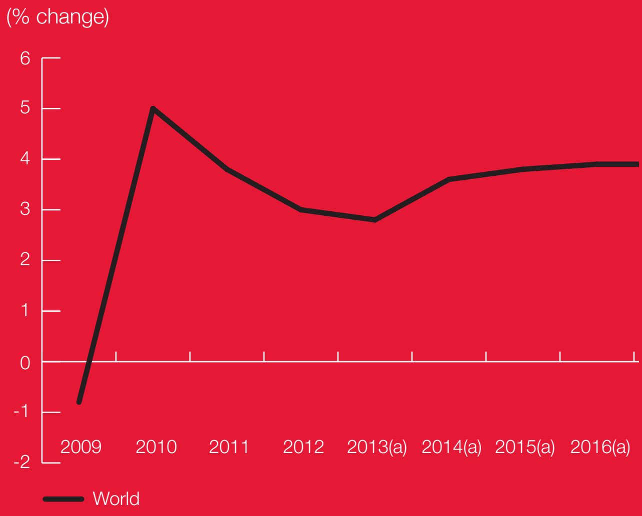
Business across borders

Leaving the nest: an overview of companies' international ventures

Cross-border business has been taking a battering. A bruised euro-zone is licking its wounds after a long crisis. The US has managed to coax life back into a still-sluggish economy. Emerging markets' headlong rush towards growth is now slowing too. Global trade, in short, is still suffering and is far from the pre-financial crisis heyday. The World Trade Organization (WTO) is forecasting 2.5% trade growth in 2013 – still below the 5.4% average of the last 20 years. The Economist Intelligence Unit (EIU) forecasts 2.8% global GDP growth at purchasing power parity (PPP) exchange rates in 2013. Given that the short-term is unlikely to bring noticeably better global economic growth, where and how are companies looking to invest?

Chart 1:
Real GDP growth at PPP exchange rates



(a) Forecast.

Source: The Economist Intelligence Unit

Unlikely favourites

Despite the continuing euro-zone crisis, investment prospects in Europe are still appealing. Nearly one-third (32%) of executives from around the world say that western Europe will feature prominently in their company's cross-border activities over the next two years, according to a recent survey carried out by the EIU on behalf of international law firm, Reed Smith. Western Europe's prospects are appealing to executives based in developed markets: two-fifths of survey respondents from North America and Europe picked the old continent.

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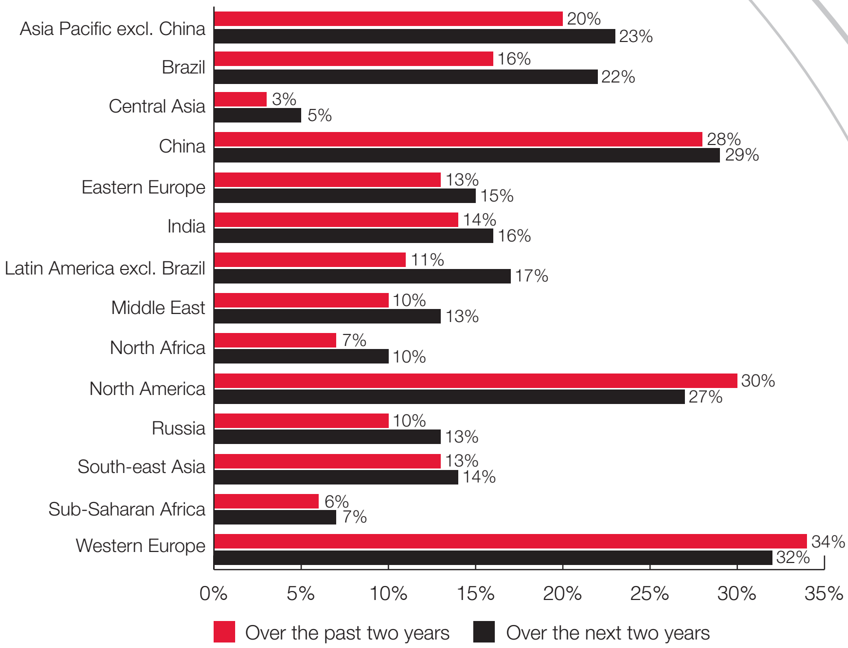
Per-Erik Lindvall, senior vice-president of technology business development at Luossavaara-Kiirunavaara Aktiebolag (LKAB)

Chart 2:
Outside of your domestic country market, which of the following countries/regions have recently figured, or soon will figure, most prominently in your company's cross-border activities?



Source: The Economist Intelligence Unit

There are a couple of key factors as to why executives from North America and Europe prefer to invest in their own markets. First, compared with rapid-growth markets, Europe and North America have a safer risk profile. "When you look at the potential returns in any country, they might be very high theoretically, but when you adjust them for the risk, you might prefer to invest in Europe and the US, as we have decided to many times," says Juan Pablo San Agustin, executive vice-president of strategic planning and new business development at Cemex, a Mexican building materials supplier.

Second, companies prefer to invest in markets that are culturally similar to their home market. Luossavaara-Kiirunavaara Aktiebolag (LKAB), a Swedish minerals group, provides a case in point. While it has some investments in Turkey and parts of Asia, Per-Erik Lindvall, senior vice-president of technology business development, says that the company is continuing to invest in organic growth in its home market, Sweden. When looking outside its borders it will first explore the opportunities in Scandinavia. "The more you know about the context of where you're investing the better," he says.

International business transactions across European countries are not the only ones aided by cultural affinity; cross-Atlantic investments also benefit. "We decided to buy a company in the UK chiefly because there is no language barrier," says Michael Fertik, founder of Reputation.com, a Silicon Valley-born online reputation management company. For Reputation.com and other Internet companies, high e-commerce presence and penetration are crucial too. "Europe is an obvious choice for us because, after the US and Canada, the next two biggest markets are the UK and Germany," adds Mr Fertik.

Asia beckons

All emerging and rapid-growth markets will feature more prominently in executives' plans over the next two years, according to the EIU survey. Inter-regional Asian business will also continue to grow. Respondents from Asia-Pacific placed the continent at the top of their list of cross-border business destinations over the past two years and over the next two, with China ahead of the pack. This is not good

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Alasdair Ross, the global product director at The Economist Intelligence Unit

news for all industries, however. In the shipping sector, the rise of regional trade, particularly amongst Asian countries, has led to a compression in freight rates as shorter routes 'consume' fewer voyage days. "The fastest growing market right now is trade among Asian countries," says Ken Bloom, chief executive of Inttra, the world's largest e-commerce network for the ocean shipping industry. "But from an ocean carrier's point of view, there are fewer voyage days associated with this market even though it's the fastest-growing market in the world today."

In recent years Asia has been steadily increasing its share of global trade. In 2005 Asia and Australasia accounted for 28% of global trade in goods and services; the proportion is set to rise to 32% in 2013 according to EIU estimates. "What we're going to see is a reinforcement of trends we've seen for a decade now, which is that the world economy is moving eastwards towards Asia," says Fredrik Erixon, director of the European Centre for International Political Economy, a world economy think-tank. "That means a lot more business activity will also go in that direction." While growth might be slowing in some parts of the region, in particular in China, prospects for growth remain a lot brighter than in the majority of Western economies.

The EIU survey finds China to be the market of choice for over one-third (34%) of financial services executives over the next two years. BBVA, a Spanish bank, sees the Chinese market as an important one. It has a 15% stake in China CITIC Bank, as well as a strategic partnership that allows it to access the Chinese market through two joint ventures in auto-finance and private banking. It is also collaborating with China CITIC Bank on the corporate and investment side, mainly on referrals to clients.

"Big corporates and institutional investors are diversifying their asset allocation and putting more emphasis on emerging economies," says Luis Alvarez de las Asturias, head of global clients and cross-border business at BBVA. The bank also has a solid presence in Latin America, especially in Mexico where it fully owns the largest bank in the country, BBVA Bancomer. BBVA also gained significant presence in Turkey through the acquisition of 25% of Garanti Bank. "This allows us to reduce our pure Spanish risk and to have a more diversified geographic presence," says Mr de las Asturias.

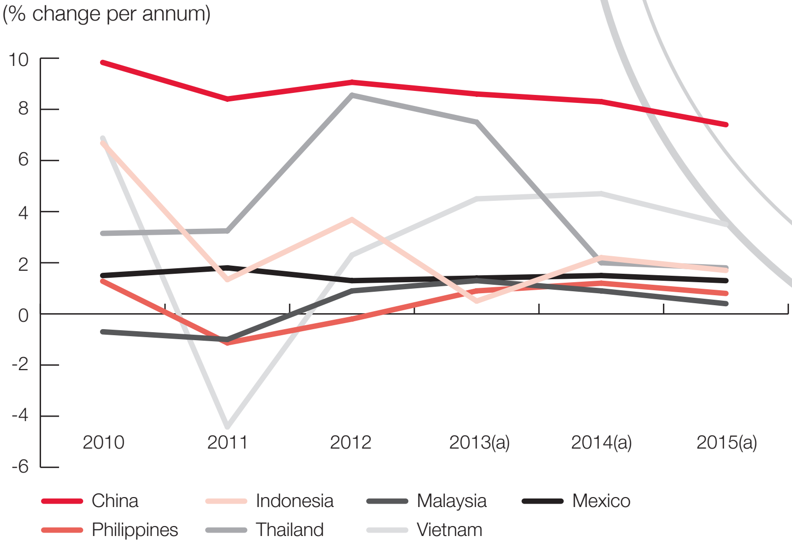
33%

from the manufacturing sector identify Brazil as being a prominent cross-border business destination over the next two years

According to the EIU survey, Brazil is set to become a more attractive market for business. Only 16% of respondents say that Brazil featured in their international plans; the proportion rises to 22% when thinking about the next two years. Executives from the manufacturing sector particularly favour Brazil, with 33% picking the South American country as being a prominent cross-border business destination over the next two years. In contrast, manufacturing companies are shifting away from China. Investment in other countries over the past two years has been dwarfed by manufacturers' Chinese commitments, with almost one-half (49%) describing China as a priority investment destination. Looking ahead, less than one-third (31%) say that this will be the case.

"Wages are probably the main factor behind slowing interest in China as a manufacturing base, while Brazil promises both a relatively low-cost and skilled workforce, as well as a large and growing domestic market for manufacturers," says Alasdair Ross, the global product director at The Economist Intelligence Unit. Rocketing wage levels in China are also driving investments to other countries including Vietnam, the Philippines, Indonesia, Malaysia, and Thailand. "The biggest thing that's going on is the re-sorting in Asia," says Theodore Moran, professor of international business and finance at Georgetown University. He believes that others may benefit from wage increases in China, particularly if the US economy strengthens. "If the US is a little more robust and China is a little off, that favours Mexico," he says. "And not just in the lower-end skills, but also in electronic components and some of the industrial products, such as auto parts."

Chart 3:
Average real wages



(a) Forecast.

Source: The Economist Intelligence Unit

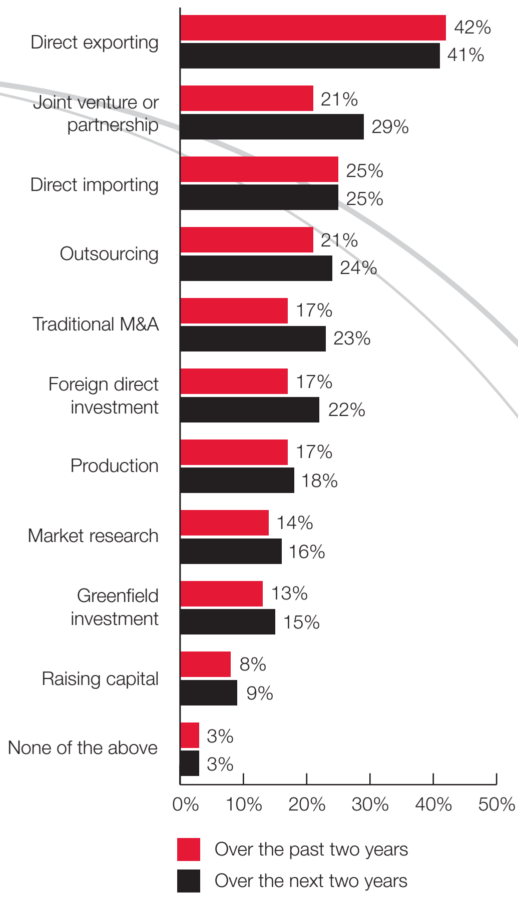
Mergers and acquisitions are on the rise, with many more companies predicting that M&A will be among their cross-border business activities in the next 24 months.

How to cross borders

When it comes to the types of cross-border activities in which companies are engaged, direct exporting is the most popular, with 41% of respondents selecting this as their most important activity looking ahead – continuing the trend of the past two years. However, in other areas, the emphasis has shifted slightly, with joint venture partnerships prioritised ahead of direct importing when companies look two years ahead. Meanwhile, mergers and acquisitions (M&A) are on the rise, with many more companies predicting that M&A will be among their cross-border business activities in the next 24 months than said this was the case over the past two years.

For some companies, different regions present different types of opportunities. For Cemex, organic growth will come largely from the Americas. "From a mergers and acquisitions point of view, we'll be taking a close look at areas like India, South-east Asia and central Asia," says Mr Agustin. He says that these regions are more attractive for companies in the construction sector than China, which in that sector is dominated by local players. "It's a market for domestic players because rules incentivise the domestic players," he says.

Chart 4:
In which of the following cross-border activities is your company most likely to engage over the next two years? In which were they engaging over the past two years?



Source: The Economist Intelligence Unit

Conclusion

Regardless of where and how a company does cross-border business, listening to the market is a good first step. "It will tell you where to find consumers that will care about your product," says Mr Fertik. "Reputation.com was a bigger hit in Germany than we had anticipated, as the average German consumer is very concerned about their privacy." Based on his personal experience, Mr Fertik's advice is to go international sooner than planned. "There are more opportunities and you will learn interesting things from other markets," he says.

Ultimately, what all companies are looking for is the prospect for growth. "Investment will follow the money and will move towards markets where there's going to be an expansion of demand," says Mr Erixon. "That's what we've seen in past years, where business investment has dropped significantly in Europe and the US but has continued in high levels in other parts of the world, such as Asia." Above all else, says Mr Erixon, the search for growth will continue to drive investment decisions.

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About the research

In January 2013 The Economist Intelligence Unit conducted a global survey of 451 executives on behalf of Reed Smith. All respondents represented companies that conduct business internationally. Over one-half of respondents (56%) are C-level executives and 53% are from companies with annual revenues in excess of US$500m. Just under one-third of respondents are from Asia-Pacific (30%) and from North America (30%), and nearly one-third (32%) are from Europe. The remainder of respondents are from the rest of the world, including the Middle East, Africa and Latin America. Respondents represent a range of industries, including: 15% from financial services, 14% from energy and natural resources, 14% from media and technology, 13% from shipping and transport, and 13% from healthcare and life sciences.

In parallel to the survey, The Economist Intelligence Unit also carried out several interviews with senior business leaders and experts.

We would like to thank all survey respondents and interviewees for their time and insight.