The international expansion of Spanish firms: Strengths and weaknesses

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In response to the crisis, Spanish firms have reduced their FDI, yet they have become more aggressive exporters, going beyond traditional markets. Both FDI and export activity remain highly concentrated in a few firms and industries, illustrating the duality of Spanish firms in terms of international competitiveness.

Spanish firms have had to reduce Foreign Direct Investment (FDI) and increase exports to remain competitive in the wake of the financial crisis. FDI inflows, however, have been less adversely affected, as confidence in Spain is on the rise and investors take advantage of opportunities. Outflows remain highly concentrated in Europe and Latin America and in the hands of a few large firms in regulated and infrastructure sectors. While exports decreased just after the crisis, they have quickly recovered, and are currently at maximum historical levels. Unfortunately, as in the case of FDI, only a handful of heavy exporting firms in selected industries still dominate the market, although companies are increasing the geographic diversity of export destinations.

Introduction

The financial crisis of 2008 has dramatically changed the corporate expansion of Spanish companies and their competitive landscape. A serious downturn in domestic demand, the credit crunch, and the rise of emerging market multinationals, among other factors, called into question the previous investment policies, the corporate strategies and even the business models of most Spanish companies. Regarding the international activity of Spanish firms, the most immediate impact of the financial crisis was the sharp reduction in FDI since 2008 and a downturn in exports in 2009. However, the financial crisis has also raised the awareness of firms about the importance of being present in foreign markets to exploit or improve their competitive advantages, reducing also their dependence on the domestic market. As a consequence, the most competitive and dynamic companies have reacted to the challenges posed by the new competitive scenario by adjusting their FDI portfolios and/or increasing their propensity to export. In fact, nowadays the current growth prospects of the Spanish economy are heavily dependent on the competitiveness of this group of firms. In this article, we analyze the most recent data on the international activity of Spanish companies to illustrate this situation and its future outlook. In the first section, we study expansion through FDI. In the second section, we analyze export trends. Finally, at the close of this article, we provide some concluding remarks.

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Foreign direct investment activity

The international expansion of Spanish companies through FDI since the late 1980s is a textbook example of what is called accelerated internationalization.[2] Exhibit 1 shows the evolution of the value of the stock of inward and outward FDI to and from Spain since 1980, as a percentage of the world's total. As could be expected, the opening of the Spanish economy in the 1980s paved the way for inward FDI rather than outward FDI, due to the competitiveness gap between Spanish firms and international competitors. However, once Spanish companies improved their international competeviness, their share in the global stock of FDI started to rise progressively with the exception of a small downturn in 1993. This chart also shows how in this new competitive scenario, the importance of Spain both as a source and destination of FDI has been reduced substantially since 2008. Even

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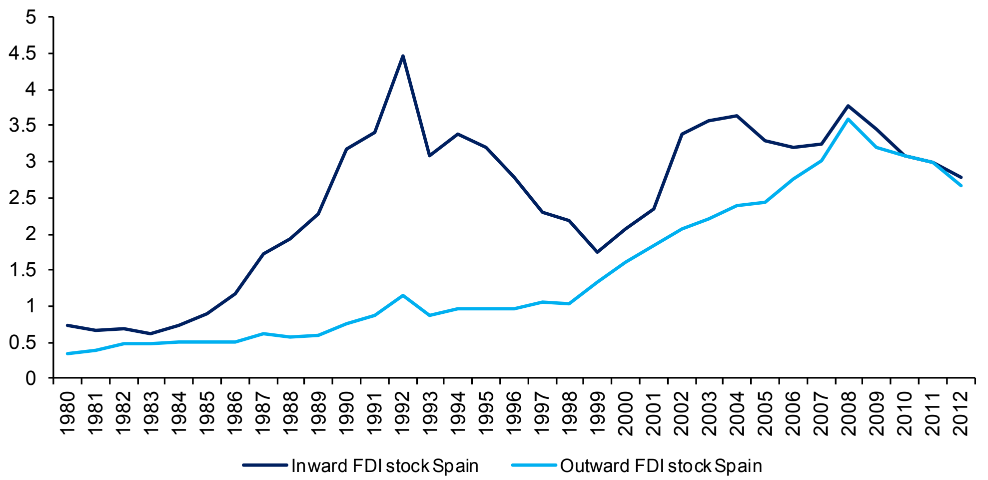
though the reduction of Spain's share in the world's total stock of outward FDI can be associated to the rise of new players in the international economy coming from emerging markets,[3] its most direct cause has been the decline in the level of net FDI flows to and from Spain. Exhibit 2 shows the evolution of incoming and outgoing net FDI flows to and from Spain, according to the official data compiled by the Spanish Ministry of Economy and Competitiveness. The exhibit shows that from 1996 to 2008, Spain had a positive net investment position in terms of the balance between outgoing and incoming FDI flows. The financial crisis put

Exhibit 1

Inward and outward foreign direct investment stock to and from Spain as a percentage of the world's total



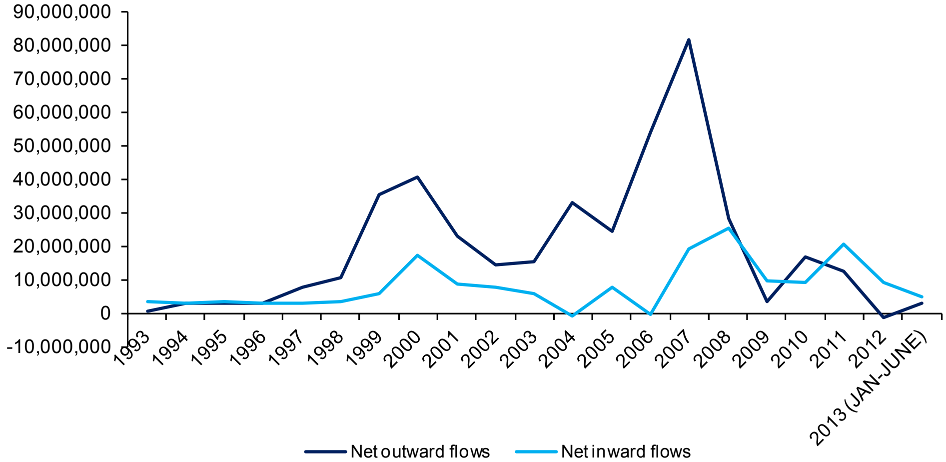
Source: UNCTAD.

[2] For more details, See Guillén, M. and García-Canal, E. *The New Multinationals: Spanish Firms in a Global Context*, Cambridge University Press, Cambridge, 2010.

[3] See Guillén, M. and García-Canal, E. *Emerging Markets Rule: The Growth Strategies of the New Global Giants*, McGraw-Hill Professional, 2013.

Exhibit 2

Inward and outward net foreign direct investment flows to and from Spain
(thousands of current euros)



Source: Secretaría de Estado de Comercio. Ministerio de Economía y Competitividad.

an end to this situation and, after 2007, the net outgoing flows fell sharply. In fact, net outgoing FDI flows were negative in 2012.

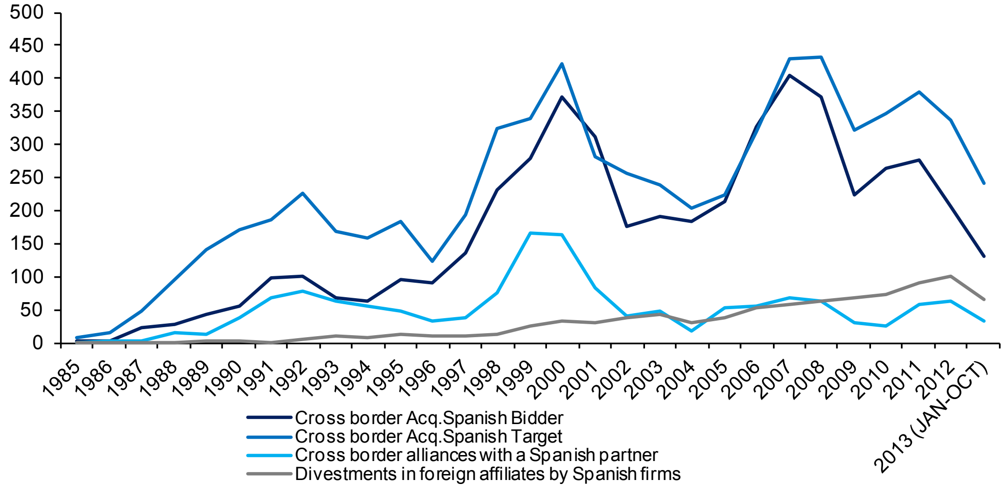
However, official statistics on FDI only provide aggregated quantitative flows, failing to report firm level data, so we do not know how many deals are behind the aggregated amount of FDI flows. To overcome this limitation, a good strategy is to complement this information with databases which disclose firm level data. One of these databases is Thomson Reuters SDC Platinum.[4] This database includes firm level data regarding acquisitions and alliances. Exhibit 3 shows the evolution of the yearly number of cross-border acquisitions of a Spanish target (inward FDI), cross-border acquisitions with a Spanish bidder (outward FDI), cross-border alliances having a Spanish partner and divestments in foreign affiliates by Spanish firms. Traditionally, international expansion by Spanish companies was based on external growth, i.e., strategic alliances and mergers and acquisitions,[5] although the importance of strategic alliances decreased sharply after 2000. However, as acquisitions entail the highest commitment of resources, this pattern has changed after the financial crisis. Basically, this is because Spanish companies have been doing the exact opposite: reducing their financial commitment to the international markets. The rise in the number of divestments in foreign affiliates, which achieved historical maximums in 2011 and 2012, confirms this fact. As outward FDI through cross-border acquisitions decreased, the relative weight of

[4] The SDC database includes mergers and acquisitions as well as strategic alliances formed worldwide. Even though its coverage is not exhaustive, it has the same biases across years, so it is appropriate for the purposes of year to year comparisons. Another limitation is that SDC does not include Greenfield investment. The only database that discloses firm level data regarding every entry mode is the *Base Sistemática de Operaciones Internacionales*. However, it was discontinued in 2010. See Guillén, M. and García-Canal, E. "La expansión internacional de la empresa española: una nueva base de datos sistemática", *Información Comercial Española. Revista de Economía*, n.º 839, pp. 23-34, 2007. See also García-Canal, E., Guillén, M. and Valdés, A. "La internacionalización de la empresa española. Perspectivas empíricas", *Papeles de Economía Española*, nº 132, pp. 64-81. 2012.

[5] See García-Canal *et al.* (2012), *op. cit.*

Exhibit 3

Number of cross-border deals involving a Spanish company acting as bidder, target, partner or seller of a foreign affiliate



Source: Thomson Reuters SDC Platinum.

cross-border alliances increased, although their number remained somewhat flat.

Interestingly, the number of cross-border acquisitions of Spanish targets has not decreased in the same way as cross-border acquisitions by Spanish bidders. This fact explains why Spain is now a net receiver of FDI. In fact, foreign investors have Spain on their radar and are taking advantage of investment opportunities. One example is the recent investment of Bill Gates in FCC. But this deal is just the tip of a huge iceberg, as many deals are being closed in 2013.[6] The prospects are that inward foreign investment will be on the rise in the following years. Spain is now ranked in the 16th position of the Foreign Direct Investment Confidence Index elaborated by the consultancy firm A.T. Kearney,[7] which ranks the 25 countries with highest likelihood of receiving FDI. In 2005, Spain was ranked in the 17th position and after that disappeared from the ranking until 2012, reentering in the 24th position.

Exhibit 3 clearly shows that most Spanish multinationals have been adjusting their portfolio of FDI to reduce their debt or to overcome the financial constraints associated with the crisis. But some of these adjustments were also related to changes in their international corporate strategies, divesting in specific countries to reinforce their presence in others. Focusing their presence in specific regions is what companies like Telefonica, Banco Santander or BBVA have been doing after 2007. Whatever the case, it is clear that the predicament of the large Spanish multinationals has worsened, as their presence in the rankings of the largest multinationals has decreased. For instance, whereas in 2009 there

[6] For more examples, see Noceda, M. "El capital extranjero redobla su apuesta", *El País*, November 1st 2013.

[7] This ranking is based on a survey of top executives of worldwide multinationals asked about the likelihood of the company of the respondent investing in a specific country in three years' time. http://www.atkearney.com/es/research-studies/foreign-direct-investment-confidence-index

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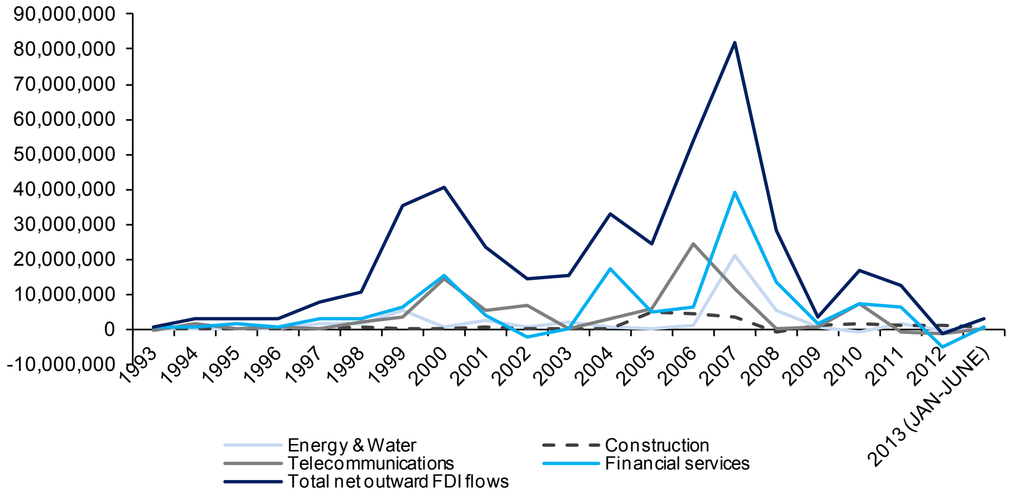
were 12 Spanish companies in the Fortune Global 500 ranking[8] (comprising the world's largest companies in terms of turnover), in 2012, the number of Spanish multinationals fell to 8. In the ranking of the world's largest multinationals in terms of foreign assets elaborated by UNCTAD, by the end of 2012, there were only three Spanish representatives, whereas France and the UK had 14 each, and Germany 10.[9]

This fact is especially important if we take into account that Spanish FDI has always been highly concentrated.[10] A few groups of firms, from specific industries, used to carry out the bulk of the investments. Large companies competing in regulated and infrastructure industries account for a high number of investments. Specifically, companies competing in regulated and infrastructure industries were responsible for about 39.6% of the total number of deals made between 1986 and 2010,[11] although their share in the total amount of FDI is higher because investment projects in these industries are large scale. Exhibit 4 shows the recent evolution of net outward FDI flows from selected regulated

Exhibit 4

Net outward FDI flows from selected industries and total net FDI outward flows from Spain (thousands of current euros)



Source: Secretaría de Estado de Comercio. Ministerio de Economía y Competitividad.

[8] http://money.cnn.com/magazines/fortune/global500/2013/full_list/?iid=G500_sp_full

[9] http://unctad.org/en/Pages/DIAE/World%20Investment%20Report/Country-Fact-Sheets.aspx

[10] See Durán, J.J. "La internacionalización de la empresa española 1979-1985", *Investigaciones Económicas*, (segunda época), suplemento: 109-112, 1987; García-Canal *et al*. (2012), *op. cit.*

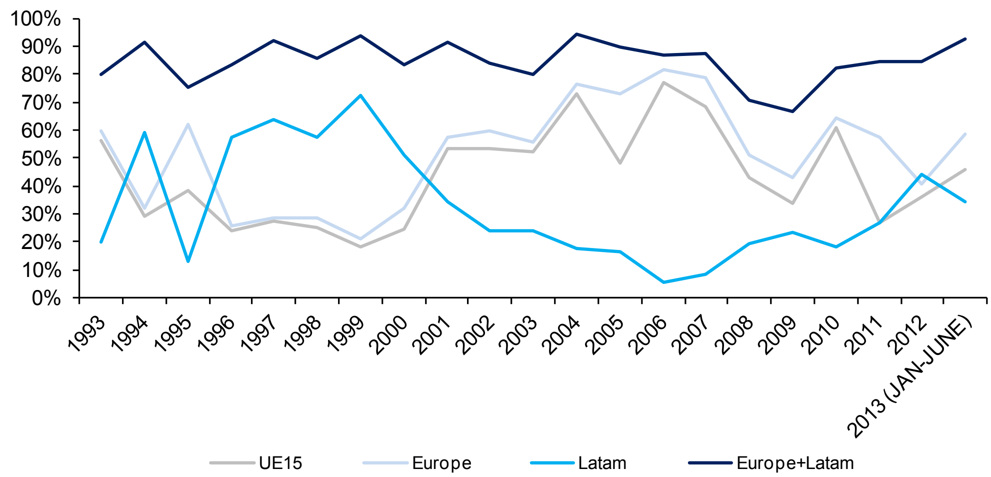
[11] Data from the *Base Sistemática de Operaciones Internacionales.* See Guillén and García-Canal. (2007), *op cit.;* García-Canal and Guillén (2012), *op. cit.*

and infrastructure industries and, for the sake of comparison, the total net amount of FDI outward flows from Spain. Looking at this chart it is clear that the ups and downs in the total amount of outward FDI flows are determined by these industries, whose share, on average, of the gross amount of outgoing FDI is about 60%. The sharp fall in outgoing FDI is directly attributable to the divestments and geographical refocusing of these companies. Thus, it is clear that, for the case of Spain, the growth prospects for outward FDI are extremely dependent on these companies and cannot be positive until they start to become net investors again. It is hard to imagine firms in other industries investing in the same way as regulated companies did in the past. First, the number of companies with potential to become multinationals is quite limited, as we have seen; and second, they have lower average size investment projects.

Spanish FDI is not only highly concentrated in certain industries but also in the geographical dimension. Two regions, Europe and Latin America, received the bulk of investment both in terms of the number and the amount of FDI.[12] The joint share of these two regions as a percentage of the total amount of gross FDI is 85% (58% Europe and 27% Latin America), although about 50% of the total amount of gross FDI was concentrated in the 15 core countries of the European Union. Exhibit 5 displays the evolution of the share of selected destination regions as a percentage of the total amount of outward gross FDI flows from Spain. The most remarkable fact is that the joint share of Europe plus Latin America was below 80% only three times over a period of 20 years, being higher than 90% for the first six months of 2013. This result is hardly a surprise as both regions are natural to the expansion of Spanish companies. Investments in Latin America were very concentrated in the second half of the 1990s, as this was the time when regulated companies invested heavily in the area, taking advantage of privatizations and the wave of liberalization on the continent. However, in terms of the number

Exhibit 5

Selected destinations of FDI flows as a percentage of the total amount of outward gross FDI flows from Spain



Source: Secretaría de Estado de Comercio. Ministerio de Economía y Competitividad.

[12] García-Canal *et al*. (2012).

of deals, international expansion to the region is more balanced than what the chart suggests,[13] and the importance of Latin America has started to rise again after 2007.

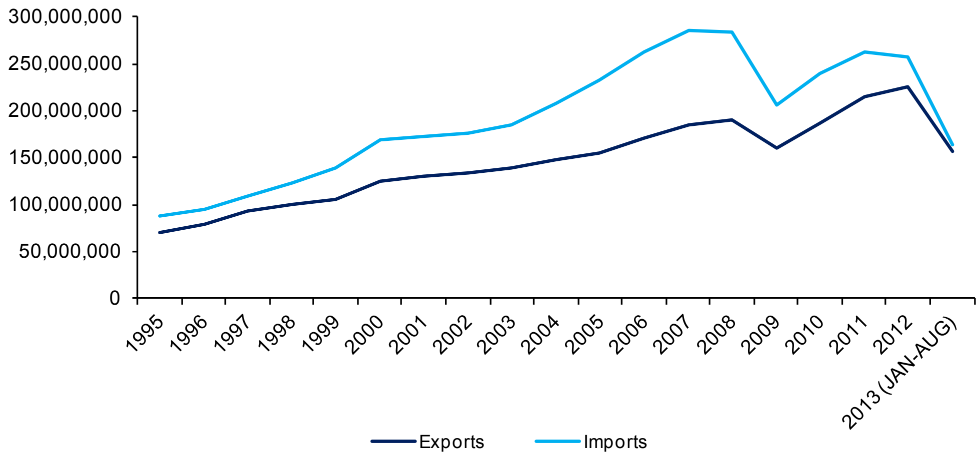
This geographical concentration implies putting almost half of the stakes on old Europe and not paying enough attention to other important growth markets in Asia, or even in the Eastern European countries. Besides, even though Latin American markets have growth potential, companies are exposed to regulatory and political risk in some of the countries. This threat is especially important for regulated firms. In this context, the rise of neo-populism in Latin America, with the wave of expropriations and nationalizations in countries such as Venezuela, Bolivia and Argentina is a source of concern for Spanish multinationals. Another source of concern in the area is macroeconomic stability. Despite these facts, the presence in Latin America, a region in which Spanish companies find it easier to compete than in Asia, has allowed Spanish multinationals to better handle the financial crisis than if they were not established there. Companies such as Telefónica, Banco Santander, BBVA or Iberdrola nowadays generate more profits in Latin America than in Spain and, interestingly, in a survey of thirty-eight big companies present in Latin America (most of them listed firms), 81% of the executives participating believed that in three-years´ time, the size of the Latin American business would be bigger than the size of the business in Spain.[14]

Exporting activity

Exhibit 6 shows the evolution of imports and exports to and from Spain since 1995. As happened with FDI, there was sustained growth in both series until 2007, thanks to the complete opening of the Spanish economy and its high growth rates during this period. Imports grew at a higher rate than exports, driven by the strength of the growth

Exhibit 6

Exports and Imports from and to Spain
(thousands of current euros)



Source: Secretaría de Estado de Comercio. Ministerio de Economía y Competitividad.

[13] See García-Canal, E.; Guillén, M.F.; Sánchez Lorda, P. and Valdés, A. “La expansión de las empresas españolas hacia América Latina: Un balance”, *GCG: Revista de Globalización, Competitividad y Gobernabilidad*, vol. 2 (2), pp. 18-45, 2008.

[14] Informe 2013: “Panorama de Inversión Española en Latinoamérica”, IE Business School.

of domestic demand, generating an important trade deficit. Again, as was the case of FDI, the financial crisis put an end to the growth track of both variables, although their behavior after the first impact of the crisis was plainly different. Due to the slowdown and recession in the Spanish economy, imports have been falling progressively to a point in which the trade deficit is close to zero in 2013, supported by the good behavior of exports, which rebounded strongly after their fall in 2009. This is an important difference with what happened with FDI.

In effect, while FDI activity has been drastically reduced after the crisis, exporting activity quickly recovered after the downturn of 2009, nowadays at maximum historical levels, returning to the growth track followed before the crisis. Clearly, the financial crisis has turned Spanish firms more oriented towards international markets. Exporting is one obvious alternative to a paralyzed domestic market. It is not a surprise, thus, that the number of companies which have turned to international markets has increased since 2007. The total number of Spanish exporters increased 40% from 2007 to 2012, as can be seen in Exhibit 7. However, exporting occasionally is one thing, but exporting regularly beyond a certain level is a completely different one. Exporting success requires having a competitive product at the international level and not all Spanish firms meet this highly demanding requirement. Exhibit 7 shows that as we adopt more restrictive criteria to define a successful exporter, the number of companies which qualify are substantially reduced. Whereas 136,973 companies exported from Spain in 2012, only 36,890 (27% of the firms) exported over the (not so high) threshold of 50,000 euros. What is more, the total number of firms exporting more than 50,000 euros grew just 3.8% from 2007 to 2012. Thus, a lot of companies tried their luck in the international markets, but barely one out of four succeeded in exports surpassing the 50,000 euros level. In addition, we can see that the number of companies that are

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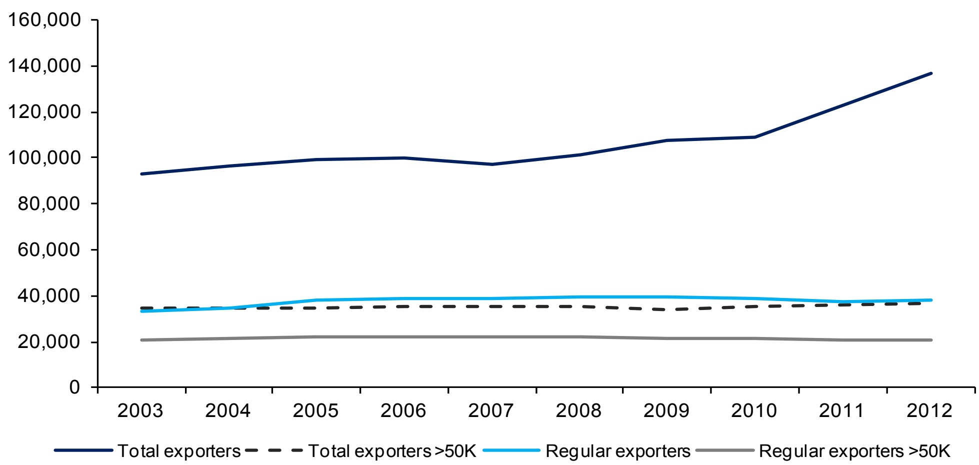
Exhibit 7

Evolution of the number of companies exporting from Spain



Source: ICEX. Perfil de la empresa exportadora española (several years).

regular exporters[15] beyond the threshold of 50,000 euros has remained flat across the whole period and even decreased slightly after 2007. This is a remarkable fact. The strength of the Spanish economy is dependent on a relatively small number of companies. In 2012, heavy exporters accounted for 86.6% of total exports from the Spanish economy, but they were less than five thousand companies (precisely 4,777 firms). The good news is that the number of heavy exporters has increased or maintained on a yearly basis with the exception of 2009, as shown in Exhibit 8. The bad news is that only this group of firms seems to be taking full advantage of the improvement in international competitiveness associated to the internal devaluation and structural reforms, showing that there is an underlying problem of competitiveness in the remaining firms approaching the international markets. In fact, despite the increase in the number of exporters, the truth is that heavy exporters now have a higher share in the total amount of exports than before the crisis. Whereas in 2000 the share of the top 1,000 exporters as a percentage of the total amount of exports was 64.4%, in 2007, it was 66.4% and in 2012, their share was 68.2%.[16]

Once again, the international activity of Spanish companies, in this case through exporting, is highly dependent on a relatively small number of companies, as happened with FDI. These companies are also clustered among few industries. Five industry groups of the ICEX's classification of industries account for about one third of total exports, namely automobiles, fuels and lubricants, auto parts, steel products and pharmachemistry. Exhibit 9 shows the evolution of the share of these top exporting industries as a percentage of total exports from Spain. The most

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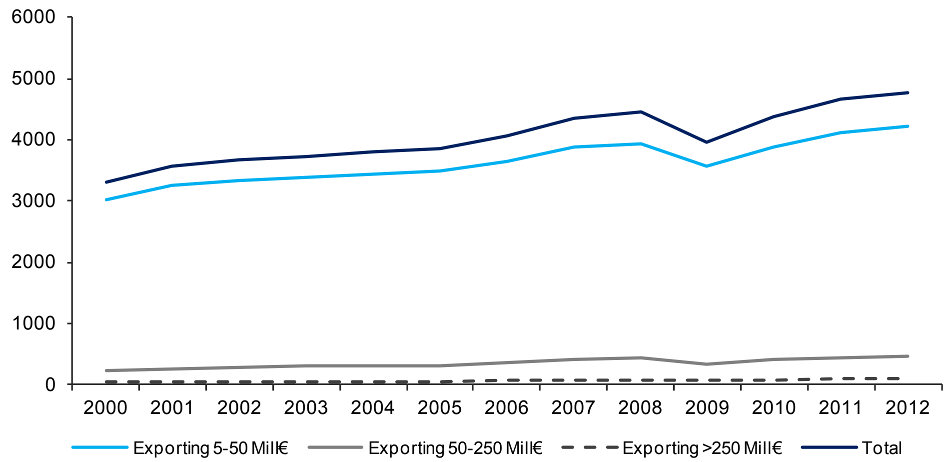
Exhibit 8

Evolution of the number of heavy exporters from Spain



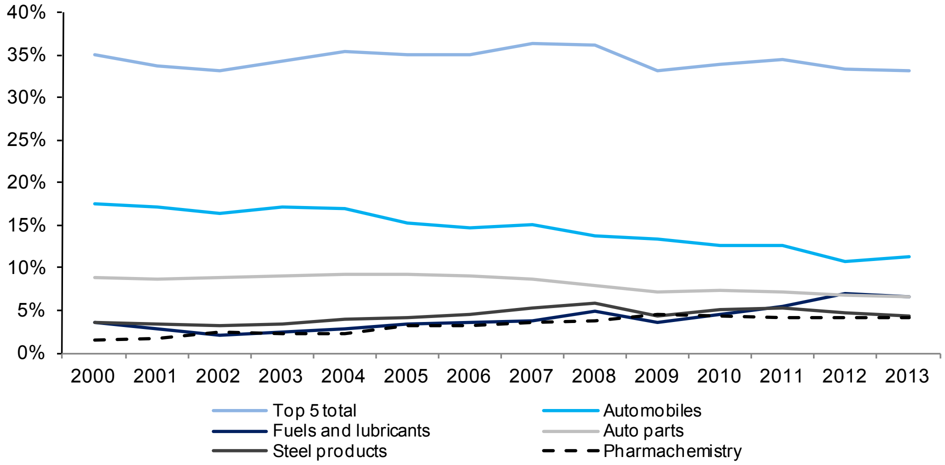
Source: ICEX. *Perfil de la empresa exportadora española (several years).*

[15] Regular exporters are companies that have been exporting consecutively for the last four years.

[16] ICEX. *Perfil de la empresa exportadora española (several years).*

Exhibit 9

Share of the top exporting industries as a percentage of total exports from Spain

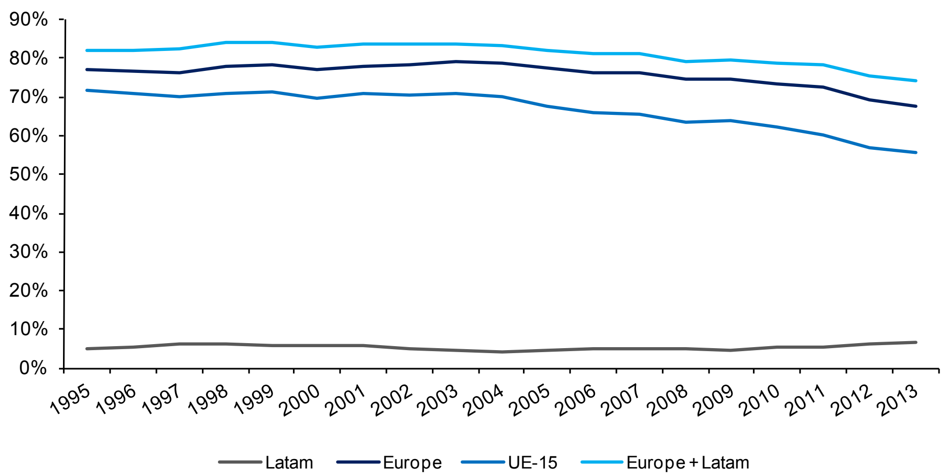


Source: ICEX. *Perfil de la empresa exportadora española (several years).*

important industry is automobiles, represented by the Spanish subsidiaries of world-leading manufacturers such as Ford, GM, Volkswagen, Renault and PSA, among others. The importance of this industry is also amplified by the relevance of the auto parts industry, in which Spain has world-class multinationals, such as Gestamp, Grupo Antolín, Ficosa, Zanini or CIE-Automotive, among others. Even though the joint share of these two industries in the total amount of exports has been

Exhibit 10

Share of selected regional areas as a percentage of total exports from Spain



Source: Secretaría de Estado de Comercio. Ministerio de Economía y Competitividad.

reduced, the absolute value of their exports has remained stable in the case of automobiles or has decreased slightly in the case of auto parts. The prospects for both industries are positive for the following years, as the Spanish subsidiaries of car manufacturers have retained or increased their manufacturing activities, after being chosen to produce new models.[17]

There is also significant geographical concentration regarding the regional destination of Spanish exports. Exhibit 10 shows the yearly share of Europe and Latin America as a percentage of total exports from Spain. Traditionally, Spanish exports were highly concentrated in the core 15 members of the European Union, which accounted in 1995 for 72% of exports. The share of exports to this area in the total amount of exports is decreasing, although it is still about 56% of exports, and Europe as a whole accounts for two thirds of exports. However, we can see that exports from Spain are now more diversified after the crisis than outward FDI flows. Clearly, the crisis has forced Spanish companies to look beyond Europe to expand their markets.

Conclusions and implications

The international activity of firms is, perhaps, one of the best indicators of their competitiveness. For this reason, downturns in economic activity inevitably affect their international expansion, as these downturns often put into question a firm's business model. The recent financial crisis has not been an exception, and Spanish firms have been forced to react to the new situation, both in their FDI and exporting activities.

The evidence presented in this article shows a different reaction on the part of Spanish firms regarding FDI and exporting activities. Burdened with debt, Spanish multinationals have reacted to the financial crisis by reducing their financial commitment to international markets. These companies divested or sold foreign affiliates in order to reduce their debt and/or focus on core areas or countries. Despite this reduction, Spanish multinationals, generally speaking, have been in a better position than non-multinationals to deal with the crisis, precisely because of their greater geographic diversification. This step backwards taken by Spanish companies in their FDI activity was followed by a step forward in exporting activities. Export-oriented companies reduced their exports in 2009, but returned more aggressively to foreign markets from then on, increasing their presence in markets beyond the traditional areas of Europe and Latin America, destinations which now account for a much higher share of FDI flows than of exports.

Having this set of internationally competitive firms has been one of the key factors which has helped the Spanish economy avoid a complete bailout and to overcome some of the negative consequences of the crisis, which is not yet completely over. Most of the optimism and positive prospects on the definitive recovery of the Spanish economy rely, thus, on these firms. However, there are some concerns we would like to mention after conducting this analysis, especially given the fact that the number of truly competitive Spanish firms at the international level is quite limited. Spain has leading companies in almost every field, as well as other firms that are competitive in the international arena, but they are few in number, and their presence in the rankings of leading multinationals in the world has been reduced. Despite the structural reforms and the improvement in competitiveness associated to the internal devaluation, the number of regular exporters has decreased, instead of increasing. This means that the less-internationalized firms have a competitiveness gap that prevents them from expanding abroad. Many Spanish firms that were heavily dependent on the domestic market saw their business model put into question. They neither had the quality, design or other differentiating attributes of competitors

[17] http://www.elconfidencial.com/motor/automaniacos/2013-08-19/el-automovil-empieza-a-generar-empleo_18777/

from developed economies, nor the low cost advantages of competitors from emerging markets. This problem, aggravated by difficulties in access to credit, has been behind many recent bankruptcies and business failures in Spain.

One of the causes of this problem is related to the size distribution of Spanish companies. When compared to other European countries, small firms are overrepresented in Spain, while large and mid-sized firms are underrepresented.[18] Large and mid-sized firms are more able to compete in international markets and more productive than the smaller ones.[19] Size, after all, is –ceteris paribus– an indicator of success. This is a problem which cannot be easily fixed by merging companies, or, at least, merging small firms to create larger ones. Merging some mediocre companies does not create a stronger company, as recent history shows. The entrance of foreign capital could be an opportunity to turnaround these companies. All in all, the different reactions to the crisis plainly show that there is still an important duality in Spanish firms. The most competitive, agile and best managed companies reacted to the new scenario by increasing their penetration in international markets. The remaining companies are still trying to adapt, and only time will tell the final outcome of this process.

[18] See the second EFIGE policy report entitled "The global operations of European firms" by Giorgio Barba Navaretti, Matteo Bugamelli, Fabiano Schivardi, Carlo Altomonte, Daniel Horgos and Daniela Maggioni, Bruegel Blueprint Series, Brussels, 2011.

[19] Laborda, M. and Salas, V. "¿Qué nos dice el tamaño y la internacionalización de las empresas sobre los factores de desarrollo empresarial?", *Economía Industrial*, 375, pp. 41-51, 2010.