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briefing paper

European Multinationals: A Globalization Scorecard

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Summary points

- Global competition requires a global response, and European firms are now at the forefront of attempts to become internationally diversified multinational enterprises.
- European firms have been accused at various times of being too focused on their integrating regional market or too tied by historical links with certain countries or regions to develop a genuinely global strategy.
- Yet figures for foreign direct investment suggest not only that European firms have invested far more abroad than their American and Japanese rivals, but that they have also done so in far more countries.
- Of particular relevance for long-term profitability, European enterprises have a much stronger presence in emerging markets than either US or Japanese firms. Europe has in turn received more inward investment from those countries than either the United States or Japan.
- These growing links between Europe and emerging economies could provide European firms with a competitive edge in what are the most promising markets of the future.

Introduction

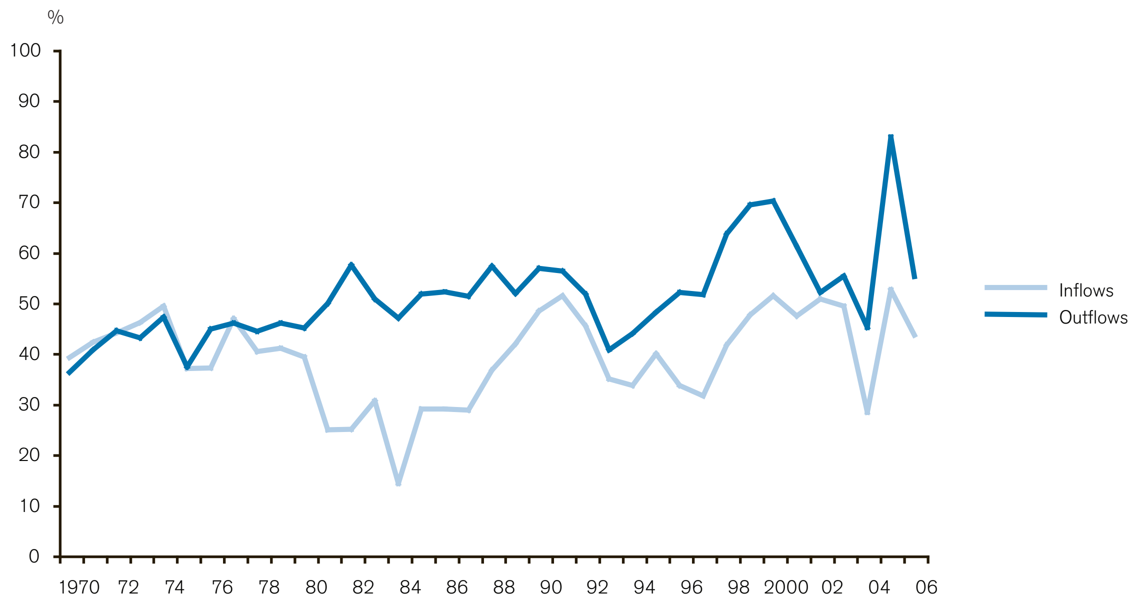
Global markets require global approaches by firms. With increasing competition both at home and abroad, a global strategy for sales, production and sourcing is increasingly seen as the key to long-term competitiveness. In many respects, European firms compare favourably with their competitors from both the United States and Japan in this domain. They have been at the forefront of the drive to create a worldwide presence and are among the most geographically diversified in terms of foreign direct investment (FDI), with a relatively strong presence in emerging markets.[1] They are also more likely than either the United States or Japan to receive inward investment from emerging markets themselves. As European firms forge greater ties with these regions through a growing web of two-way FDI flows, they will be well placed to tap into the rising share of global demand that these economies represent.

Multinational activity through FDI is not necessarily synonymous with competitiveness for any particular firm, but this comparison of FDI flows at an aggregate level between the three major home regions does suggest that European firms are no longer the lumbering, state-coddled creatures of popular legend. They have moved quickly to position themselves to benefit from the growth of emerging markets and thus have potential first-mover advantages over their rivals.

The EU plays a leading role in global FDI flows ...

As both home and host to multinational enterprises (MNEs), the European Union is unparalleled. It is both the largest outward investor and the greatest recipient of inward investment worldwide. The EU share of global FDI inflows reached a low of only 13% in 1984 but increased rapidly in the run-up to 1992 and has remained at between 30% and 50% ever since (Figure 1). In most years since 2000, EU member countries have taken in one half of global FDI inflows. European FDI represents an even higher share of worldwide outflows, as one would expect given the high number of European MNEs. Except for the first half of the 1980s, total European outflows and inflows have tended to move in tandem.

Figure 1: EU-25 share of world FDI flows



Source: UNCTAD.

1 See Table 2 for a list of key emerging markets.

... with the largest share going to other EU countries ...

Much of this investment involves mergers or greenfield investments within Europe rather than to or from other regions. Intra-EU FDI is partly a structural response to the increasingly integrated European market and partly a means of tapping into neighbouring markets, particularly in services where a local presence is often necessary. Figure 2 shows how important intra-EU flows are within total EU outflows.[2] On average since the early 1990s, 58% of EU-15 outflows have remained within the European Union. Another 10% or so have gone to the newest EU members and to the four remaining EFTA countries, principally Switzerland and Norway.

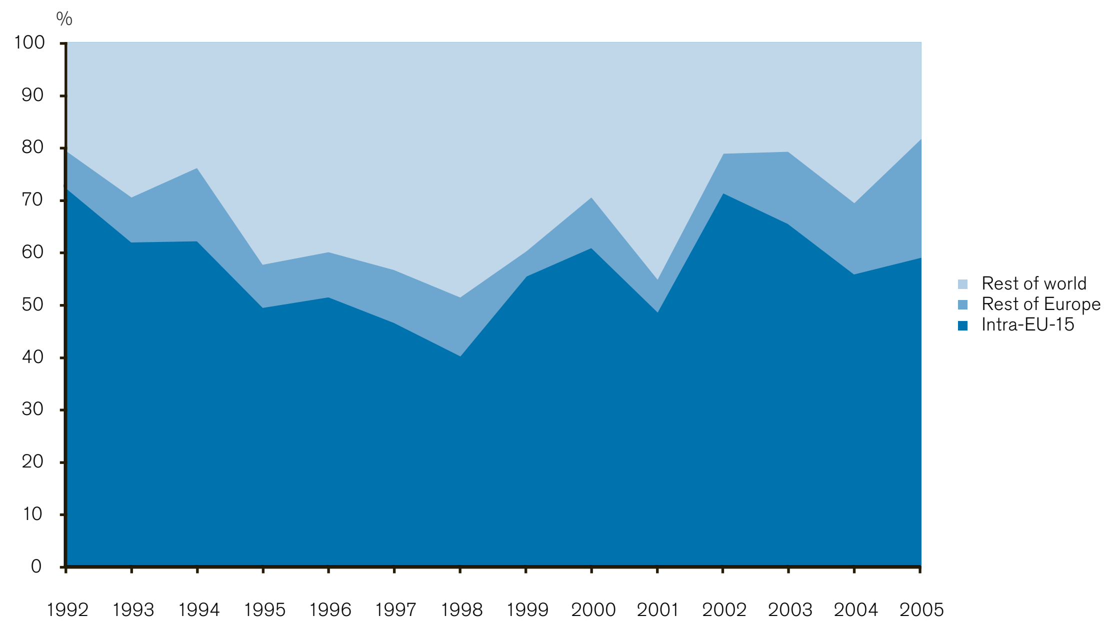
In terms of the stock of inward investment in each EU member state, on average three out of every four euros invested by foreign investors have come from firms in other EU countries (Table 1). Not all member countries are equally regionally focused. Smaller or more recent members tend to have a higher share of inward investment from within the European Union, but almost every EU member takes in over two-thirds of its inward FDI from other EU countries, with the following exceptions:

- Malta and Cyprus, which, partly for tax reasons, have a high share of inward investment from non-EU countries (e.g. Russia in the case of Cyprus);
- the Netherlands, which often serves as a location for holding companies for both EU and non-EU firms;
- the United Kingdom, which is a popular gateway to Europe for firms from the United States, Japan, Korea and, more recently, India and China.

A regional bias is common for many MNEs, particularly smaller ones. Even US firms invest disproportionately in Canada and Japanese firms in Asia.

The rest of the paper considers European FDI flows outside the home region, because this is the true test of

Figure 2: EU-15 outflows by destination, 1992–2005 (as share of total EU-15 outflows)



Source: Eurostat.

2 Intra-EU flows are measured as the average of EU outflows to an individual member country and its reported inflows. Since many countries are better at reporting inflows than outflows, this has the effect of inflating the intra-EU share of total EU outflows. This effect is not likely to alter the conclusion that intra-EU FDI represents the greater part of total EU FDI.

Table 1: Intra-EU share of inward FDI stock, 2006 or latest year

Country	%
Slovakia	93
Finland	91
Czech Republic	89
Estonia	88
Romania	86
Belgium*	86
Poland	85
Lithuania	84
Luxembourg	83
Greece	82
Slovenia	78
Ireland	77
Italy	77
Spain	74
France	74
Germany	73
Portugal	73
Denmark	72
Latvia	72
Hungary	70
Austria	70
Sweden	67
Cyprus	61
Netherlands	59
Malta	56
United Kingdom	50
Bulgaria	41

*Cumulative inflows since 2003.

Source: Eurostat.

the global reach of European firms compared with that of their rivals from Japan and the United States.

... but even outside Europe, EU firms are the world's most active direct investors ...

A high intra-regional share of total inflows does not imply that European firms are turning inward and becoming purely regional players or seeking a regional solution to what is increasingly a global challenge. For European firms, regional FDI is more likely to be a prelude to, rather than a substitute for, global investment, giving firms experience in operating in a multinational and multicultural environment.

Collectively, the European Union is the largest foreign direct investor worldwide, even discounting the large share which arises within the Union itself. A comparison between the activities of American and Japanese MNEs abroad and the extra-EU investments of European MNEs shows the extent to which European firms have the edge in terms of a global presence, particularly in those emerging markets that offer the best growth prospects in the long term.

Table 2 shows the stock of outward investment by Japan, the United States and the European Union (excluding intra-EU FDI). Overall, European firms invest slightly more abroad than the rest of the world combined and far more than American MNEs – in spite of the roughly equal size of the two economies. This finding helps to explain why the European Union has well over twice as many firms in the list of the top 100 MNEs (ranked by foreign assets) as the United States and almost six times as many as Japan. Much of this difference can be accounted for by the importance of intra-EU flows, but EU firms have still invested far more outside their own regional market than either US or Japanese firms have done outside their national ones.

The largest share of this FDI flows among the richest economies, often in the form of cross-border mergers and acquisitions. Transatlantic FDI alone now represents a stock of $2,500 billion. Of particular interest here is the degree to which firms from each developed region have invested in emerging markets. It is clear from Table 2 that European firms have a significant edge over their rivals from both Japan and the United States. Among the emerging market economies listed in Table 2, US firms have invested more than EU multinationals in only three cases (Israel, Mexico and Taiwan). In ASEAN countries and in Venezuela, US and European investors have achieved a rough parity. In the rest of the emerging countries in the list, including most of the largest ones, European firms have invested between two and three times as much as their US competitors, and substantially more in Russia and

Table 2: Direct investment position abroad, 2006 ($m)

Host country/region	Source country/region		
World	US	Japan	EU-25*
of which:	2,384,004	469,088	3,397,315
Key emerging markets (18)	**382,338**	**122,020**	**694,400**
Argentina	13,086	**	40,856
Brazil	32,601	8,167	110,494
Chile	10,243	**	21,647
China	22,228	31,624	41,076
Hong Kong	38,118	8,112	104,738
India	8,852	2,415	16,865
Indonesia	10,585	7,779	11,825
Israel	9,964	**	3,754
Korea	22,280	11,129	32,401
Malaysia	12,450	8,098	12,385
Mexico	84,699	1,850	55,275
Philippines	7,034	4,437	7,529
Russia	10,064	269	65,483
Singapore	60,417	14,885	71,180
South Africa	3,818	1,174	62,440
Taiwan	16,126	6,601	11,339
Thailand	8,217	15,480	11,182
Venezuela	11,556	**	13,930

*excludes intra-EU FDI
**not available

Sources: Eurostat, US Bureau of Economic Analysis, Bank of Japan, UNCTAD.

South Africa. Japanese firms are the largest investors only in Thailand.

What is perhaps most surprising is that European firms have achieved a greater presence in all emerging regions, including South America which has traditionally been considered the exclusive preserve of US multinationals. Similarly, European firms have invested almost three times as much as their Japanese rivals in the countries of East and Southeast Asia – in spite of the substantial vertically integrated activities of Japanese MNEs in the region.

The greater geographical spread of European firms is likely to derive in part from the diverse nature of the European market itself. Firms from different European countries have different strengths growing out of the home market, as well as different geographic orientations depending in part on historical and cultural ties. Spanish and Portuguese firms move easily to Latin America, and French and British firms to former colonies in Africa or Asia, for example. But historical ties are not the only reason for this diversity. British firms have invested heavily in Latin America and German firms in South Africa, for example. And China was as much *terra incognita* for European firms as it was for US or Japanese investors in the early 1990s.

Some of these differences in FDI levels may stem from variations across countries in the way FDI is defined and recorded. As a way of checking the reliability of the figures for FDI, Table 3 presents estimates

Table 3: Employment by European, Japanese and US investors in the BRICs

	China	India	Russia	Brazil	BRICs total
Europe 6	217,344	88,585	103,544	319,750	729,233
Japan	575,036	23,809	600	39,849	639,294
US	257,900	60,100	18,400	245,000	581,400

Europe 6 includes Austria, Finland, Germany, Italy, Sweden and Switzerland.

Source: OECD based on national sources.

for employment in the manufacturing sector accounted for by Japanese, European and American investors in each of the four BRICs (Brazil, Russia, India and China). Unfortunately, some of the largest European investors (France, the Netherlands, Spain and the United Kingdom) do not report employment figures for their foreign affiliates. The total employment levels for European investors are therefore likely to be much larger than those shown in Table 3.

Table 3 indicates that Japanese manufacturers are far more important in China than the FDI figures would suggest. This probably reflects the relatively high labour-intensity of production of Japanese affiliates in China. Even if the full European employment figure were available for China, it would probably be less than the total for Japan. But although Japanese firms dominate in China, they are relatively insignificant in the other three BRICs. Overall, the six European countries shown in Table 3 have far more manufacturing employment in the BRICs as a group than either Japan or the United States. If the remaining European countries were to be included, the dominance of European firms in these markets would be even more pronounced.

As another test of the perceived greater diversification on the part of European MNEs, it is instructive to look at the pattern of exports from these three source regions to emerging markets (Table 4). Given the strong influence of geography on trade, it is not surprising that Japan exports relatively more to East and Southeast Asia or that US firms export the most to Mexico or European firms to Russia. Nevertheless it is clear that Europe is far more diversified in terms of export markets in emerging economies than either Japan or the United States.

... as well as receiving more FDI from emerging markets than other developed countries

Exports and outflows of FDI are just one side of the globalization equation. The counterpart to diversified outflows of FDI is a wide range of sources for inward

Table 4: Exports to emerging markets from the US, Japan and the EU (US$bn, 2006)

	US	Japan	EU
South & Central America	88	20	62
Brazil	19	3	22
CIS	7	8	129
Russia	5	7	89
Africa	19	9	112
South Africa	5	4	25
Middle East	39	19	110
Asia (except Japan)	221	324	280
China	55	93	78
NIE6*	119	187	117
Other	46	44	85

*Hong Kong, Korea, Malaysia, Singapore, Taiwan, Thailand
Source: WTO.

FDI in Europe. As with outflows, a comparison with the United States suggests that Europe has closer ties with MNEs from emerging markets. Table 5 shows the stock of inward investment from the most prominent emerging market economies for which data are available. Only Taiwanese and Venezuelan firms have invested more in the United States than in the European Union. Overall, these emerging market firms have invested four times as much in Europe as in the United States. Even for Mexico, which for reasons of proximity alone would be expected to invest more in the US market, the stock of FDI in Europe is 75% higher than in the United States.[3]

Table 5: Inward FDI stock in the US and EU by emerging-market investor (US$m, 2006)

	Host	
Source	US	EU
Argentina	419	2,463
Brazil	2,122	13,213
Chile	162	1,862
China	554	4,412
Hong Kong	3,524	20,548
India	2,002	4,013
Israel	4,308	6,465
Korea	8,609	10,374
Malaysia	432	2,826
Mexico	6,075	10,583
Russia	879	15,792
Singapore	2,412	46,230
South Africa	652	5,685
Taiwan	4,199	1,390
Turkey	220	12,417
Venezuela	7,246	3,331

Sources: Eurostat, Bureau of Economic Analysis.

Conclusion

At a macro level, bilateral flows of FDI between regions stimulate the exchange of technology, know-how and ideas, as well as serving as a conduit for trade and as a vehicle for increasing competition. In this way, FDI flows between Europe and emerging markets will enhance the level of integration between the two regions.

At the level of the firm, internationalization through FDI is increasingly seen as a way of enhancing a firm's competitiveness in the global market. A local presence in a foreign market often allows the investing firm to expand market share beyond what could have been achieved through trade alone. Many, if not most, MNEs sell far more abroad through their local affiliates than they export from the home country.

At a time when emerging markets are expected to represent an ever-larger share of global demand, the ties formed between European and emerging market firms could well translate into improved global competitiveness for both parties. The evidence presented above suggests that European firms have a head start over their American and Japanese rivals in this respect.

This finding is unlikely to be a mere statistical artefact. Discrepancies in data reporting, together with exchange rate movements (although most of the data pertain to 2005–06, before the period of greatest dollar weakness), may explain away part of the difference, but they are unlikely to alter any of the conclusions presented here. The differences between Europe and the United States and Japan are simply too great. They are also corroborated by employment figures, host country statistics and trade flows. The tendency of large firms in some emerging markets such as South Africa or Hong Kong to seek a primary listing in

3 Since emerging markets often do not systematically record FDI outflows by ultimate destination and many EU countries do not report inward FDI from each emerging market separately, it is difficult to verify the accuracy of the Eurostat figures in Table 5. Some EU inflows seem surprisingly high. A cross-check of other sources suggests that, although the difference between emerging market FDI in the EU and the US is not always as high as in Table 5, Europe is still most often the favoured located for such investment. As emerging-market firms become more active international direct investors, these reporting deficiencies will need to be addressed.

London may also inflate FDI outflows from Europe to these markets, but such flows do not stem from any one source country. A dozen European countries have invested over $100 billion abroad through FDI.

> ‘European firms are becoming genuinely diversified geographically’

Nor is this apparently high degree of geographical diversification of EU MNEs simply a result of aggregation whereby individual firms are not particularly diversified but appear to be when added together. Historical and linguistic ties still influence FDI flows, but EU FDI in Latin America is not just by Spanish firms nor in East Africa only by British firms, and so on. European firms are becoming genuinely diversified geographically.

The question remains whether European firms manage to translate this first-mover status into a lasting competitive advantage in emerging markets. Competition is fierce in these fast-growing markets, not just from other investors from OECD countries, but also from local firms with global ambitions of their own. A strong local presence in emerging markets will aid in the struggle for market share but does not guarantee success. At the very least, strong links with emerging markets through both trade and FDI will continue gradually to sever the link between the performance of EU MNEs and that of the relatively slow-growing European economy.

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