THE MULTINATIONALIZATION OF PRIVATIZED FIRMS *

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11.1 INTRODUCTION

The history of foreign direct investment (FDI), mostly made by firms, and consequently of the multinationalization process of companies, have been showing a certain gradual evolutionary character, not only from the point of view of sectors of activity but also from the geographical areas of destination and origin of such investments. These processes are related, among others, to the technological progress, to institutional changes and to cultural and institutional distances between host and origin countries of FDI. Broadly speaking the multinationalization of sectors has been taken place gradually: first natural resources and infrastructures, later manufacturing and commerce, following by business services (financial, accounting, advertising,...), construction and tourism, and finally the so-called public utilities (energy, telecommunications, water...). The developed countries were the main actors leading the process (not only from the point of view of outward direct investment but also from the inward perspective), specially the Triad countries (first, United States, following by Europe and later on Japan), and to a lesser extend the less developed countries (mostly the named emerging economies). Within this context we can situate the Investment Development Path (IDP) theory.

The existence of a systematic relationship between the degree of multinationalization of firms in an economy (as measured by inward and outward direct investment) and its degree of economic development allows for the establishment of an international investment development path (Dunning, 1993; Dunning and Narula, 1996). This investment development path (IDP) is made up of five stages: the first three cover less developed countries, while the final two comprise more advanced countries. The first group is a net recipient of direct investment; they all showed a negative net investment position (stock of outward investment less stock of inward investment). The type of investment received is associated with each country’s specific location factors, while the outward direct investment is related to the competitive advantages of firms and countries.
Typical entry sectors for direct investment in countries of the first three stages were natural resources, undifferentiated capital-intensive sectors and differentiated ones (Ozawa, 1996; Narula and Dunning, 1998); while in the 1990s public services and information technologies were also affected. Third-stage countries are those known as ‘emerging economies’, whose foreign direct investment levels are significant and sometimes attain consistent rates of growth that bring them closer to countries in the fourth stage of the international cycle of direct investment.

Fourth-stage countries are characterized, as from a given level of GDP per capita, by having produced exponential (intensive) rate of growth growth in the outflow of direct investment. Such countries behave heterogeneously as regards inflows of direct investment. Therefore, their net position (difference between outward and inward investment) may be either positive or negative (Durán and Úbeda, 2005). Finally, fifth-stage countries tend towards unstable situations close to zero. There is no statistically significant difference between inward of direct investment in fourth- and fifth-stage countries. Fourth-stage countries have lesser knowledge-intensive assets, and thus have a lower capability for issuing foreign investment (Narula, 1996; Durán and Úbeda, 2001).

The new Multinational firms of the nineties come mostly from the following sectors of activity: telecomunicaciones, electricity, gas, water, and to some extend insurance and banking. Those sectores were, from the geographical point of view under a somehow generalize process of privatizations.

In this chapter I shall address the potencial of privatizations for the multinationalization of firms. I shall also underlying the relation of privatized firms, acquired by foreing companies (FDI), to the level of development of countries according to the investment development path. Finaly I address the case of some Spanish multinational, coming from privatezed sectors and that their FDI in Latin América has been also made in privatized entitties, following their expansion and consolidation of their relevant position in that area throug
excercising real options through greenfields projects in the same sectors of activity.

11.2. THE PRIVATIZATION OF STATE OWNED FIRMS.

DETERMINANT FACTORS.

The privatization of public utilities may, prima facie, be viewed as an issue of ownership rather than one of control, because their operation is governed by a given system of rules (service quality and safety requirements). Control of public utilities may be exercised politically, either directly through State ownership or indirectly by regulation. Privatization and liberalization in a context of market competition may improve efficiency, while requiring effective regulation (Vickers and Yarrow, 1991). However, it may be that privatization is a necessary but not a sufficient condition of efficiency (Newbery, 1997), because the degree of efficiency is determined, more than by company ownership, by the extent and quality of market competition.

Public companies (owned by the State and managed and controlled by Government) are created for a wide variety of reasons: shortage of private capital in phases of autarky or relative closure to the outside; in order to set in place activities in aid of the private economy; to work out economic crises (at the large company or industry-wide scale); or for ideological or political reasons (expropriations and nationalizations).

It was formerly accepted that the State should own (or closely control) certain activities, in particular telecommunications and postal services, electricity and gas, air and rail carriers, industries relating to national defence, and steel1. Economies of scale and scope, externalities and entry barriers (e.g., political or legal impediments) may, it has been argued, make State ownership preferable to private (Vickers and Yarrow, 1991). In open, competitive economies, however, technological progress provides grounds for a contrary argument. Thus, the effects of regulation and ownership on the efficiency of an enterprise depend on whether or not the firm operates in a competitive sector (Vickers and Yarrow, 1991).
The ownership structure of a firm is important insofar as it influences its objectives, decision-making process and corporate governance. Privatization transfers ownership of corporations from the State to the private sector; this may change the structure of incentives and the nature of agency relationship.

In a public company, the principal (the Government) may give priority to aims other than making the largest possible profit, which is what a private firm must pursue over the long term in its shareholders’ interests. In the first and very often in the private owned firms, the agents involved are company executives. They may be replaced on privatization.

On a given system of incentives, it is accepted that in general terms a private company is more efficient than a State-owned company (Megginson and Setter, 2002), because it brings forth better operating and financial performance indicators (Dewenter and Malatesta, 2001; D’Souza and Megginson, 2000).

There is no financial market for State-owned companies that aids the alignment of executives’ interests with those of Government. Instead, control is in the hands of Government departments and, ultimately, of the national Parliament. The weight (and agents’ perception) of indebtedness, financial risk and financial solvency and the likelihood of going bankrupt are felt differently by public and private firms.

The international privatization process is associated in significant ways with countries’ deficit, with how developed (and liquid) domestic capital markets are, with Government ideology and with institutional development (Bortolotti et al, 2003). The high uptake capacity of highly developed, liquid financial markets makes it easier for privatization proceeds to match the total value of a privatized company, as there will be no need to discount stock, as tends to be norm in shallower, less liquid markets. Privatizations are fewer in less advanced democracies and less developed economies. A paper by Jones et al (1999) examines 137 privatizations in 34 countries that were underpriced with respect to their estimated value, and found that this move was associated with Government’s need to obtain domestic political support for its decisions.
The process of privatization in progress worldwide since the mid-1980s is to be viewed against a backdrop of economic liberalization (deregulation of markets and encouragement of competition). One of the distinctive features of the period is the privatization of enterprises operating in regulated sectors: telecommunications, air carriers, gas, water and electricity, postal services. The deregulation of other sectors such as banking and insurance has also fostered internationalization, especially through foreign direct investment. Therefore, taking a gradualist view, it can be said that one of the key features of the 1990s was the multinationalization of public utilities.

As a forerunner of the current privatization process, one could point to the decisions to “denationalize” in Germany in 1961 (Roger Noll, 2000) through sale of shares in State-owned companies (Volkswagen, among others) to small investors. Later came the Chilean privatizations of 1974-75 following the Pinochet coup d’état, as a reversal of the nationalizations of 1970-73 under President Allende. Another forerunner was the United Kingdom. With its privatizations of 1979 the procedure began to spread virtually worldwide. Currently, the process is present in over a hundred and twenty countries (Megginson and Netter, 2001; Mahboobi, 2000).

Some of the empirical evidence on the role of privatizations in business internationalization—on foreign direct investment, specifically—can be found in the data about sale of privatized companies to foreign investors in the annual UNCTAD report (2001) and, for Latin America, in CEPAL (2001)².
11.3. **EXPROPRIATIONS AND PRIVATIZATIONS. TWO SIDES OF THE SAME COIN**

Figure 11.1 shows the behaviour to date of expropriations, defined as take-over by the State of a foreign-owned subsidiary (foreign direct investment). The process was especially significant from the late 1960s to the early 1980s. Most expropriating countries were states created by decolonization. Selective expropriation affects one or more sectors chosen by Government, while mass expropriation affects the virtual entirety of foreign direct investment in the country\(^3\). Twenty eight less developed countries accounted for two thirds of total expropriations (Kobrin, 1984) and, as a whole, covered a wide range of sectors (see Table 11.1).

A further highlight is that, in Europe after the Second World War, a number of key companies were nationalized. Hence, the same sectors that were nationalized in 1940s in Europe to promote efficiency as from the 1980s began to be privatized theoretically in pursuit of that same goal.\(^4\) In both cases, most of the expropriated sectors became the target of foreign direct investment and privatizations in the 1990s: energy, telecommunications, banking and insurance, transport, etc.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Mass expropriation</th>
<th>Selective expropriation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Oil</td>
<td>49</td>
<td>129</td>
</tr>
<tr>
<td>• Ore and mineral extraction</td>
<td>39</td>
<td>53</td>
</tr>
<tr>
<td>• Energy</td>
<td>16</td>
<td>22</td>
</tr>
<tr>
<td>• Communications</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>• Transport</td>
<td>15</td>
<td>16</td>
</tr>
<tr>
<td>• Banking</td>
<td>260</td>
<td>27</td>
</tr>
<tr>
<td>• Insurance</td>
<td>71</td>
<td>17</td>
</tr>
<tr>
<td>• Trade</td>
<td>95</td>
<td>8</td>
</tr>
<tr>
<td>• Manufacturing</td>
<td>248</td>
<td>36</td>
</tr>
</tbody>
</table>

*Source: Adapted from Kennedy (1993)*
Figure 11.1 also shows increasing convergence among countries with laws favouring foreign direct investment. Convergence is reinforced by a wide range of agreements to avoid international double taxation and bilateral agreements for promotion and reciprocal protection of investments: 2316 and 2265, respectively, were signed up to 2003 (UNCTAD, 2004). Increasing numbers of less developed countries have set up independent competition agencies– such are now present in near hundred countries, almost 50% of all countries in existence. Likewise, in 2002, 154 countries have agencies for promotion of investment or equivalent bodies (UNCTAD, 2003, p. 29). In addition to this system – made up of national laws, bilateral treaties and regional and multilateral agreements – a particular highlight is that many countries now accept that disputes about foreign direct investment should be decided by international arbitration. Institutions operating in this field include the Arbitration Court of the International Chamber of Commerce and the International Centre for Settlement of Investment Disputes (ICSID) attached to the World Bank. The aim of this institution is to “provide a forum to settle disputes in a context that aims expressly to de-politicize investment disputes.” Today, about 130 countries are signatories to the ICSID convention. It can now be said that the salient risk faced by multinational firms is the risk of legislative changes or discriminatory application of the law based on a company’s sector or nationality.
Technological progress destroys the alleged ‘natural monopoly’ of certain businesses, transforms whole sectors and creates new areas of activity. Institutional change (deregulation of domestic markets, proliferation of bilateral, regional and multilateral agreements) and greater international interdependence are also arguments in favour of privatizing State-owned companies. Many privatized firms operate in sectors that have now become strategic and are, precisely, the driving force of internationalization; it is of note that some were formerly not of that nature at all. A further consideration is the impact on expectations (and on corporate morale) of the triumph of the de-centralized or market economy in the wake of the fall of the Berlin Wall and the subsequent dismantling of the Soviet Union. These events gave rise to processes of privatization in the so-called ‘transitional economies’. In addition, there has been a direct relationship between privatizations and the prime goals that
Governments have pursued to some extent or another: to improve the state of public finances, increase investment, achieve higher service quality, obtain a better economic balance with the outside world (improve foreign trade, attract foreign investment, etc.).

The key privatized sectors as from the late 1980s and, especially, in the 1990s, were also the fastest to become internationalized, basically through foreign direct investment and strategic alliances (joint ventures, cooperation and partnership agreements). Again, the following industries took the lead: telecommunications, electricity, gas, water, air carriers and banking. Other relevant fields were natural resources, oil and mining. These were the sectors that had mostly been nationalized in earlier phases, and subjected to tough restrictions and prohibitions on foreign ownership.

Privatizations are carried out in several different ways: private sale of shares (to domestic or foreign investors), public offering of shares (domestic and foreign markets), sale to employees and executives, and winding-up and subsequent sale of assets. The degree of transparency, independence and competitiveness of a privatization process tends to be associated with negotiation costs, the potential for corruption and, taken as a whole, efficiency.

In the period 1977-1999 there were 2459 privatizations in 121 countries for a total value of about $1100 billion (Megginson and Netter, 2001). Only rarely, however, did Government wholly transfer ownership and control of a public corporation. In that period (1977-1999), of a total 617 privatized companies studied (Bertolli et al, 2003), a shareholding majority was sold only 30% of the time, and this was never the case in 11 of the 76 privatizing countries under study. In some countries (Spain, Belgium, France, and others) where a majority of stock was privatized in public utilities regarded as strategic, Government held on to a “golden share”, carrying a right of veto in certain circumstances, although this “privilege” will disappear in the near future. The empirical evidence, therefore, shows that privatizations have mostly been partial or incomplete so as to let Government to hold on to some measure of direct or indirect power. Such power may take the form of influence on company
management appointments and on decisions about future transfers of ownership (e.g., to foreign investors).

From a financial standpoint it has been observed (Boutchkova and Megginson, 2000; Henry, 2000; Perotti and Van Oijen, 2000) that privatizations have increased market liquidity and the number of both minority and institutional shareholders in several countries. Privatized firms – mostly utilities (telecoms, electricity, water and gas) and oil companies – are among the largest and most highly valued in both developed and emerging economies. Moreover, thirty of the 34 largest public offerings of shares in history were privatizations (Buchkova and Megginson, 2000).

In countries of the civil law tradition (as opposed to common law countries) investor protection is less (while creditor protection is higher), and capital markets carry less weight than credit institutions (La Porta et al, 1997, 1998). This may explain why there have been fewer privatizations in civil law countries (Bertolli et al, 2001).

11.4 THE IMPACT OF PRIVATIZATIONS ON THE DEVELOPMENT OF FOREIGN DIRECT INVESTMENT

The cross-border acquisitions through privatizations in the period 1987-1999, has been of a great quantity showing strong acceleration in the second half of the 1990s. The distribution of the value of international acquisitions of privatized firms, by vendor country and divided into two sub-periods (1987-1995 and 1996-1999), is shown in Table 11.2 and 11.3. Thus, from 1987 to 1995 Australia and Sweden led the field, followed by Argentina and Peru, while from 1996 to 1999 the largest vendors of privatized firms to foreign investors were Brazil, Argentina, Australia and Germany. In fact, the weight of privatizations in the second sub-period determines the order of vendor countries for the entire period from 1987 to 1999. Spain placed as the 12th-largest vendor for the whole period, being 16th from 1987 to 1995 and 10th from 1996 to 1999.
Table 11.2 shows a calculation of the weight of the sale of privatized firms of Less Developed Countries (LDCs) to foreign investors within total foreign direct investment received by each country. In the period 1987-1990, privatizations accounted for slightly over 3.9% of FDI, while from 1991-1999 they accounted for 96%. On a classification by stages of investment development\(^5\) using year 2000 data (Durán and Úbeda, 2002), the more advanced countries sold to foreign investors 47.13% and 39.11% of the value of privatized firms acquired by EM in the periods 1987-90 and 1991-99, respectively (see table 11.3)

The impact of privatizations carried out by LDCs and acquired by foreign investors – which in the 1990s represented about 60% of the world total – on IDP development has been highly varied. Table 11.2 shows that countries moving from stage two to stage three account for over 42% of privatizations acquired by multinationals, chiefly based in developed countries. But some second-stage countries that entrained large privatization programmes (Venezuela, Peru, Colombia and Romania) remain at the same stage of development; privatization has not enabled them to advance to a further stage. In a considerable number of countries, moreover, privatizations make up over 40% of foreign direct investment, and occasionally account for almost all of it (83% in Bulgaria, for instance). In some cases, privatization helps explain progress in the IDP, moving from stage two to stage three (Argentina, Brazil, Poland, the Philippines, Hungary and the Czech Republic). In countries at stages one and two, however, although privatizations accounted for a high proportion of incoming foreign direct investment, this has not boosted growth sufficiently to move the economy ahead to a more advanced stage. For the developed countries according to the IDP theory we have reviewed at the beginning of the chapter the sale of private firms to foreign investors that not have influenced on their development stage. However it could have an effect on the development stage throughout the outward direct investment in privatized firms in foreign countries, as it is in the case of Spain.
Table 11.2 Value of privatizations of Less Developed Countries (LDCs) acquired by foreign investors, classified by country and IDP stage, 1987-1999.

<table>
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<tr>
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<tbody>
<tr>
<td></td>
<td>US$ billions</td>
<td>% of total</td>
<td>Privat./DI inflow</td>
</tr>
<tr>
<td>Stage 1</td>
<td>0</td>
<td>0.00%</td>
<td>3.4</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0</td>
<td>0.00%</td>
<td>1.1</td>
</tr>
<tr>
<td>El Salvador</td>
<td>0</td>
<td>0.00%</td>
<td>0.9</td>
</tr>
<tr>
<td>Stage 2</td>
<td>0.3</td>
<td>3.45%</td>
<td>20</td>
</tr>
<tr>
<td>Venezuela</td>
<td>0</td>
<td>0.00%</td>
<td>5.4</td>
</tr>
<tr>
<td>Peru</td>
<td>0</td>
<td>0.00%</td>
<td>5.2</td>
</tr>
<tr>
<td>Colombia</td>
<td>0.3</td>
<td>3.45%</td>
<td>3.3</td>
</tr>
<tr>
<td>Romania</td>
<td>0</td>
<td>0.00%</td>
<td>2.4</td>
</tr>
<tr>
<td>Bolivia</td>
<td>0</td>
<td>0.00%</td>
<td>1.7</td>
</tr>
<tr>
<td>Stage 2 to 3</td>
<td>2.8</td>
<td>32.18%</td>
<td>89.9</td>
</tr>
<tr>
<td>Brazil</td>
<td>0.1</td>
<td>1.15%</td>
<td>31.7</td>
</tr>
<tr>
<td>Argentina</td>
<td>0.6</td>
<td>6.90%</td>
<td>25.7</td>
</tr>
<tr>
<td>Poland</td>
<td>0</td>
<td>0.00%</td>
<td>7.5</td>
</tr>
<tr>
<td>Philippines</td>
<td>0</td>
<td>0.00%</td>
<td>5.2</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.2</td>
<td>2.30%</td>
<td>4.2</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.8</td>
<td>20.69%</td>
<td>2.8</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>0</td>
<td>0.00%</td>
<td>3.7</td>
</tr>
<tr>
<td>Russia</td>
<td>0</td>
<td>0.00%</td>
<td>2.3</td>
</tr>
<tr>
<td>Chile</td>
<td>0.1</td>
<td>1.15%</td>
<td>2.2</td>
</tr>
<tr>
<td>Thailand</td>
<td>0</td>
<td>0.00%</td>
<td>2.1</td>
</tr>
<tr>
<td>South Africa</td>
<td>0</td>
<td>0.00%</td>
<td>1.7</td>
</tr>
<tr>
<td>Unclassified</td>
<td>1</td>
<td>11.49%</td>
<td>11.6</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>0</td>
<td>0.00%</td>
<td>4.7</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>0</td>
<td>0.00%</td>
<td>1.9</td>
</tr>
<tr>
<td>TOTAL LDCs</td>
<td>4.1</td>
<td></td>
<td>83.3</td>
</tr>
<tr>
<td>TOTAL WORLD</td>
<td>8.2</td>
<td>100.00%</td>
<td>208.2</td>
</tr>
</tbody>
</table>

Source: Author’s calculation, based on the WIR (2000) and online UNCTAD database.
Table 11.3 Value of privatizations made by Developed Countries (DCr) and the IDP stages. 1987-1999.

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Spain</td>
<td>0.2</td>
<td>4.4</td>
<td>4.7</td>
</tr>
<tr>
<td>Stage 4</td>
<td>1.6</td>
<td>12.9</td>
<td>14.4</td>
</tr>
<tr>
<td>Italy</td>
<td>0.4</td>
<td>4.2</td>
<td>4.6</td>
</tr>
<tr>
<td>Austria</td>
<td>0.2</td>
<td>3.2</td>
<td>3.5</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1</td>
<td>1.6</td>
<td>2.7</td>
</tr>
<tr>
<td>Ireland</td>
<td>0</td>
<td>2.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Stage 5</td>
<td>2.3</td>
<td>66</td>
<td>68.3</td>
</tr>
<tr>
<td>Australia</td>
<td>0.4</td>
<td>24</td>
<td>24.3</td>
</tr>
<tr>
<td>Germany</td>
<td>0.6</td>
<td>8.4</td>
<td>9</td>
</tr>
<tr>
<td>Belgium</td>
<td>0.1</td>
<td>8.6</td>
<td>8.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>0</td>
<td>8.4</td>
<td>8.3</td>
</tr>
<tr>
<td>France</td>
<td>0.4</td>
<td>5.6</td>
<td>5.9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.2</td>
<td>4.3</td>
<td>4.5</td>
</tr>
<tr>
<td>Netherlands</td>
<td>0</td>
<td>4.4</td>
<td>4.3</td>
</tr>
<tr>
<td>Finland</td>
<td>0.1</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Canada</td>
<td>0.5</td>
<td>0.6</td>
<td>1.2</td>
</tr>
<tr>
<td>TOTAL DCs</td>
<td>4.1</td>
<td>124.9</td>
<td>129</td>
</tr>
<tr>
<td>WORLD TOTAL</td>
<td>8.2</td>
<td>208.2</td>
<td>216.4</td>
</tr>
</tbody>
</table>

Source: Author’s calculation, based on the WIR (2000) and online UNCTAD database.

11.5 THE STAGE FOUR OF THE INVESTMENT DEVELOPMENT PATH. THE CASE OF SPAIN.

As we have mentioned before fourth-stage countries are characterized, as for a given level of GDP per head, by having produced exponential (intensive) rate of growth in their outward direct investment. Their net investment position (stock of outward less stock of inward investment) may be either positive or negative (Durán and Úbeda, 2005). Based on those findings it is possible to graph the IDP behaviour of the average fourth stage country (see figure 11.3)

The Spain direct investment abroad during the period 1993-2003 summed up over 265 thousands of millions of euros of which about 38% were located in Latin American countries and 46% in the EU. The investment made in energy, water, telecommunications, transportation and financial services (banking an insurance) represented about 54% of the total. The direct investment in Latin
America in the privatized sectors, for the same period, was 57% of the total invested in the region and taken into account the finance sector the share were 80%. Overall the privatization in Latin America was the dominant form of investment in the sectors abovementioned (World Bank, 2004, UNCTAD, 2004).

During the ninetees the main Spanish multinationals coming from privatized and regulated sectors, that invested in the same sectors also were privatized, and they also continued their expansion in Latin America undertaken new investments, exercising growth options, to have majority or whole property of their subsidiries. They also undertook geenfield projects in new areas of activities (for example, mobile phones, new sources of energy, new forms to provide energy and integrating systems in the region).

**Figura 11.3 Economic growth, inward and outward stock of direct investment of the fourth stage countries of the IDP 1980-2000.**

* Countries of the fourth stage: Spain, Italy, Korea, Irland and Portugal.

ODI (t): Outward direct investment at t. IDI: Inward direct investment at t. GDP: GDP per capita

Equations

\[
\log(DDI.pci,t) = 3.80 + 0.926 \log(ODI.pci,t-1) + 0.0004(GDP.pci,t - GDP.pci,t-1) + \eta_i + \varepsilon_{it}
\]

\[
\log(IDI.pci,t) = 0.219 + 0.969 \log(EID.pci,t-1) + 0.00014(GDP.pci,t - GDP.pci,t-1) + \eta_i + \varepsilon_{it}
\]

Source: based on Durán and Úbeda (2005)
The degree of concentration of Spanish direct investment in Latin America, especially in Brazil, Argentina, Peru, Mexico, etc., confirms that this phenomenon has helped Spain to attain the fourth stage of the IDP, i.e., the process of privatization and of internationalization of privatized public utilities explains the improved level of economic development achieved by the Spanish economy. These enterprises have demonstrated ownership-related competitive advantages which have been transferred to Latin American countries offering location advantages (Durán, 1999), and showing efficiency and productivity in their performance. The Spanish multinationaly in telecommunications, oil, gas, electricity, as well as in banking are, in most of the countries of region, the leading foreign investors.

Privatization by a public offering of shares can be regarded as a transparent and competitive process, because it enables the market to assess the value of the company. This method is also appropriate for privatizing large corporations that require some restructuring after privatization. However, the procedure may not be suitable for underdeveloped financial markets. This drawback may be partly made up for if a tranche of shares or equivalent securities (e.g., share depositary receipts) is allocated to liquid, efficient foreign markets able to provide a market value. Subscription of these securities lends credibility to the process. But obviously not all privatized companies are able to internationalize their shareholder make-up in this way.

11.6 EMPIRICAL OBSERVATIONS ON THE CASE OF SPAIN. Telefónica, Repsol-YPF, Endesa

Some State-owned firms have become multinationals, i.e., they own subsidiaries in other countries and have thus made foreign direct investments over a period prior to the spread of the privatization phenomenon. A relevant point here is that national laws may require that any company owned by a foreign State wishing to make a direct investment in the country must be granted prior express authority; the requirements may be either of a general nature or in respect of certain investment amounts or target sectors. Private
enterprises, being free from the political implications of State ownership, may therefore enjoy wider options and lower entry costs in foreign markets.

For the period 1988-1992 (Treviño, Daniels, Arbelaez and Upadhyaya, 2002) it has been concluded that liberalization of capital markets and privatizations in Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela) are closely associated with the entry of direct investment into the region. Privatizations may be viewed not only as an option for FDI but also as a signal of improvement of the environment in which businesses operate. In less developed countries, over two thirds of privatizations are sold to foreign investors (Megginson, 1999).

Spain is one of the main investors in Latin America, being the largest or second-largest foreign investor in most countries of the region. This has been the case since the late 1980s. The main multinationals in Latin America are the typical utilities and oil companies (mostly privatized) and financial services (banking and insurance) concerns, along with hotels, manufacturing industries and others. These businesses largely generated their competitive advantages in the 1980s, particularly through accession to the European Economic Community, and perceived the location advantages available in Latin America; this was demonstrated in the 1990s with the establishment of a new model of outward expansion. The Latin American option was a reserve of strategic value for Spanish business (Durán, 1999). It may even be said that privatized companies were able to finance the creation of competitive advantages through monopolistic turnover garnered in a sheltered domestic market.

Spanish privatized public utilities (at various stages of development) made direct investments in Latin American utilities that had likewise been privatized. Spanish direct investment also targeted privatized firms in other fields of business in Latin America and elsewhere (such as Morocco), sometimes through programmes of conversion of debt into equity.

Table 11.4 lists the Spanish companies that took part in some of the 50 largest privatizations acquired by foreign investors in the period 1987-1999. They are Telefónica, Repsol-YPF and Endesa, which have been involved in nine of the largest privatizations of the period. Another nine privatizations took
place in Latin America; seven were acquired by US companies, one by an Italian firm and another by a Portuguese firm. In addition, twenty-one of the 50 companies were privatized in developed countries, while six were privatized in transitional economies.

Table 11.4: Participation by Spanish companies in the 50 largest* privatizations acquired by foreign firms. 1987-1999

<table>
<thead>
<tr>
<th>Position</th>
<th>Privatized firms</th>
<th>Year</th>
<th>Value of the acquisition (US$ billions)</th>
<th>Country</th>
<th>Purchasing company</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>YPF, S.A.</td>
<td>1999</td>
<td>13.2</td>
<td>Argentina</td>
<td>Repsol, S.A.</td>
</tr>
<tr>
<td>3</td>
<td>TELESP (Telebras)</td>
<td>1998</td>
<td>5.0</td>
<td>Brazil</td>
<td>Telefónica*</td>
</tr>
<tr>
<td>13</td>
<td>YPF, S.A.</td>
<td>1999</td>
<td>2.0</td>
<td>Argentina</td>
<td>Repsol, S.A.</td>
</tr>
<tr>
<td>15</td>
<td>Entel Perú, S.A.</td>
<td>1994</td>
<td>2.0</td>
<td>Peru</td>
<td>Telefónica*</td>
</tr>
<tr>
<td>27</td>
<td>Cia. De Electricidade do Estado</td>
<td>1997</td>
<td>1.6</td>
<td>Brazil</td>
<td>Endesa</td>
</tr>
<tr>
<td>38</td>
<td>Codensa</td>
<td>1997</td>
<td>1.2</td>
<td>Colombia</td>
<td>Grupo Inversor</td>
</tr>
<tr>
<td>41</td>
<td>Telesudeste Celular (Telebras)</td>
<td>1998</td>
<td>1.2</td>
<td>Brazil</td>
<td>Telefónica*</td>
</tr>
<tr>
<td>49</td>
<td>Cia Riograndense de Telecomin.</td>
<td>1998</td>
<td>1.0</td>
<td>Brazil</td>
<td>Telefónica*</td>
</tr>
</tbody>
</table>

(*) Jointly with other multinationals

Source: Adapted from UNCTAD (2001. p.134)

Table 11.5 shows the privatizations and auctions in Latin America for a value in excess of US$100 million in which Spanish firms took part in the period 1999-2000. Besides the sectors pointed out above, others appear in which Spanish private firms took up positions – Dragados, Aguas de Barcelona and BSCH in construction, water and banking – and Spanish companies that were also privatized (the former Tabacalera, now a part of Altadis).

Table 11.6 shows purchases of the private portion of Latin American companies, mostly already subsidiaries of Spanish multinationals, also for the period 1999-2000. These Spanish firms were among the 100 largest multinationals present in Latin America, according to consolidated turnover figures. By way of example, Telefónica since 1998 and Repsol-YPF and Endesa since 1999 are on the list of the hundred largest multinationals by assets overseas according to the UNCTAD transnationality index. Similarly,
Telefónica and BBVA (Argentaria privatization) are among the 25 privatized companies of the highest market value, according to data from Morgan Stanley Capital International published by Business Week in 2001 (“The Business Week Global 1000”), and Endesa was among the 35 largest international public offerings of shares of the period 1987-2000.

The privatization of telecommunications has been a variegated process in Latin America, at either extreme of which one might place Argentina and Brazil. Thus, in 1989 Argentina privatized in favour of two consortia, one led by Telefónica and another by France Telecom. Over the following decade the firms made large investments, enabling the sector to grow strongly. The absence of competition, however, made prices remain relatively high and allowed for large profits, and the consortia retained dominant positions. Brazil, on the other hand, following a longer, more slowly matured process as from 1995, finally entrained privatization in 1998, opting for a universalization of services through competition: six segments were created in which several companies were to compete within an appropriate regulatory framework (CEPAL 2001, pp. 208-210).

Throughout this entire period Telefónica has gradually penetrated Latin America and exercised a range of real options. It has also been affected by the tech bubble (and stock-exchange bubble), which has caused a process of debt reduction (as in other sectors) and a change of strategy in the rest of the world (divestments in Europe) and consolidation of its presence in Latin America. Alongside all which Telefónica has opted for concentric and international diversification and multinationalization of its financial structure. In parallel, Repsol-YPF and Endesa are present in virtually all Latin American countries, contributing strategically to greater energy integration in the region.
Table 11.5: Privatizations and auctions in Latin America and the Caribbean for a value of over 100 million US$ with involvement of Spanish investors 1999-2000.

<table>
<thead>
<tr>
<th>SPANISH FIRM</th>
<th>PRIVATIZED FIRM</th>
<th>COUNTRY</th>
<th>PERCENTAGE OF CAPITAL</th>
<th>YEAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repsol-YPF</td>
<td>YPF</td>
<td>Argentina</td>
<td>15%</td>
<td>1999</td>
</tr>
<tr>
<td>Repsol-YPF</td>
<td>“First Round of Bloques Petroleros”(*)</td>
<td>Brazil</td>
<td>---</td>
<td>1999</td>
</tr>
<tr>
<td>Aguas de Barcelona (Agbar)</td>
<td>Empresa Metropolitana de Obras Sanitarias (EMOS)</td>
<td>Chile</td>
<td>25.6</td>
<td>1999</td>
</tr>
<tr>
<td>RENFE and Ferrocarriles de la Generalitat de Cataluña</td>
<td>“Operación de dos sistemas de red ferroviaria”</td>
<td>Colombia</td>
<td>---</td>
<td>2000</td>
</tr>
<tr>
<td>Grupo Dragados</td>
<td>Second urban concession: Sistema Norte-Sur(*)</td>
<td>Chile</td>
<td>---</td>
<td>2000</td>
</tr>
<tr>
<td>Iberdrola, S.A.</td>
<td>Compañía Energética de Pernambuco(CELPE)</td>
<td>Brazil</td>
<td>79.6</td>
<td>2000</td>
</tr>
<tr>
<td>Gas Natural SRG</td>
<td>Gas distribution south of São Paulo</td>
<td>Brazil</td>
<td>---</td>
<td>2000</td>
</tr>
<tr>
<td>Unión FENOSA Desarrollo y Acción Exterior</td>
<td>Electricity distribution firms, North and South</td>
<td>Dominican Republic</td>
<td>21.2</td>
<td>1999</td>
</tr>
<tr>
<td>Unión FENOSA Desarrollo y Acción Exterior (Uface)</td>
<td>Instituto Nacional de Guatemala</td>
<td>Guatemala</td>
<td>80.0</td>
<td>1999</td>
</tr>
<tr>
<td>Telefónica</td>
<td>Band B to operate PCs in Greater Buenos Aires(*)</td>
<td>Argentina</td>
<td>---</td>
<td>1999</td>
</tr>
<tr>
<td>Telefónica</td>
<td>Band A of PCs in Greater Buenos Aires PCs overseas (*)</td>
<td>Argentina</td>
<td>---</td>
<td>1999</td>
</tr>
<tr>
<td>BSCH</td>
<td>Banca de Estado de São Paulo (BANESPA)</td>
<td>Brazil</td>
<td>33.0</td>
<td>2000</td>
</tr>
<tr>
<td>Altadis</td>
<td>Arisco Industria Ltda. Habanos</td>
<td>Cuba</td>
<td>50.0</td>
<td>1999</td>
</tr>
</tbody>
</table>

Source: Adapted from CEPAL(2001), pp. 72-74.
Table 11.6: Purchase of private firms worth over US$ 100 million by privatized Spanish corporations (1999-2000)

<table>
<thead>
<tr>
<th>SPANISH FIRM</th>
<th>ACQUIRED FIRM</th>
<th>COUNTRY</th>
<th>PERCENTAGE ACQUIRED</th>
<th>DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENDESA</td>
<td>Smart Com PCs (Exchilesat Telefonia Personal)</td>
<td>Chile</td>
<td>100.0</td>
<td>2000</td>
</tr>
<tr>
<td>Repsol-YPF</td>
<td>YPF</td>
<td>Argentina</td>
<td>83.2</td>
<td>1999</td>
</tr>
<tr>
<td>ALTADIS</td>
<td>Arisco Industrial Ltda. Habano</td>
<td>Cuba</td>
<td>50.0</td>
<td>1999</td>
</tr>
<tr>
<td>Telefónica de España, S.A.</td>
<td>Atlántida Comunicaciones, S.A. (ATCO)</td>
<td>Argentina</td>
<td>100.0</td>
<td>2000</td>
</tr>
<tr>
<td>Telefónica de España, S.A.</td>
<td>Telefónica do Brasil (ex Telesp, S.A.)</td>
<td>Brazil</td>
<td>62.7</td>
<td>2000</td>
</tr>
<tr>
<td>Telefónica de España, S.A.</td>
<td>Telefónica de Argentina (TASA)</td>
<td>Argentina</td>
<td>44.2</td>
<td>2000</td>
</tr>
<tr>
<td>Telefónica de España, S.A.</td>
<td>Telefónica de Perú (ex Entel Perú)</td>
<td>Peru</td>
<td>56.7</td>
<td>2000</td>
</tr>
<tr>
<td>Telefónica de España, S.A.</td>
<td>TeleSudeste Celulares</td>
<td>Brazil</td>
<td>73.4</td>
<td>2000</td>
</tr>
<tr>
<td>Endesa España</td>
<td>Enersis, S.A.</td>
<td>Chile</td>
<td>32.0</td>
<td>1999</td>
</tr>
<tr>
<td>Endesa España</td>
<td>Companhia de Electriade do Rio de Janeiro (CERO)</td>
<td>Brazil</td>
<td>25.0</td>
<td>2000</td>
</tr>
<tr>
<td>Repsol-YPF</td>
<td>Grupo Lipigas</td>
<td>Chile</td>
<td>45.0</td>
<td>2000</td>
</tr>
</tbody>
</table>

Source: Adapted from ICEPAL (2001), pp. 76-81.

The ownership structure of a company obviously changes on privatisation, by definition. But the nature of this structural change may vary significantly in accordance with the stratification of the new ownership (atomized shareholder structure, institutional investors, controlling shareholders, listing of shares on efficient or inefficient markets, etc.). In this regard, the presence or absence of foreign shareholders (institutional and small investors) is a key consequence of the privatization process. Hence privatizations and their articulation with a company’s multinationality (privatized companies making direct investments in other privatized companies in host countries) may influence financial structure, which may also be affected by institutional and sectoral factors.

We shall not examine here the financial internationalization of Spanish multinationals, which have undergone a privatized process in two directions; but, as an illustration of the multinationalization and internationalization of the sources of capital of these companies we shall set out a number of estimates regarding Repsol-YPF, Endesa and Telefónica. Table 11.7 and estimated data as at early 2003 show that the foreign shareholders of Endesa and Telefónica hold over 50% of capital; further, foreigners hold 44.5% of Repsol-YPF.
Holdings of foreign institutional investors are significant. Similarly, in Repsol-YPF stable holdings account for about 32%, with 68% thus being “floating” capital. Telefónica was first listed on the New York Stock Exchange in 1987, almost at the same time as its first round of privatization. It currently lists on the London, Tokyo, Paris, Frankfurt, Sao Paulo, Lima and Buenos Aires exchanges. Repsol-YPF lists on the Madrid, New York and Buenos Aires markets. Endesa is present on the Madrid, New York and Santiago de Chile markets.

Table 11.7: Shareholder structure and debt currency of Repsol-YPF, Endesa and Telefónica: percentages (2003)

<table>
<thead>
<tr>
<th></th>
<th>REPSOL-YPF</th>
<th>Endesa</th>
<th>Telefónica</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Spanish shareholders</strong></td>
<td>54,5</td>
<td>48</td>
<td>&lt;50%</td>
</tr>
<tr>
<td>Individual</td>
<td>27,2</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Institutional</td>
<td>27,3</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td><strong>Foreign shareholders</strong></td>
<td>44,5</td>
<td>52</td>
<td>&gt;50%</td>
</tr>
<tr>
<td>United States</td>
<td>20,1</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>Rest of the world (chiefly Europe)</td>
<td>24,4</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td><strong>DEBT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currencies</td>
<td>50</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Euros</td>
<td>50</td>
<td>65</td>
<td>65</td>
</tr>
<tr>
<td><strong>Main Shareholders</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| La Caixa* (12,5%); BBVA* (5,10%); Chase Nominees (9,35%); Pemex (5,00%); Fidelity (1,90%) | | Caja Madrid* (5,00%); La Caixa* (5,00%); Chase Nominees (5,70%); Grupo de Cajas* (5,00%); SEPI (State holding) (2,95%) | BBVA* (6,09%); La Caixa* (5,38%); Chase Maniatan (9,91%)

*Spanish banks

Source: Author’s calculations based on data released by the companies

As regards these companies’ debt, there is a measure of currency diversification. The US dollar predominates, supplemented by the currencies of the countries in which the firms’ main direct investments are located. The firms use currency swaps (e.g., euro for dollar), among other instruments, to restructure their debt and hedge their foreign exchange risk.

In the table 11.7 we can observe the main shareholders of these three companies, of which most of them are banks. So we can say that the evolutionary process the multinationalization of these firms took place first in their real economy and after in their financial structure (debt and equity),
becoming a truly multinational firm under both types of capital (economic and financial).

Currently, many multinationals, given the internationalization of their financial structure, have become important channels for international savings. Decision-making power in these companies, however, associated with organizational efficiency and suitable allocation of resources, is based at head offices (locations) of a specific nationality.

11.7 INTERNATIONAL PRIVATIZATIONS AND MICRO COUNTRY RISK

Country risk may take the form of events (expropriations, strikes, etc.) or stem from ongoing processes (effects of a given economic policy, currency devaluation, etc.). Country risk can operate at the macro level, affecting foreign investors as a whole, or at the micro level, being influenced by even by individual companies. Generally, the commonest instances of country systematic risk are administrative action, Government intervention, legal uncertainty, etc.

Popular sensibilities and nationalist sentiment are more marked with regard to public utilities than in connexion with other sectors penetrated by foreign capital such as, for instance, automobile parts manufacturing or fornyture. Cases in point range from the demonstrations in Peru against privatization of power plants in favour of Belgian companies, to tariff- and rate-freezing for telecommunications, water, gas and electricity companies in Argentina. Therefore, nationalist sentiment, laws, their duration over time (frequency of change), the extent to which they are enforced, how they are interpreted by the judiciary, corruption and, in general, the quality of public institutions are key factors of country risk that inform a firm’s decision-making.

Political (and thus social) acceptance of and support for privatizations in a competitive, transparent and independent context facilitate efficient allocation of resources. This is especially necessary for the sale to foreign investors of large corporations and companies in sensitive sectors of the economy. If the privatizations process is accepted by public opinion, therefore, the multinational acquiring a local privatized firm will find it easier to manage micro country risk.
Country risk may also be exacerbated by the creation of private monopolies as a result of privatizations (structural risk, as it is named by UNCTAD, 2004:13a), due to the appearance of corruption that surrounds such a development, increased prices and tariffs, inadequately explained staff lay-off processes, etc. Likewise, difficulties in the supply of public services that are *prima facie* beyond the control of a foreign-owned privatized company may be used in an election campaign as a cudgel with which to beat the Government and its privatizations policy, thus bringing about a negative reaction of public opinion against the company in question. A Government might also blame previous incumbents for supposedly tolerating opportunistic behaviour by foreign firms providing public services, without proper reference to the quality and productivity of those services. But consistent, ongoing privatization programmes may remove uncertainty about a country’s political commitment to market-orientated policy in a context of respect for the right to property. Successful privatization programmes have not only favoured the growth of securities markets in general and of emerging economies in particular (Bourchkova and Megginson, 2000), but also reduce public deficit and have a beneficial indirect effect on the macro political risk perceived by investors by improving credibility and credit ratings (Perotti and Van Oijen, 2001). In any event, country risk management is a key consideration for a company. Micro country risk should be managed, as far as possible, in cooperation with Government, thus enhancing the company’s “relational capital”.

As at late 2003, there were 64 cases (8 of which were Spanish) pending decision by the International Centre for Settlement of Investment Disputes (ICSID), of the World Bank group; 37 related to Latin America (Argentina was concerned with 25 of those cases, 6 of which involved Spanish companies), 13 to Africa and 16 to transitional economies. The vast majority of cases pending arbitral award concerned electricity, water, gas, oil (30) and construction (7), followed by financial services (4) and mining (3).
11.8 CONCLUSIONS

The wave of privatizations worldwide, increasing in the 1990s and very especially in the second half of the decade, has come about in a context of liberalization and opening-out of national economies. Recognition of the importance of foreign direct investment for economic growth and development has significantly reduced the likelihood of expropriation.

The privatization process in connexion with the sale of domestic corporations to foreign investors has varied widely in different countries. Less developed countries account for a majority of sales of privatized companies to multinational firms. Some countries have facilitated their economic development by following the direct investment path. Privatization of public utilities in less developed countries requires a special emphasis on managing micro country risk.

In the late 1980s, and in the 1990s especially, Spain privatized the main public operators in telecommunications, electricity, fuels, gas, air transport and banking. These companies enjoyed competitive advantages and high availability of funds to finance their international expansion. They opted strategically for direct investment in Latin America, to a large extent by acquiring companies that had themselves been privatized. In addition to geographic diversification in other areas (chiefly Europe through strategic alliances and, to a lesser extent, through direct investment), these firms have internationalised their borrowings and multinationalized their shareholders structure, and are now international channels for savings from various domestic financial systems.
REFERENCES


ENDNOTES

1 Many companies have come under Government ownership for ideological reasons through expropriation from the private sector or through creation from scratch. They have also been used as instruments of industrial development or to face social (employment) and economic difficulties. On occasion large interest groups owning distressed businesses have exerted pressure to have ownership transferred to the public sector.


3 Figure is based on the available data (Stephen Kobrin, 1984; Charles Kennedy, 1992; UNCTAD, 1993, 1998, 2003).

4 An important expropriation was that of the Mexican oilfields in 1938. Also significant were the nationalizations and expropriations of the former Soviet Union and its satellites.

5 The variables used to classify countries by their stage of development were: inward and outward direct investment per capita (stock terms), GDP per head, Gross Capital Formation, agricultural population, human capital (secondary and University education, number of scientists), health expenditures, number of patents, R&D/GDP, exports of raw materials, market size, growth of high technology goods, percentage of exports of high technology goods over total exports (Durán y Úbeda, 2002).

6 The US company ITT operated telecommunications in several European countries (Germany, Spain, Eastern European countries) and was expropriated in the 1940s. Repsol was created in the 1980s on the basis of the State oil monopoly. Endesa was also State-owned, although in general the Spanish electricity industry, unlike the rest of Europe, was not expropriated, albeit heavily regulated.

7 Comparable situations came about in the Spanish banking industry (Durán, 2002).