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Résumé de l'article

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Spanish Foreign Direct Investments in Latin America: Internationalization Strategies and Financial Management Practices

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This study analyzes the internationalization strategies and the financial management practices of seven Spanish companies with the largest volume of investments in Latin America. The companies selected for an in-depth analysis represent approximately 80 percent of the total Spanish foreign investments during the period of analysis. Their investments have taken place mainly in service sectors such as banking, energy, and telecommunications. The study identifies the market conditions and the corporate strategies that have allowed these Spanish companies to successfully initiate and expand business activities into Latin America. The findings suggest Spanish investors have strengthened their global competitiveness and have accomplished greater financial results.

1. Introduction

This study presents a comprehensive analysis of the corporate internationalization strategies and financial management practices implemented by seven Spanish companies to initiate and expand operations into Latin America. Such practices include strategies for domestic or international financing, international capital budgeting and risk management for exposures such as foreign exchange risk, credit risk, institutional and country risks. All companies analyzed in this study had limited international experience before engaging in foreign direct investments (FDIs) in Latin America. Therefore, this study provides insights on the formation of Spanish multinational enterprises (MNEs).

Previous studies of corporate internationalization strategies suggest that the analysis of success factors should be centered on the capacity of companies to exploit their knowledge and capabilities in new markets more than on factors such as their operational cost and/or efficiency (Dunning, 1977; Johansson and Vahlme, 1977; Caves, 1982, 1985; and Madhock, 1998). In fact, when companies expand into international markets they strategically use their knowledge and capabilities in the development of those new markets. The understanding of successful internationalization strategies is of interest to researchers and corporate executives alike.

This study begins by analyzing the universe of Spanish foreign direct investments into Latin America. We utilize Spanish investors' records obtained from Standard & Poor's Research Insight. Subsequently, to analyze corporate internationalization strategies and financial management practices we collect primary data through personal interviews with financial executives of the Spanish companies with the largest volume of foreign direct investments in Latin America. In effect, seven Spanish companies were selected for an in-depth analysis. These companies represent approximately 80 percent of the total Spanish foreign investments during the period of analysis.

This study identifies the antecedents and factors that explain the internationalization of premier Spanish companies in Latin America. Evaluating the competitive advantages, risk factors, and management practices associated with such Spanish investments in Latin America, the study analyzes the seven Spanish companies' strategies associated with corporate decision-making in areas such as financing and investment.

The results suggest that the selected Spanish companies with foreign direct investments in Latin America have been successful. The survey respondents indicate that their investments have strengthened their global competitiveness and have generated the expected financial results. Nevertheless, as the 1999 crisis in Argentina occurred, it became evident that economic volatility, political instability, institutional fragility and consequently, a high level of uncertainty within these emerging economies, have conditioned the investment strategies forcing the Spanish companies under study to periodically adjust their financial practices (Cardoza et al., 2007; Fornés and Cardoza, 2008).

The following sections of this study present a theoretical background regarding the internationalization of corporations, a synthesis of economic development and foreign direct investment in Latin America, a description of the research methodology, a discussion of results and finally some concluding remarks.

2. Theoretical Framework for the Internationalization of Corporations

In his seminal work on internationalization, Hymer (1960) defines, for the first time, the term of Foreign Direct Investment (FDI) as the financial operation that does not entail the change of the proprietor of the transferred goods and that goes accompanied with technology flows and know-how. This author introduces in addition the concepts of ownership advantages and internalization that later are retaken in the internationalization theories (Dunning, 1992). Particularly, the theory of internalization proposes that companies internalize value-generating operations beyond their country borders based on the strategic advantages anticipated for their growth (Buckley and Casson, 1976; Helpman, 1984). These processes are materialized through the FDI and they contribute to the creation of value for the company if the benefits of using its intangible assets in a foreign market are greater than the costs of opening, coordinating and operating a branch (Mork and Yeung,

1992; Dunning, 1992).

Another theoretical framework used to explain internationalization processes, particularly in the selection of the entry mode to a new market, is the transaction cost1 theory (Coase, 1937; Williamson, 1985). According to this theory, the decision to enter into a foreign market entails acquisition costs, costs of the necessary information and resources as well as the costs of managing uncertainty and distrust. On the other hand, the resource-based view of the firm (Wernerfelt, 1984; Barney, 1991) approaches the relationship between the tangible and intangible2 resources, the strategy and the company results. This theory has been used in the internationalization studies (Buckley and Casson, 1976; Dunning, 1988, 1993) which suggests that building competitive advantages depends mainly on getting or developing high-value-added resources that are difficult to imitate. The acquisition of these resources can be achieved through international alliances, mergers and acquisitions, or by FDIs.

Nevertheless, agency theory suggests that the lack of trust between parties explains the determination of contracts in internationalization processes through strategies such as alliances, acquisitions, or mergers (Bergen, Dutta, and Walker, 1992). The lack of confidence and the uncertainty present in all internationalization processes are derived from the fact that the parties involved in an international transaction are primarily motivated by their own interests and are ready to assume different risks.

The eclectic theory provides another conceptual development for internationalization processes. In particular, this theory as proposed by Dunning (1988) focuses on the selection of mode of entry into a new market. This theory merges the approaches proposed in the theories of resources and capacities, internalization, and transaction costs and suggests that the success of internationalization depends on creating and taking advantage of ownership, location and internalization3.

Finally, the Uppsala model (Johanson and Vahlme, 1977, 1990) suggests that due to the risks associated with internationalization processes, corporate executives have the tendency to focus their internationalization efforts initially in "psychologically" closer markets. They may be more comfortable because they better understand the culture, or simply because they have greater knowledge and experience in these markets.

3. Economic Development and Foreign Direct Investments (FDIs) in Latin America

Latin American countries have sought external savings to finance their industrialization process, which allows them to obtain greater levels of economic development. In fact, the low level of local savings in Latin American countries represents one of the major obstacles for economic development in the region. The problem is circular: the savings can only be increased through a greater level of productive activity, a condition that itself requires an adequate amount of

available savings in local markets. An adequate level of savings is a necessary and determining condition to achieve economic development (Edwards, 1995).

In general, external savings can be obtained by foreign investment and external debt. The foreign investment can be classified as foreign portfolio investment (which seeks a financial return through investments in financial assets) and as foreign direct investment (which seeks a financial return through investments in real assets). External debt has traditionally been the strategy to access external savings in Latin America. External debt has been obtained through international private banks, foreign governments, and multilateral organizations. Nevertheless, FDI has also been an important source of external savings in Latin America. In the 1990s, foreign direct investment became the most important source of external financing in Latin America (see Grosse, 1997; World Investment Report, 2005).

Table 1 shows the inflows of foreign direct investment (FDI) into Latin America in 1990 and from 2000 to 2007. The most significant change can be observed between years 1990 and 2000 when the FDI inflows grew from approximately $10 billion to $95 billion. This change reflects a growth superior to 900 percent during the decade of the 1990s and represents the period during which Spanish companies made most of their initial investments into Latin America. Unfortunately, that tendency changed its course in 2002 when such inflows diminished significantly. This change may be partially explained by the completion of the privatization process in the region and a worldwide economic recession. The FDI flows recovered in 2004 when they reached a value of $100 billion and have for the most part continued expanding ever since.

Table 1: Inflows of Foreign Direct Investments Toward Latin America (Million Dollars)

Country	1990	%	2000	%	2001	%	2002	%	2003	%	2004	%	2005	%	2006	%	2007	%
Argentina	1,836	19	11,657	12	3,206	4	1,003	2	1,652	4	4,274	4	4,662	6	5037	5	5720	5
Bolivia	67	1	723	1	660	1	553	1	197	0	65	0	-277	0	281	0.3	204	0
Brazil	989	10	32,779	34	22,457	27	16,566	30	10,144	22	18,146	18	15,066	20	18822	20	34585	27
Chile	661	7	3,639	4	4,477	5	1,603	3	4,307	9	7,173	7	6,667	9	7358	8	14457	11
Colombia	500	5	2,237	2	2,521	3	2,034	4	1,758	4	3,117	3	10,192	13	6464	7	9028	7
Ecuador	126	1	720	1	1,330	2	1,275	2	1,555	3	1,160	1	1,913	3	271	0	178	0
Paraguay	71	1	104	0	95	0	-22	0	21	0	41	0	219	0	170	0	190	0
Peru	41	0	681	1	1,151	1	1,462	3	1335	3	1,559	2	2,579	3	3467	4	5343	4
Uruguay	42	0	274	0	318	0	85	0	416	1	332	0	600	1	1399	2	879	1
Venezuela	451	5	4,465	5	3,448	4	1,318	2	2,659	6	1,518	2	2,957	4	-590	-0.6	646	1
Costa Rica	162	2	409	0	409	0	642	1	575	1	617	1	653	1	1469	2	1896	2
Dominican Rep.	133	1	953	1	953	1	961	2	613	1	758	1	899	1	1459	2	16981	13
El Salvador	2	0	173	0	173	0	208	0	142	0	376	0	518	1	219	0	1526	1
Guatemala	59	1	230	0	230	0	110	0	131	0	155	0	208	0	592	1	724	1
Honduras	44	0	282	0	282	0	143	0	247	1	325	0	272	0	674	1	816	1
Jamaica	175	2	468	0	614	1	479	1	721	2	602	1	601	1	882	1	779	1
Mexico	2,633	27	15,484	16	25,334	30	13,627	24	14,184	31	18,674	19	18,055	24	19291	21	24685	20
Nicaragua	1	0	267	0	150	0	174	0	201	0	250	0	241	0	287	0	355	0
Panama	136	1	603	1	513	1	57	0	771	2	1,012	1	677	1	2574	3	1825	1
Others	1,458	15	19,211	20	15,404	18	13,741	25	4,508	10	40,352	40	9,710	13	22819	25	5449	4
Latin America	9,586	100	95,358	100	83,725	100	56,019	100	46,137	100	100,506	100	76,412	100	92945	100	126266	100
World	207,878	100	1,396,539	100	823,825	100	716,128	100	557,869	100	648,146	100	958697	100	1411048	100	1833324	100

Source: World Investment Reports 2003, 2006, and 2008

In 2007, FDI inflows reached an outstanding all-time high of $126 billion. Brazil and Mexico became the countries with the greatest levels of foreign direct investment in Latin America. These countries have been benefiting by receiving approximately 50 percent of the total FDI flows into the region during the 1990s and from 2000 to 2007. Argentina and Chile nearly tie for the third and fourth place with approximately 5 to 10 percent of the total FDI in the region.

4. Research Methodology

The information on these Spanish companies was obtained from *Standard & Poor's Research Insight*, which includes approximately 200 companies with investments throughout the region. Subsequently, after a preliminary analysis of the investment values, the study was focused on the Spanish companies with the largest investment values in the region. As a result, seven Spanish companies were selected and included in the study. These companies are headquartered in Madrid, Spain and the value of their investments represents approximately 80 percent of the total value of investments of Spanish companies in Latin America. The use of a convenient sample does not allow us to make the results of this study generalizable; however, it let us perform an in-depth study of the internationalization processes of the most successful recently-formed Spanish multinational enterprises (MNEs). Indeed, this focused approach allowed us to identify the best corporate practices and internationalization patterns. As a result, this study provides some lessons useful for policy and business decision making in regards to the design and implementation of successful corporate internationalization strategies.

Table 2 lists the Spanish companies selected for analysis in this study. These companies belong to energy, banking, insurance and telecommunications sectors and provide respective services.

Table 2: Sample of Spanish Foreign Direct Investments in Latin America

Investor	Sector	Latin American Countries Receiving Foreign Direct Investments
Endesa, S.A.	Energy	Argentina, Bahamas, Brazil, Chile, Colombia, Caiman Islands, México, Panamá, Peru.
Repsol YPF, S.A.	Energy	Argentina, Bermuda, Bolivia, Brazil, Chile, Caiman Islands, Perú.
Unión FENOSA, S.A.	Energy	Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Guatemala, Caiman Islands, México, Nicaragua, Panamá, Dominican Republic, Uruguay.
Banco Bilbao Vizcaya Argentaria (BBVA)	Banking	Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Caiman Islands, México, Panamá, Paraguay, Dominican Republic, Uruguay, Venezuela.
Banco Santander Central Hispano	Banking	Bahamas, Bolivia, Brazil, Chile, Colombia, Caiman Islands, México, Panamá, Uruguay, Venezuela.
Mapfre, Insurance	Insurance	Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Guatemala, México, Nicaragua, Panamá, Peru, Dominican Republic, Uruguay, Venezuela.
Telefónica, S.A.	Telecommunications	Argentina, Brazil, Chile, Colombia, El Salvador, Guatemala, México, Peru, Uruguay, Venezuela.

A semi-structured questionnaire was designed in order to gather primary data through personal interviews with Chief Financial Officers (CFOs) of the selected companies. The questionnaire included closed-end and open questions in order to

capture the specifics of the internationalization strategies and investment processes of the selected companies. The objective of the interviews was to discuss in detail the corporate strategies, specific management practices, corporate state of affairs, and market conditions that were at the center of the decision-making process regarding the respondents' foreign direct investments in Latin America. The analysis of the primary and secondary data collected for these companies centered on the internationalization strategies and financial management aspects associated with financing, investment, and risk hedging. The following section presents the results of such analysis.

5. Research Results

5.1. The Internationalization of Spanish Companies: Antecedents

The primary data obtained through personal interviews allowed us to identify a set of diverse factors that influenced the internationalization processes of the selected Spanish companies and their foreign direct investments into Latin America. In particular, the executives indicated a series of antecedents and key drivers that influenced their decisions to expand into this region.

Table 3 lists the fundamental drivers that explain the internationalization decision-making process as suggested by the corporate executives who participated in this study. It is important to point out that Spanish companies had a very low level of engagements internationally before expanding toward Latin America in the early 1990s. Indeed, these companies were mostly focused on serving domestic markets in Spain. The seven companies analyzed in this study had limited international experience. Only the insurance provider had important international activities in the reinsurance market before its expansion into Latin America. In some cases, companies have had a few international engagements either through branches, strategic alliances, or imports focused mainly in other European countries.

Table 3: Key Internationalization Drivers for Spanish Foreign Direct Investors in Latin America

The Spanish companies operated in a mature domestic market with a high level of competition.
The expansion toward Latin America was a strategy of defense against the competition generated within European markets.
The companies had limited financial resources to enter and to compete in other European markets.
The opening up, deregulation, and privatization in Latin America offered great stability and growth opportunities.
The opportunities of investment in Latin America had a relatively low cost.
Latin America offered an attractive profit/risk relationship and high profit margins.
Spain's historical, cultural, and language bonds with Latin America also helped.

The internationalization of Spanish companies was positively influenced by the integration of Spain into the European Economic Community in 1986. All companies interviewed suggested that they operated in a highly competitive and mature domestic market. It was difficult to grow their businesses within rather saturated domestic markets. Respondents indicated that the integration of Spain into the European Union (EU) generated a new threat for most Spanish companies.

In fact, operating in an expanded European market was a test for Spanish companies that were required to compete head-to-head with well established and more sophisticated European companies.

Beginning in the 1990s, many Spanish companies were faced with a dilemma: whether to stay and compete within domestic markets or to expand and compete across international markets. These companies felt a need to pursue business internationally, to diversify their portfolio of activities, and to develop a level of competitiveness that would allow them to remain feasible in a globalized business environment. Expanding into other European countries was not perceived as viable due to lack of substantial capital. Respondents from five companies said they did not have enough financial capital to compete in an expanded European market. Therefore, as predicted by the Uppsala model, the solution that most Spanish companies found to these challenges was to expand initially into Latin America, "psychologically" closer markets with similar cultures. This strategy allowed them to achieve two objectives: 1) to protect themselves from possible takeovers or acquisitions by other European companies; and 2) to expand into emerging markets that offered growth potential.

In the early 1990s, companies in Spain were facing very intense competition, which originated as a result of the incorporation of Spain into the European Union. In the meantime, most countries in Latin America were immersed in a process of neo-liberal reforms based on liberalization, deregulation, economic opening, and privatization of public entities. In this context, Latin America as a region offered not only a potential source of growth but also a solution to the Spanish companies' lack of competitiveness within European markets. Indeed, the respondents of this study emphasized that Latin America's neo-liberal reforms promised great political and macroeconomic stability for this region. Most Spanish foreign direct investments in the region have been directly related to privatization processes in strategic sectors such as energy, banking, insurance, and telecommunications. These sectors of the economies are strategic because of factors such as a relatively low level of banking services used and an increasing demand for energy and telephone lines within the region.

The inflows of foreign direct investments into Latin America made Spain one of the major sources of investments in the region, competing closely with the United States for such leadership (Peek and Rosengren, 2000; Rodriguez and Tschoegl, 2000; Arteaga and Jeffus, 2004; and Guillén, 2005). Respondents indicated that investment opportunities in Latin America were available at relatively low costs and highlighted that Latin America offered an attractive profit/risk ratio and high profit margins. Nevertheless, the expansion of these Spanish companies into Latin America took place by different means: direct and indirect exports, strategic alliances, mergers and acquisitions, and other forms of foreign direct investment.

Today, Spain is the second largest foreign direct investor in Latin America (the leading investor being the United States). This outstanding position has been achieved during the last 15 years. This places Spain in a leadership position as a

source of investments within the region. Therefore, Spanish investors are called to play a major role in the host countries' economies given the volume and the strategic nature of their investments. Respondents suggested the historical and cultural links (mainly linguistic) between Spain and the region positively influenced the level of foreign direct investments.

Table 4 shows the geographical distribution of Spanish foreign investments in Latin America from 1993–2004. This distribution indicates that Brazil was the main recipient of foreign direct investments from Spain with 32 percent of the accumulated investments during this period. Argentina appears in the second place with 31 percent of the total, while Mexico and Chile accounted for 15 percent and 9 percent respectively, followed by Colombia and Peru both with 3 percent.

Table 4: Geographical Distribution of Spanish Foreign Direct Investment in Latin America 1993–2004

Country	Euros (Millions)	Percentage
Brazil	36,094	31.60
Argentina	34,937	30.58
Mexico	16,779	14.69
Chile	10,814	9.47
Peru	3,793	3.32
Colombia	3,565	3.12
Other Countries	8,251	7.22
Total	114,233	100

5.2. Competitive Advantages for Operations in Latin America

The respondents indicated that they had ownership of strategic competitive advantages to achieve superior performance in Latin America. Table 5 lists the source of competitive advantages, the associated theories of internationalization, and the industrial sector of the investments.

The internalization theory is applicable across all the strategic competitive advantages identified by respondents. This suggests Spanish investors had successfully identified and used their most important differentiating factors to generate value added outside domestic markets. For instance, Spanish banks emphasized the transfer of knowledge associated with managerial processes and financial risk management as major sources of competitive advantage for operations in Latin America. In addition, Spanish banks also reported that their technological platforms were perhaps more advanced than those of other operators in Latin America.

Table 5: Competitive Advantages

Originated by	Internationalization Theories	Economic Sector
Transfer and utilization of administrative processes and advanced financial risk management techniques	Internalization	Banking Insurance Energy
Transference and utilization of knowledge and more advanced technological platforms	Internalization	Banking Insurance Telecommunications
Benefits from economies of scale by becoming large operators.	Internalization Resources and Capacities	Energy Telecommunications
Availability of qualified human resources with language, cultural, and regional knowledge.	Internalization Uppsala Model	Banking Energy Telecommunications

The resources and capacities theory is applicable for the strategic competitive advantages identified by Spanish investors in the energy and telecommunications sectors. This suggests companies in these sectors focused on developing high-value-added resources and capacities, which are difficult to imitate. Indeed, companies in these sectors indicated they needed to be large operators to achieve economies of scale.

The Uppsala model is relevant as a strategic competitive advantage identified by respondents in the energy, banking, and telecommunications sectors. This suggests companies in these sectors felt a need to internationalize initially in “psychologically” closer markets. Indeed, respondents emphasized the availability of highly qualified human capital, the knowledge of the language and the local culture as other sources of competitive advantage.

5. 3. Risk Factors Associated with Investments in Latin America

Table 6 shows the most important risk factors identified by respondents in regard to the investments in Latin America. In effect, institutional weakness, legal insecurity, and political instability, which can change the conditions of operation, were identified as the main risks by all respondents. One of the executives suggested “the rules of the game can be modified overnight”.

Table 6: Risk Factors Associated with Foreign Direct Investments in Latin America

Associated to...	Sector
Relatively unstable markets in relationship to the European market.	Banking Energy
Handling of the effects associated to exchange rate volatility. Latin American currencies tied closely to the U.S. dollar rather than the euro.	Banking Energy
Availability of sources of information to measure credit risk to transact with other corporations and individuals.	Banking
The use of corporate debt in U.S. dollars or euros with inflows denominated in Latin American currencies, which normally lose value against the U.S. dollar and the euro.	Banking Energy
Institutional weakness, the legal and political instability that may change the rules of the game overnight.	Banking Energy Telecommunications
The impact of the corruption and fraud that may have a negative impact in the operation of the companies.	Banking Energy

In the case of Spanish banks, the lack of stability in Latin American markets as contrasted with the stability in European markets was identified as one of the major risks. In addition, companies in this sector expressed a concern regarding the potential effects of volatility in the value of Latin America currencies against the U.S. dollar and the euro, and also the lack of availability of sources of information to measure credit risk.

In the case of Spanish investors in the energy and telecommunication sectors, the most fearing risks were associated with financing operations in Latin America through corporate debt denominated in U.S. dollars and euros while generating income mainly denominated in Latin American currencies. They argued Latin American currencies normally lose value against the U.S. dollar and the euro. Lastly, they also indicated the risk associated with corruption and fraud that affects operations in Latin America.

5.4. Managerial Practices for Operations in Latin America

Centralization vs. Decentralization

This study also questioned respondents about the formulation of strategy and the implementation of operational plans for investments in Latin America. The answers in this area do not suggest a distinct pattern; however, it appears that the Spanish investors analyzed in this study had a tendency to delegate strategy formulation at the subsidiary level early in the implementation stage. Such activities were subsequently transferred to the parent company and most of them indicated they were currently implementing a participative strategy formulation approach that reflects a combined effort of headquarters and subsidiaries.

The Spanish bankers indicated they formulated strategy and operational plans at the headquarter level; however, they normally incorporated proposals and elements contributed by subsidiaries throughout Latin America. In all cases, plans are approved, supervised, and evaluated at the headquarter level.

In the case of investors in the telecommunications industry, the parent company provided subsidiaries with general directives on human resources, accounting, and financial management; the headquarters expected subsidiaries to define their own strategies and operational plans.

The seven companies under scrutiny had a tendency to: 1) revise managerial practices based on the parent company's level of knowledge regarding operations in Latin America; 2) decentralize operational decisions while maintaining centralized financial decision–making that required a significant level of resources, and 3) centralize decisions of strategic importance for headquarters. For instance, investors centralized the financial decision-making process to control allocation of resources and to maintain consolidated financial information for global operations.

Standardization vs. Adaptation

The study also questioned respondents about their preferences for the standardization or adaptation of managerial practices for operations in Latin America. The findings suggest that investors have followed a policy of standardization in areas such as products or services, compensation systems and in the use of administrative procedures. Spanish investors sought benefits associated not only with economies of scale in production but also with the consistent use of common managerial practices and administrative procedures. For instance, the use of standardized compensation systems implies Spanish investors considered on one side, that the contributions of Latin American managers were at par and equally valuable, and on the other, the need to apply consistent human resources practices to allow fluid mobility of middle level managers across these countries.

In some instances, these Spanish companies also followed a customization approach in some areas of managerial practice in Latin America. For example, advertising, pricing, and terms of payment were customized by most companies to mimic traditional business practices within the region. Nevertheless, respondents indicated they sometimes followed different managerial styles across Latin American countries.

6. Investment Processes in Latin America

Resources Used for Investments and Operations in Latin America

Most respondents indicated the financing source for Latin American investments was primarily internally generated funds rather than bank loans or capital markets issuances. In some cases, the companies were in relatively good financial conditions since they had previously been state-owned enterprises and as such had operated in monopoly markets, which allowed them to generate and accumulate excess liquidity.

In addition, when these companies used external funds, respondents emphasized the use of financing in hard currencies such as the U.S. dollar and the euro4. Nevertheless, some of them also indicated that they have already converted corporate debt denominated in hard currencies into domestic currencies in Latin America. Such a move was taken with the goal of reducing the investment risk within the region.

Table 7 shows the source of resources used for investments and operations in Latin America. It showcases the percentage of resources sourced in Spain, Latin America, and other countries. The interviews also revealed that these investors have recruited managerial talent within Latin America, both for top and middle management positions. In addition, most supplies for Latin American operations are acquired within the region. Therefore, these findings suggest the international expansion of these major Spanish corporations should have had a positive economic impact associated with an increase in demand for qualified labor and supplies

within local markets.

Table 7: Source of Resources Used for Investments and Operations in Latin America

Resources Associated with:	Spain	Latin America	Other Countries
Top Management Personnel	28	72	0
Middle Management Personnel	0	100	0
Equipment and Technology	15	40	45
Supplies for Operations	5	75	20
Research and Development (R&D)	60	40	0

The respondents indicated that capital goods such as equipment and technology were basically acquired in various other countries and subsequently taken into Latin America. Nevertheless, on average 40 percent of those assets were purchased in Latin America and 15 percent were brought from Spain into Latin America. The research and development (R&D) efforts were mostly centralized in Spain. However, in some cases new products or services have been initially developed in Latin America and then transferred into other countries within the region and Spain. For example, some banking products have been developed and initially introduced in Mexico and subsequently brought to Spain.

Capital Budgeting and Risk Management Analysis

Most respondents indicated they use the net present value (NPV) methodology as the most important mechanism to evaluate foreign direct investments in Latin America. On average, these companies use 5 to 10 years as the period of analysis to project cash flows for investment in Latin America. Only a single respondent indicated a higher preference for the repayment period as a methodology to evaluate such investments. This was the case in part due to the magnitude of the investment and to the investor's priority to recover the investment rather than to maximize expected return.

To forecast exchange rates, most companies used third-party forecasting providers. Specifically, several companies indicated that they used investment bankers to help them in such endeavors. However, other companies had their own econometric models to anticipate future currency values. They compared in-house forecasts with those of external analysts. The investors also reported the use of theoretical approaches such as purchasing power parity (PPP) and interest rate parity (IRP) to forecast exchange rate values and movements.

Profit Reinvestment Levels

Most Spanish of the foreign direct investors included in this comparative study have generated a level of reinvestments of about 50 percent of annual profits. Only a single investor indicated a reinvestment rate of 30 percent. This finding suggests Spanish investors anticipate growth potential and value creation within

the region. However, most emerging countries allow foreign direct investors to repatriate 100 percent of their profits; therefore, the reinvestment of profits implies investors expect to further generate value within a market. The reinvestment of profits in Latin America is not associated with a limitation to repatriate profits.

Sustainability of Investments

Most study respondents acknowledged that only in a few cases they thought about or decided to divest from a market within the region. Such decisions were made mostly to correct lack of "due diligence" on their part when making the original investment decisions. In several cases, the investors did not clearly recognize the key drivers for success in specific markets. For example, they overestimated the market size during the analysis and later discovered that there was not enough "critical mass" for a product within a country.

At the same time, some investors indicated that retrenching from a market was not an option because of the potential negative impact on the company's image and reputation. Therefore, to leave a previously entered market, even within a period of crisis, was not in some cases an alternative. Some of those markets were chosen based on their global strategic importance and value for the company.

Hedging Exchange Rate and Interest Rate Risk

Within the energy sector, investors indicated they hedged positions through natural hedging 90 percent of the time. In this industry, these companies balance assets and liabilities in foreign currencies to mitigate the impact of volatilities in exchange rates and interest rates. In addition, some respondents reported the use of financial derivatives, with a preference for forward and swap contracts. They don't typically use futures or options contracts to hedge exchange rate and interest rate exposures.

On the other hand, Spanish banks expressed that hedging exchange rate and interest rate risk was common practice for them. They suggested that most transaction risk exposures are managed to cover net expected profits. In addition, they highlighted that their hedging strategies are implemented based upon the expected levels of volatility within Latin America for specific time periods.

The respondent within the telecommunications sector reported the use of financial derivatives to hedge exchange rate and interest rate risks. Specifically, this company expressed its preference for forward and swap contracts. Additionally, the company also use futures and options contracts, but on a smaller scale.

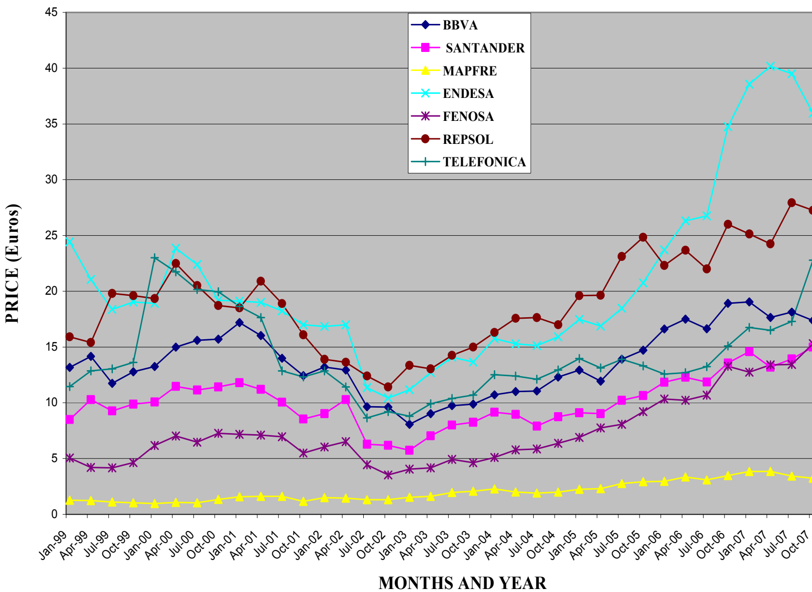
Performance of Spanish Investors in Latin America

Even though the companies do not use a specific methodology to calculate expected rates of return for investments in Latin America, it can be said that on average they seem to be between 16 percent and 20 percent5. The methodologies

they use to build performance expectation include: 1) Cost of capital plus an additional risk premium associated with country risk; 2) Cost of capital plus a risk premium for Latin America of about 4 percent, and 3) Expected return rate for Spain plus a premium of 5 percent.

Figure 1 showcases quarterly stock prices during the last 10-year period for the Spanish investors included in our sample. Please note the price trends are reported since the introduction of the euro as a currency of trade. Overall, there is an upward trend in prices that are consistent with the CFOs' feedback.

FIGURE 1
QUARTERLY STOCK PRICES



Spanish investors included in this study indicated that as of today Latin America represents between 30 percent and 50 percent of their profits, which constitutes a significant contribution to the consolidated operating results of these companies. Some companies felt they might have paid a high price for some investments in Latin America. Moreover, they have had to face periods of crisis in Argentina, Brazil, Venezuela, and Bolivia. Nevertheless, they felt they have successfully generated high rates of return on investments while at the same time accomplishing the internationalization objectives. Now these Spanish investors have market strength and financial leverage that will allow them to redirect some of investments toward other world regions. For example, companies like Telefónica and Grupo Santander have already initiated expansion toward other European countries.

In all cases the respondents affirmed their companies would not have reached their current levels of development without having invested in Latin America. Before pursuing investments in Latin America, these Spanish investors operated almost exclusively within domestic markets in Spain. Today, they have become successful multinational enterprises.

7. Summary and Conclusion

Spanish companies included in this study, currently leaders in terms of foreign direct investment levels in Latin America, had very limited international exposure and experience before they engaged in expansion toward this region. It is important to stress that the expansion into Latin America began their internationalization process and the consolidation of the first multinational enterprises from Spain.

The following conditions accelerated the international expansion of Spanish companies: 1) High level of competition in domestic markets, predominantly generated by the participation of Spain in the European Union; 2) Lack of investment opportunities in the domestic markets; 3) Growth potential and opportunities generated by the process of opening and privatization of key economic sectors in Latin America; 4) The urgency to gain market share to avoid being the object of hostile acquisitions by other European corporations; and 5) The profit/risk relationship offered in Latin America in comparison to other world regions.

This study also identified several common factors that have contributed to the financial success of the Spanish investors analyzed in this study:

- Adoption of financial strategies to evaluate the entrance and/or the expansion of operations in the countries of the region.
- Implementation of high quality risk management processes that allowed investors to be more competitive and to generate higher profits (particularly important for banks).
- Availability of abundant financial resources to acquire companies during the privatization processes.
- Transfer and application of administrative systems, operating systems, and relatively advanced technological systems.
- Use of advanced techniques to undertake capital budgeting analysis and to finance the investments.
- Access to international capital markets, mainly after the integration of Spain into the EU and the implementation of the euro as the common currency.
- Use of risk hedging strategies for credit, country, and exchange rate risk through natural hedging and the use of derivatives such as forward, futures, options and swaps contracts.

The respondents highlighted that the major investment risks were those associated with changes in the regulatory and political environment in Latin America. These investors suggested that the rules of the game in this region tend

to be unstable. They also pointed out a significant exchange rate risk because Latin American currencies tend to lose value against the U.S. dollar, the euro and their home currency.

Nevertheless, respondents also indicated their investments in the region have been carefully protected to recover any losses that might be caused by unstable economies and political instability. For instance, various investments were strongly affected by the crisis in Argentina; however, they already show a positive recovery thanks to the recovery that country has experienced in recent years.

In summary, the large Spanish companies included in this analysis have been successful in Latin America, even though this region may showcase a higher level of volatility than investors are used to experiencing within Spain. Nevertheless, investors find that the potential for growth and financial return within the region justifies taking higher levels of risk.

Endnotes

[1]The transaction costs include the costs of coordination and costs of motivation (Milgrom and Roberts, 1992). Coordination Costs are related to the costs to reunite the parts, to negotiate the prices and to complete the transaction. The motivation costs originate in the asymmetry and imperfection of the information, and the imperfect commitment or opportunistic behavior between the parties.

[2] According to Elango (2000) the resources can be classified in: a) intangible (brands, know-how); b) financial; c) physical (plants or equipment) and, d) operative (coordination and management).

[3] The property advantages include the tangible capacities (information, management techniques) and assets (capital and equipment). The location advantages are associated with the characteristics of the market, quality of the institutional surroundings and the risk of investment in different countries or regions where the company can expand its operations. The internalization advantage is derived from the decision to operate with external or subsidiary structures.

[4] In some cases the respondents emphasized a positive effect related to the participation of Spain in the European monetary system, which brought greater stability for the peseta in relation to the euro.

[5] It is interesting to note that the rate of return expected for projects developed within Spain is on average 10 percent and in some cases it is estimated as the capital cost plus an additional risk premium to be from 3 to 4 percent.

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