

**United Nations
Conference
on Trade and
Development**Distr.
GENERALTD/B/COM.3/EM.26/2/Add.1
27 October 2005

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD

Commission on Enterprise, Business Facilitation and Development

Expert Meeting on Enhancing Productive Capacity of

Developing Country Firms through Internationalization

Geneva, 5-7 December 2005

Item 3 of the provisional agenda

Case study on outward foreign direct investment from Argentina *

Executive summary

Argentina was a pioneer in outward foreign direct investment (OFDI) from developing countries in the late 19th century. It was also the largest outward investor in Latin America for a significant part of the 1990s, with substantial investment in oil and gas. The economic crisis in the early part of that decade had slowed down OFDI and led to a series of acquisitions of local firms by foreign players. Some of these local firms were among the most active outward investors from Argentina. However, other important OFDI players that remained under Argentine ownership include such firms as Techint and Arcor in the steel and food industries, respectively. OFDI by Argentine small- and medium-sized enterprises is mostly related to export promotion and support of trade channels.

Most OFDI from Argentina has been market-seeking or natural-resource-seeking, particularly in the oil and gas industries. OFDI has also been used as a risk diversification strategy, with foreign markets serving as buffers against loss of sales due to local economic turbulence. Such internationalization has helped increase the competitiveness of Argentine firms by providing access to raw materials, and facilitating greater efficiency in supply and improvement in the quality of products, as well as productivity.

This paper is one of five case studies prepared as background documents for the Expert Meeting to facilitate discussions on enhancing enterprise competitiveness through OFDI. It examines trends, drivers, motivations, policy and obstacles relating to OFDI from Argentina. It also highlights selected corporate cases of internationalization through OFDI and how OFDI has increased the competitiveness of Argentine firms.

* This document was submitted on the above-mentioned data as a result of delays in processing.

Contents

| | Page |
|--|-------------|
| I. Introduction | 3 |
| II. Historical overview: OFDI and the domestic development process | 3 |
| III. OFDI trends..... | 4 |
| IV. Key drivers and motivations for OFDI by Argentine enterprises | 6 |
| V. Selected cases of enterprises, OFDI strategies..... | 7 |
| VI. OFDI by Argentine SMEs..... | 10 |
| VII. OFDI and enterprises competitiveness..... | 11 |
| VIII. Obstacles to OFDI | 12 |
| IX. Key laws and regulations relevant to OFDI | 12 |
| X. Conclusion: Future prospects and challenges | 12 |
| References..... | 14 |

Case study on outward foreign direct investment from Argentina

I. Introduction

1. Argentina is often quoted as being the first developing country whose firms established industrial plants abroad (Chudnovsky and López, 2000; United Nations, 1993). Alpargatas, a textile manufacturer, set up a manufacturing affiliate in Uruguay in 1890 and later in Brazil. In the late 1920s and during the 1930s, S.I.A.M di Tella, a mechanical engineering company, and Bunge & Born, a diversified conglomerate in agribusiness and food products, established production plants in neighbouring countries.¹ Argentina's investments abroad today do not reflect its initial pioneering role as an outward investing developing country. Nonetheless, Argentina was one of the most important Latin American outward investors throughout the 1990s. In the early 2000s, recorded outward foreign direct investment (OFDI) fell as a result of macroeconomic crisis and the acquisition of important Argentine companies by foreign investors. Recent years have witnessed a renewal of OFDI flows, but they tend to be concentrated in a small number of firms and industries.

2. This paper examines the trends, drivers, motivations, policy developments and difficulties relating to OFDI from Argentina. It also highlights selected corporate cases of internationalization through OFDI and how OFDI has increased the competitiveness of Argentine firms.

II. Historical overview: OFDI and the domestic development process

3. Dunning's (1993) "investment development path" (IDP) theory relates stages in a country's economic development to the characteristics and intensity of inward and outward FDI. As a country develops, its combination of ownership, location and internalization advantages changes, and as a result investing abroad becomes worthwhile. At a certain stage in development, the combination of ownership, location and internalization advantages is such that the rate of growth of inward FDI starts to fall and the rate of growth of OFDI starts to rise. According to Dunning (1986), at the same stage of development, the amount and type of a country's OFDI will depend largely on the orientation of internal economic policy: "overall the degree and pattern of industrialization and the development strategy pursued by host governments are among the more important structural variables influencing Third World multinational enterprise activities, at any given level of income". Outward investment is likely to be small in countries with inward-oriented policies, and more significant in economies such as Hong Kong (China), China and Singapore pursuing export-led growth. This finding is compatible with the fact that Argentina was a pioneer in developing country OFDI at the end of the 19th century while the country pursued a development strategy based on exports of agricultural products and integration to world markets (parallel to incipient industrialization). The early overseas investments by S.I.A.M. di Tella and Alpargatas as mentioned above were made in this context.

4. From the 1930s to the 1970s, import-substituting industrialization processes were pursued. This led to a decline in OFDI in terms of the investing companies' total activities. OFDI during this period had the following general characteristics: (i) firms were often family businesses related to the personal skills and visions of recent immigrant entrepreneurs and their families; (ii) most firms operated independently and with a small volume of ramifications and/or diversification in the local market; they were also in general not connected to the financial system; (iii) companies were often national leaders in their respective markets, having developed with an import-substitution policy structure (that included protection, government credit and promotion mechanisms); (iv) they developed their own technological capital by adapting existing product and process technologies to the characteristics of the local market; many also came to produce new and original products; and (v) they often operated with a high degree of vertical integration, largely as a result of the insufficient degree of development of independent distribution networks.

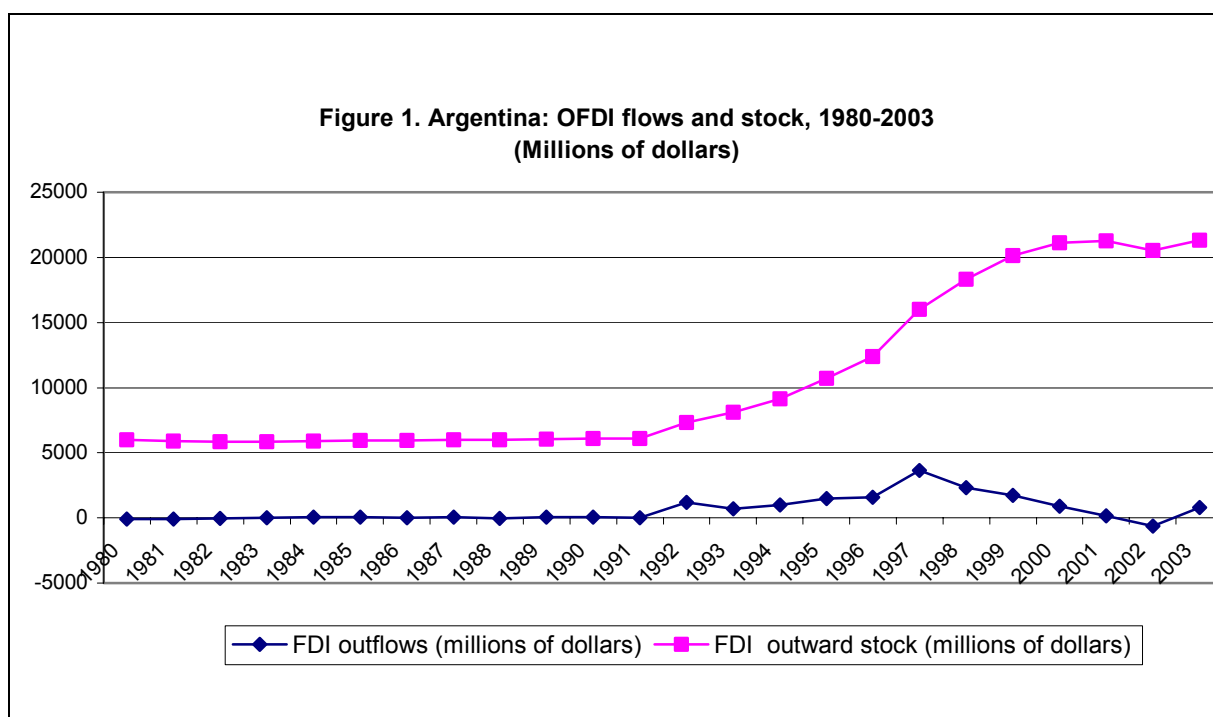
¹ Alpargatas became a small shareholder in its main operations in Brazil, S.I.A.M. di Tella was nationalized after a period of large losses and Bunge & Born moved its headquarters out of the country (United Nations, 1993).

5. Some of the motivations for internationalization by Argentina during this phase include: (i) exploration of natural resources, in the case of oil and gas companies and companies using minerals or agricultural products such as cocoa as material for industrial production; (ii) consolidation of trade flows between headquarters and subsidiaries, where the latter were established to execute certain stages of production that were more efficiently undertaken closer to consumer markets; and (iii) to overcome trade barriers in foreign markets (Kosacoff, 1999).

6. By the end of the 1970s and the early 1980s, crisis in the domestic market, factors inherent to the firms, and crisis and changes in target markets, led to the closing down of a significant number of Argentine operations abroad. It was only after the crisis of the 1980s and the beginning of the institution of a new and outward oriented development paradigm that OFDI began to pick up again. A new wave of investment took place, against a background of trade liberalization, deregulation, privatization and stabilization programmes. Investments in this period were undertaken mainly in neighbouring countries or in developed countries. Internationalization was experienced as part of broader restructuring programmes of major corporations trying to maintain their positions in the domestic market. The main push factors for outward investment from Argentina by the end of the 1990s were the limited availability of raw materials, especially oil and inputs for petrochemicals, and the limited size of the domestic market, which left little room for growth (Chudnovsky and López, 2000).

III. OFDI trends

7. Until the 1980s, Argentina – like other countries in the region – pursued inward-oriented industrialization policies which meant that outward investment was not a priority and there was no specific policy encouraging OFDI. These policies, however, facilitated the development of a small number of companies that were domestically strong, with the capability to internationalize their operations. Hence, once the country started to open up, enterprises took advantage of the benefits of internationalization in an increasingly integrated global market.



Source: UNCTAD FDI database.

8. OFDI from Argentina took off in 1992 (figure 1). The country was the largest outward investor in Latin America and the Caribbean during the period 1992-1997. This trend was strongly influenced by the restructuring of the Argentine industry, which came as a response to the economic transformations during that decade (Kulfas, 2001). From 1998 onwards, OFDI flows from Argentina declined in each consecutive year, except in 2003. Available data do not yet permit an interpretation of the results for 2003 as the beginning of a reversal of the previous trend. From the peak of \$2.3 billion in 1998, OFDI flows fell to a negative level in 2002; this suggests that Argentine enterprises sold their assets abroad as a way of improving their liquidity problems caused by the macroeconomic crisis in the same period. While OFDI flows recovered in 2003, they remained under \$1 billion. Despite the erratic pattern of OFDI flows in the wake of the crisis, Argentina has the second largest OFDI stock in the region, after Brazil.² Both countries have held these positions since the 1980s (UNCTAD, 2004).

Sectoral developments

9. Most of Argentina's OFDI flows in the 1990s were in non-financial activities. The country's participation in the main trans border mergers and acquisitions, as registered by UNCTAD, is concentrated in the oil and gas, iron and steel, and food sectors.

10. By the 1990s, Argentine OFDI was mainly in the iron and steel, oil and gas, and food industries. From 1990 to 1996, the oil and gas industry accounted for 82 per cent of OFDI flows from Argentina, followed by the food industry. Since the late 1990s Argentine oil companies that invested abroad, such as Pérez Companc and YPF, have been sold to foreign companies, the Brazilian Petrobras and Spanish Repsol respectively. Steel remains a leading industry for OFDI, a position reinforced by the recent acquisition of the Mexican company Hylsamex by Techint, discussed below. Other industries in which there was outward investment from Argentina, especially up until the end of the 1990s, are food and beverages, engineering and construction, pharmaceuticals, petrochemicals, telecommunications, information services, banking and construction materials.

11. Key OFDI transactions during the peak years of 1997 and 1998 were led by Arcor, Pérez Companc and Techint (table 1).

**Table 1. Most significant acquisitions abroad by major economic groups in Argentina:
The peak years of 1997-1998**

| Acquiring company | Target | Country | Year | Value of transaction (millions of US\$) |
|-------------------|---|-----------|------|--|
| Arcor group | Koppol (packaging) | Brazil | 1997 | 25 |
| | Dos en Uno (food products) | Chile | 1997 | 200 |
| Clarín | Cable operators | Paraguay | 1998 | n/a |
| Macri Group | Isabela (food products) | Brazil | 1997 | n/a |
| | Zabet (biscuits) | Brazil | 1997 | 38 |
| | Chapecó (refrigeration) | Brazil | 1998 | 135 |
| Mastellone | Leitesol (dairy products) | Brazil | 1998 | 14.1 |
| Pérez Companc | Petroleum Commercial Supply (oil and gas) | USA | 1997 | 1.8 |
| | Exploration area La Concepción | Guatemala | 1997 | 76.5 |
| | Exploration area Colpa y Caranda | Bolivia | 1997 | 5.9 |
| | Exploration area Acema | Venezuela | 1997 | 20.5 |
| Soldati | Onado (oil and gas) | Venezuela | 1997 | 5.1 |
| Techint | Sidor (steel) | Venezuela | 1997 | 192.3 |
| | Sakeb Furnace (industrial furnaces) | USA | | |

Source: ECLAC, based on Kulfas (2001).

² As in the case of data from other countries, Kosacoff (1999) highlights the fact that data on outward investment by Argentine companies are incomplete and issued by different entities that use different methodologies. This requires that quantitative data be read cautiously.

Geographical destinations of OFDI

12. The majority of the most significant acquisitions by Argentine companies took place within the Latin American region, a fact that reflects the influence of geographical proximity, business familiarity and cultural affinity. Investment opportunities and privatization in the region also played a role in the geographical spread. Between 1997 and 2000, some 85 per cent of Argentine OFDI flows were directed at Latin American countries, with 31 per cent going to Brazil and 28 per cent to Venezuela (Kosacoff, 1999). This geographical pattern was consistent throughout the 1990s, and until 2004, for OFDI from Argentina.

IV. Key drivers and motivations for OFDI by Argentine enterprises

13. The motivations of FDI or OFDI strategies can be grouped under resource-seeking, market-seeking, efficiency-seeking (with a view to conquering third markets) and strategic-asset-seeking (Dunning, 1994). Most OFDI from Argentina has been market-seeking and natural resource-seeking.

14. Resource-seeking strategies constituted a large part of Argentine OFDI in the 1990s, particularly in the oil and gas sector, undertaken by such enterprises as YPF and Pérez Companc (see section V). These were mostly resource-seeking investments aimed at complementing Argentine reserves and were motivated by diversification of supply sources. Market-seeking OFDI in such areas as service-station networks by such enterprises as YPF has also occurred. Pérez Companc invested in refineries and pipelines that would allow oil and gas to be processed and/or transported, and thus marketed.

15. Access to agricultural resources and markets motivated recent acquisitions by Bunge in Brazil and France. By investing in oilseed production in France, Bunge established a stronger presence and foothold in the European market.

16. Market-seeking OFDI strategies are prominent in the food and beverages industry. In the case of beverages, it was largely associated with the complexities of the beverage distribution process, which make exports to distant markets less effective. In the case of food products – where Arcor stands out – investment abroad has been a means to grow beyond the limits of the national market. OFDI by Arcor was also a means of exposure to international quality standards and of acquiring both scale and scope to defend and strengthen the company's position within the home country, in accordance with the logic of a strategic-asset-seeking drive. Overseas investments by the Macri group have also been motivated by market-seeking factors. Investments in the food sector in Brazil by some of these Argentine enterprises served as regional platforms for distribution and export of dairy, meat and flour-based products. Impsa has used its bases in Malaysia and the Philippines as export platforms for the rest of Asia.

17. In the pharmaceutical industry, Bagó invested overseas to support exports as well as to complement its domestic production.

18. Techint, a conglomerate in the steel industry, also expanded its domestic capacity to be able to gain a larger share of the export market. It subsequently complemented this capacity with acquisitions and investments abroad that supported the company's exports through distribution networks (Catalano, 2004), and complemented domestic production with sites situated close to consumer markets.

V. Selected cases of enterprises' OFDI strategies

19. Described below are some of the main Argentine companies that have invested abroad in the recent past, as well as their OFDI strategies:³

Pérez Companc

20. Pérez Companc,⁴ a family-based conglomerate in oil and gas, was established in 1946. Between 1990 and 1994, the company expanded its domestic activities in the oil business and in a number of other industries through participation in the country's privatization programme. In 1989, it undertook its first major investment abroad. In partnership with YPF and Pluspetrol, it acquired an interest in Andina, a company that had originated in the process of capitalization of Bolivia's YPFB and that supplied gas to the Bolivia-Brazil pipeline. Since 1994, Pérez Companc had made a series of overseas investments in oil and gas exploration and production in neighbouring countries such as Brazil, Bolivia, Ecuador, Peru and Venezuela. In 1997, the company began investments in petrochemicals in Brazil and in 1999 acquired two refineries in Bolivia in partnership with Petrobras. In 2000, as part of an asset swap (see below) with Repsol YPF, it gave up its share in Andina, along with other assets, receiving in return the Repsol-YPF share of the gas-bearing zones in southern Argentina. Before its acquisition by Petrobras, Pérez Companc invested in exploration and production of oil and gas and in pipelines in Ecuador (Pacheco, 2001; ECLAC, 2002). At the time of the acquisition, only 40 per cent of the company's oil reserves were in Argentina (Campodónico, 2004).

YPF

21. YPF (Yacimientos Petrolíferos Fiscales) was established in 1922 as Argentina's State oil and gas enterprise. It was privatized in two stages between 1993, when State interests were reduced to 20 per cent, and 1999, when the company was acquired by the Spanish oil company Repsol, with this leading to the creation of what is now Repsol YPF. Although YPF had made investments abroad previously, including partnerships with Repsol, its most significant internationalization took place in 1995 when it acquired Dallas-based Maxus Energy. Through Maxus, it acquired assets or exploration rights in oil and gas fields in Indonesia, the United States, Bolivia, Ecuador, Venezuela and Peru. Subsequently, the company acquired 50 per cent of the Bolivian company Andina in partnership with Pérez Companc and Pluspetrol. Investments were then made in Bolivia, Peru, Chile and Brazil in such areas as exploration and production, refining and service station networks (Gadano, 1998). A significant spur to the internationalization process was also given by the Argentine Government's conditions attached to the acquisition of YPF by Repsol, although by then the company was already part of its Spanish acquirer. Concerned about the effects of this acquisition on competition in the Argentine market, and considering that Repsol already owned assets in the country, the authorities demanded divestment of a number of service stations, refining capacity and production fields. This led to swaps of part of the company's Argentine assets for others situated in Brazil.

Techint

22. The Techint group was established in Milan in 1945 and subsequently set up its base in Argentina. The company almost immediately started providing engineering and construction services in other Latin American countries and Europe, and was thus practically "born an international company". The scope of its activities was expanded, reaching over 50 countries, especially in the pipeline sector and in the establishment of turnkey plants. The company's first construction projects outside Argentina were pipeline networks in Brazil. The company gradually expanded its steel business. The first international investment in this sector was the construction of seamless steel tube plants in Mexico in the 1950s. Internationalization was intensified in the 1990s. In 1993, Techint

³ Unless otherwise indicated, sources are the companies' websites and public documents.

⁴ Up until its acquisition by Petrobras, Pérez Companc S.A. controlled Pecom Energía S.A., which in turn was the head of a group of companies active in a number of industrial sectors. Here, unless stated otherwise, "Pérez Companc" or "the company" refers to the corporate group.

took control of the Mexican steel tube maker Tamsa. In 1996 the group acquired control of the Italian steel company Dalmine. Steel pipe manufacturing facilities were acquired or set up in Brazil, Venezuela, Japan, Canada, and recently Romania. Tube products are now consolidated under Tenaris. In 1997, Techint led the consortium that acquired control of Sidor, Venezuela's largest steel plant, producing both flat and long products. In the 1990s, the Techint Group participated in privatizations in Italy and entered the health services sector in that country. Through Tegas it acquired interests in the gas transmission business in Peru. The group has also been active in energy trading in Italy through Dalmine Energie. Finally, in 2005 Techint reached an agreement with the Alfa group for the acquisition of the latter's stakes in the Mexican steel producer Hylsamex, including that company's shares in Sidor.

Arcor

23. Arcor was founded in 1951 and is now the world's largest producer of hard candy. It operates in four main areas: foodstuffs, confectionery, chocolates and biscuits, but has, over time, integrated vertically into packaging and other inputs of its core businesses. Arcor started exporting in the 1970s, and internationalization followed with investment in Arcorpar in Paraguay (1976) and approval for investments in projects in Uruguay (Van Dam) and Brazil (Nuchar), which were undertaken in the early 1980s. A sales office was opened in the United States and a fruit processing plant was established in Chile in the 1980s. In the 1990s, Arcor intensified its regional presence through acquisitions and investments in Chile (Dos en Uno) and Brazil (development of a greenfield investment in the chocolate sector). In 1996, Arcor de Perú was established with a greenfield investment in Chancay. In April 2004, Arcor and Danone announced that they would merge their biscuits businesses in Argentina, Brazil and Chile. The resulting company (49 per cent owned by Danone and 51 per cent by Arcor) leads the biscuits market in Latin America. In support of its strategy in penetrating export markets overseas, Arcor has established sales offices in Brazil, Chile, Canada, Colombia, Ecuador, Mexico, Paraguay, Peru, Spain, Uruguay and the United States (Kosacoff et al, 2002; Arcor, 2005).

Mastellone

24. Mastellone, founded in 1929, is a family-controlled company and one of Argentina's largest dairy producers through its most important operation, La Serenísima. In 1995, it undertook a joint-venture with the French group Danone to establish the Argentine-based Danone S.A. Its stakes in this company were later sold to Danone. The "mother" company, however, has remained in the hands of the Mastellone family. Mastellone exports to 32 countries. In Latin America, Mexico, Venezuela and Brazil are the major export destinations, while Algeria and Iraq rank highest outside the region (*Latin American News Digest*, 2005). Since 1991, Mastellone has had OFDI activities in Brazil with a subsidiary chiefly concentrating on sales and distribution. In 1998 the company completed the acquisition of Leitesol, a producer of powdered milk and other dairy products, in Brazil. Leitesol now markets the La Serenísima brand in Brazil. The Mastellone family sold part of its operations – namely in yoghurts and desserts and in logistics – to Danone in 1999 and 2000.

Bagó

25. The leading company in the Bagó group, founded in 1934, is Laboratorios Bagó, a pharmaceutical company which is a leader in the Argentine and Latin American markets. The group includes other companies producing prescription drugs and over-the-counter, veterinary and agricultural products, and providing distribution, engineering, consulting and insurance services (Fundación Invertir Argentina, 1998). It had invested abroad in the 1970s and 1980s within Latin America, but its internationalization strategy was consolidated in the early 1990s. International revenues grew from \$25 million in 1991 to \$110 million in 1997. In 1997, Bagó acquired Laboratorios Ariston in Colombia for \$10 million. In 1998 it had production facilities in Colombia, Chile, Mexico, Bolivia and Uruguay. It now owns 18 subsidiaries in Latin America (Mexico, Brazil, Bolivia, Chile, Colombia, Cuba, Ecuador, Paraguay, Peru, Uruguay, Guatemala, El Salvador, Honduras, Panama, Nicaragua, Costa Rica, Dominican Republic and Venezuela), the Russian Federation and Sri Lanka. In other countries, Bagó maintains agreements with other laboratories for

the distribution of its products. Some 40 per cent of the group's revenues are generated by its subsidiaries outside Argentina.

Grupo Macri

26. The main activities of the Macri group in the early 1990s were in food products, the automobile industry (including participation in a Fiat plant in Uruguay from which it has since withdrawn) and provision of services to the State. It has since sold many of its industrial interests in Argentina and expanded its services component, participating actively in privatizations mainly in roads and gas supply. In 1999 it took part in the winning consortium for the privatization of the country's mail services – Correo Argentino (a concession rescinded in 2003) (EIU, 2004). During the same period, the group expanded abroad, especially through investments in Brazil. Many of these OFDI activities were in the food industry. In 1994 the company bought Procesa (a data processing company), which focused on financial and credit card services, from Bunge & Born. The group also participated in Brazilian privatizations and was involved with concessions in providing public services such as road building, power transmission and environmental services. Other sectors in which the group operates in Brazil include construction and production of cotton and beans. The latter activity was in partnership with Cremer (Germany) (Kulfas, 2001). After the 2001 crisis in Argentina, the group restructured its operations. In this context it left the controlling group of Frigorífico Chapecó in Brazil.

Impsa (Pescarmona group)

27. Corporación Impsa S.A., controlled by the Pescarmona family, is a holding company that is associated with high-tech capital goods, auto parts, cargo transportation and other services. Its main operations include provision of integrated engineering solutions for hydro- and wind energy projects, manufacturing of machinery and investing in power generation projects. It has participated in more than 150 projects in 30 countries in North America, Central America, South America, Africa, Asia, Europe and the Middle East over the last 25 years. The group also has investments abroad through which it provides various types of services which include insurance, GPS monitoring (in Argentina, Brazil, Uruguay, Chile and Colombia) and environmental services in Colombia. In 1995 Impsa acquired TCA Ltd, a Ford subsidiary in north-eastern Brazil. Overall, the group has overseas subsidiaries or business units in Brazil, Colombia, Costa Rica, Ecuador, Egypt, Hong Kong (China), India, Indonesia, Malaysia, the Philippines, Switzerland, Thailand, the United States and Venezuela.

Quilmes/Bemberg

28. The Quilmes brewery started business in the late 19th century, run by the Bemberg family, in Quilmes, Buenos Aires. The company was founded in Paris, initially importing barley produced in Argentina for the French and German beer industry. Throughout the 20th century it grew in Argentina through acquisitions and greenfield investments. International investments began with plants in Paraguay in 1932, followed by Uruguay in 1965 and Chile in 1991. In 1996 the company invested in two breweries in Bolivia. In 2002, its breweries had market shares of 64.5 per cent in Argentina, 76.1 per cent in Paraguay, 51.9 per cent in Uruguay, over 97 per cent in Bolivia and approximately 11 per cent in Chile.⁵ In bottled soft drinks, from 1965 to 2000, the company held a Coca-Cola bottling licence in Paraguay, which was sold when the company decided to focus on bottling PepsiCo drinks in Argentina and Uruguay. In 2003, the company entered into a strategic relationship with AmBev (now Inbev after a merger with the Belgian company Interbrew), involving operations in the southern cone area, excluding in Brazil.

⁵ According to the company's own estimates.

VI. OFDI by Argentine SMEs

29. Data on OFDI by small and medium-sized enterprises (SMEs) from Argentina are scarce. Argentinean SMEs have been investing abroad: they are visible in such industries as software (box 1) and agricultural machinery (box 2). In general, Argentine OFDI has been market-seeking, either to intensify exports or to meet host country demand through local production. Although some of the companies mentioned in the boxes below have grown beyond the official limit of medium-sized enterprises, they still maintain management characteristics that justify their inclusion in the category of SMEs for the purposes of this paper.

30. Argentine software companies have started to invest abroad as a means of gaining proximity to clients and thus expanding sales. Three examples are Idea-Factory, Cubika and Sistemas Estratégicos S.A.

31. SMEs, and especially exporting SMEs, have been seen in Argentina as important agents of development and are the subject of important government support policies. Outward investment by these companies has become an increasingly important issue as the number of exporting SMEs has risen significantly and investment abroad by SMEs is often strongly linked to, or preceded by, exports (CEP, 2005).

Box 1

SME international investment in the software industry

Idea-Factory

Idea-Factory inaugurated a “Customer Proximity Center” in Madrid in 2004 in order to better exploit the Spanish market, one of the company’s main consumer markets. This has been done essentially – and at an initial stage – through investment in the training and certification of local partners in Spain to help expand exports of the company’s products from Argentina. This type of investment has been simple to manage and cost-effective for the current volume of sales. Other types of investment may be considered once the expected returns of sales to the Spanish market justify them. Although it is too early to make an assessment of the benefits gained from this investment, it is clear that the company has already benefited from the high standards of the Spanish market, which have been reflected in higher quality standards for the company’s production in general.

Cubika

Cubika, founded in 1999, has also focused on the Spanish market as its main export market because of its size, cultural and linguistic proximity, and a perceived unmet demand for software development services with J2EE technology, where the company has a competitive advantage. Cubika set up a subsidiary in Barcelona, to manage overseas operations, including projects in France, Germany, Switzerland, Australia, Brazil, Chile, Cuba, Mexico, Venezuela and Costa Rica. In many cases, projects were developed with local partners. Support from the Argentine Government in commercial missions to promote software exports was important in the company’s internationalization process. The company found that, with the exception of a very small number of local companies, it was comparatively more advanced technologically than its competitors in Spain. However, Idea-Factory found that the Spanish market was more demanding for a number of factors, such as customer support and product management (Proargentina, 2005).

Sistemas Estratégicos

Sistemas Estratégicos was founded in 1992 and developed a strong position in the local market, especially in customer relationship and management products throughout the 1990s. It gradually expanded internationally through a system of partner distributors, which allowed it to rapidly establish its presence regionally. It has representation in Chile, Peru, Honduras and Mexico, and projects in Puerto Rico, Uruguay, Ecuador, Colombia, Venezuela, Bolivia and Brazil (Proargentina, 2005).

Box 2
SME international investment in the agricultural machinery industry

Plá

Plá, is producer of several types of agricultural machinery in Argentina. It established a plant in Porto Alegre, Brazil, to produce self-propelled pulverizers. With an initial investment of \$1.5 million, the plant currently employs 30 people. What attracted Plá to Brazil was the potential of the host country's market. An additional reason for establishing a plant in the host country, versus exporting from Argentina, is that the company's products qualify for subsidized credit offered to local buyers through the finance programme provided by the Brazilian development bank (*La Capital 2004, 2005*).

Metalfor

Metalfor, based in Marco Juaréz, Córdoba, established a subsidiary in Brazil to produce agricultural pulverizers. The plant, situated in the southern state of Paraná, employs 100 people. Investments have been made to relocate and expand the plant in a nearby site. Metalfor also has facilities in the State of Mato Grosso, from where machinery is sold and spare parts are stocked for distribution. There are plans for the construction of an assembly plant in Mato Grosso, as well as a plastic compounds operation (Metalfor do Brasil, 2005).

32. OFDI by larger Argentine companies mentioned above is likely to provide SMEs in Argentina with important opportunities to place their products in foreign markets. Techint's investments abroad have, according to the company, had that effect in recent years (Techint, 2004b).

VII. OFDI and enterprise competitiveness

33. The effects of OFDI on competitiveness vary between firms and industries. Pérez Companc, Arcor and Techint offer interesting illustrations. The results of the internationalization of Pérez Companc were expansions of the company's resources, contributing to an appreciation of the value of the firm (Kosacoff, 1999). For Arcor, besides strengthening sales and exports,⁶ internationalization upgraded the quality of the company through expansion of the scope and scale of operations, which strengthened the company's presence in Argentina. Arcor's international presence also shielded the company, to an extent, from the impact of the 2001 crisis. Although other companies reached out to the international market in response to the crisis, Arcor had an invaluable advantage in that it had pursued a long-term and systematic strategy to develop clients and markets abroad. By 2002, it exported to over 100 countries and enjoyed the confidence of retail channels in Europe (Kosacoff et al., 2002). For Techint, besides providing the opportunity for growth and expansion of sales, internationalization allowed the company to benefit from greater efficiency in obtaining supplies, machines and other inputs through greater bargaining power derived from the unification of the company's supply management. Techint also gained through technology transfer between its international units with respect to the mobility of human resources within the group.

34. In general, for companies that rely on OFDI as a means of expanding exports, one of the likely effects of these investments is the upgrading of quality standards and productivity to meet the demands of global customers (box 1). The competitive pressures of the international market have also contributed to the enhancement of the quality and productivity of SMEs through OFDI in both services and manufacturing.

⁶ From 1990 to 1999, before crisis hit, the share of the Argentine sugar confectionery industry (excluding chocolates) in world imports of these products went from 1.09 per cent to 2.16 per cent. Argentina's share in world imports of chocolates went from 0.05 per cent in 1990 to 1.43 per cent in 1999 (TradeCAN, 2004). Arcor's contribution to these numbers is undisputed. The company's exports rose by a multiple of almost 7 during this period.

VIII. Obstacles to OFDI

35. One of the main obstacles to OFDI from Argentina has been the limited availability of funding at internationally competitive rates (Kosacoff, 1999), aggravated in some cases by higher debt-equity ratios than foreign competitors (ECLAC, 2002). In the past few years, economic crisis significantly weakened Argentine firms, causing a number of them to be bought by foreign firms. For companies that remained under Argentine ownership, the crisis had led to restricted investment capacity and often a need to divest. Other obstacles to outward investment include access to personnel qualified in international business operations or in management of overseas investment activities.

36. The current legislation on capital outflows limits the amount of foreign exchange that residents (both companies and natural persons) can acquire (section IX). This issue is not, however, in itself generally considered a major obstacle to OFDI.

IX. Key laws and regulations relevant to OFDI

37. Current legislation on capital outflows allows residents (both companies and natural persons) outside the financial sector to have access to the Mercado Único y Libre de Cambios (official foreign exchange market) to acquire foreign currency for the purpose of undertaking direct investment abroad, subject to a monthly limit (Banco Central, 2005). The current limit is \$2 million, but can be increased according to export duties paid by the company and taxes paid on movements in the company's current account. The Government has recently instituted a system whereby OFDI must be declared to the Central Bank annually. Declaration is mandatory for values of over \$1 million.

38. Government-subsidized financing programmes such as those executed by the Banco de Inversión y Comercio Exterior (BICE) seem to focus on investment made domestically and on support to SMEs. The latter may have a positive effect, in the long run, on OFDI by these companies to the extent that the programme supports the development of exporting SMEs, and, more generally, the growth and competitiveness of local companies.

X. Conclusion: Future prospects and challenges

39. The prospect for OFDI flows from Argentina is caught between the positive trend of companies such as Techint and Arcor, as well as a selected group of SMEs, that have pursued aggressive internationalization strategies in the post-crisis environment, and a process of denationalization where important Argentine firms that could lead a trend towards OFDI are being acquired by foreign firms.

40. Support policies for OFDI from Argentina could be thought out in terms of weighing, on the one hand, the potential of this kind of investment for generating social benefits in the form of development of local industrial production, productivity, employment and other potential benefits, including innovation capacity, and, on the other hand, the opportunity cost of the support. To the extent that the perceived social benefits of OFDI outweigh the cost of measures to support it, such policies may be justified in the context of broader industrial development strategies. An immediate challenge is to build institutional capacity for evaluating the potential social benefits effects of OFDI and related policies. If the evaluation leads to the conclusion that active support for OFDI is warranted, it is important to consider addressing the main obstacles to investment abroad by Argentine enterprises, in particular the difficulty in accessing finance.

41. Another opportunity for government action is the provision of market intelligence and legal investment information in target host countries and reducing the transaction costs of OFDI, which is especially important for SMEs. The Centro de Estudios de la Producción, institutionally situated under the Ministry of Economics and Production, in the past maintained an important database on OFDI, but no longer does so. The importance of such a database in supporting policy analysis is crucial. This is another area that merits closer attention.

42. Support to the general business environment could lead to greater amounts of OFDI and could spur a virtuous cycle towards competitiveness. Greater public-private sector dialogue could be established to exchange experiences, information and policy feedback on internationalization and competitiveness of Argentine firms.

References

- América Economía (2004). “Diamantes en bruto”, No. 291-292, 10 December.
- América Economía (2005). “Comprador Compulsivo”, 10-23 June.
- Arcor (2005), www.arcor.com.ar.
- Argentina Trade & Investment News (1998)*. Vol. 5. no. 5, September/October, <http://emb-euu.mrecic.gov.ar/news198.htm>.
- Banco Central de la República Argentina (2005). “Comunicado Nro. 48268, Ref.: Regulaciones vigentes en materia de comercio exterior y cambios. Síntesis”, 31 May.
- Campodónico, Humberto (2004). “Reformas e Inversion en la Industria de Hidrocarburos de América Latina”. Serie Recursos Naturales e Infraestructura, No. 78, Comisión Económica para América Latina y el Caribe (CEPAL), December.
- Catalano, Charles (2004). “Tenaris: Creating a global leader from an emerging market”. Stanford Graduate School of Business. Cas IB-60.
- Centro de Estudios para la Producción (CEP) (1998). “Las inversiones de empresas argentinas en el exterior.”
- Centro de Estudios para la Producción (CEP) (2005). “Performance exportadora reciente de las pequeñas y medianas empresas”, in *Síntesis de la Economía Real No. 48*, March.
- Chudnovsky, Daniel and Andrés López (2000). “A third wave of FDI from developing countries: Latin American TNCs in the 1990s”, *Transnational Corporations*, vol. 9, no. 2, August.
- Cotelo, Emiliano, Interview with Francisco Macri, president of Sociedad Macri, Clarín, 6.10.99.
- Danone (2005), www.danone.com.
- Dunning John (1986). “The investment development cycle and Third World Multinationals”, in Khan, Khushi M., *Multinationals of the South: New Actors in the International Economy*, St. Martin’s Press, New York.
- Dunning John (1993). “*Multinationals Enterprises and the Global Economy*”, Wokingham, Addison-Wesley.
- Dunning John (1994). “Re-evaluating the benefits of foreign direct investment”, *Transnational Corporations vol. 3, no. 1*.
- ECLAC (Economic Commission for Latin America and the Caribbean) (2002). “Foreign Investment in Latin America and the Caribbean, 2001” (LC/G.2178-P), Santiago, Chile. United Nations publication, Sales No. E.02.II.G.47.
- Economist Intelligence Unit (EIU) (2004). “Argentina: Difficult Commute”, 19 July.
- Fundación Invertir Argentina (1998). *Argentina Monthly*, July.
- Fundación Invertir Argentina (2001). *Argentina Monthly*, August.

- Gadano, Nicolás (1998). “Determinantes de la inversión en el sector petróleo y gas de Argentina”. Serie Reformas Económicas, No. 7, Comisión Económica para América Latina y el Caribe (CEPAL), October.
- Gazeta Mercantil Online (1996). “Argentine company buys Sao Paulo dairy company”, Gazeta Mercantil Online, 8 July.
- Gazeta Mercantil Online (1998). “Mastellone to take over Leitesol for \$14 million”, 21 July.
- Gutman, Graciela E. (2002). “Impact of the Rapid Rise of Supermarkets on Dairy Products Systems in Argentina”, *Development Policy Review*, vol. 20, issue 4.
- Kosacoff, Bernardo (1999). “Las multinacionales argentinas: una nueva olha en los noventa”, Documento de Trabajo no. 83. Comisión Económica para América Latina y el Caribe – Oficina de Buenos Aires, July.*
- Kosacoff, B., J. Fortezza, M. In’s Barbero, F. Porta and A. Stengel (2002). *Going Global from Latin America: The Arcor Case*, Buenos Aires, Mc. Graw Hill.
- Kulfas, Matias (2001). “El impacto del proceso de fusiones y adquisiciones en la Argentina sobre el mapa de grandes empresas. Factores determinantes y transformaciones en el universo de las grandes empresas de capital local”. Serie Estudios y Perspectivas, Economic Commission for Latin America and the Caribbean, May.
- La Nación* (2005). “Buscan crecer en el exterior grandes empresas argentinas”, 23 May.
- La Capital* (2004). “Con Buena chapa, Pla alista su desembarco en la plaza brasileña”, 4 September.
- La Capital* (2005). “Las maquinas salen a exportar”, 20 March.
- La Nación* (2004). “De Rafaela al mercado mundial”, March 2.
- Latin America News Digest (2005). “Argentine Mastellone plans \$10 mln investments”, 22 February.
- Metalfor do Brasil (2005). www.metalfor.com.br.
- Middle East News Items* (1998), “Mastellone – A success story”, 22 November.
- Pacheco, Carlos Augusto G. (2001). “Monitoramento de empresas - Pérez Companc S.A.” Infopetro, Instituto de Economia, Universidade Federal do Rio de Janeiro (UFRJ) (www.ie.ufrj.br/infopetro/pdfs/perez_companc_resumo.pdf).
- Techint (2004a). www.techint.com.mx.
- Techint (2004b). *The Techint Group of Companies 2003-2004*.
- TradeCAN (2004): A Tool to Analyze International Competitiveness*, CD version. ECLAC and World Bank.
- United Nations Conference on Trade and Development (UNCTAD) (2004). *World Investment Report 2004: The Shift Towards Services*.
- United Nations (1993). *Transnational Corporations from Developing Countries: Impact on Their Home Countries*.
- West, Jonathan (2003). “Bunge Limited”, Harvard Business School Cases.