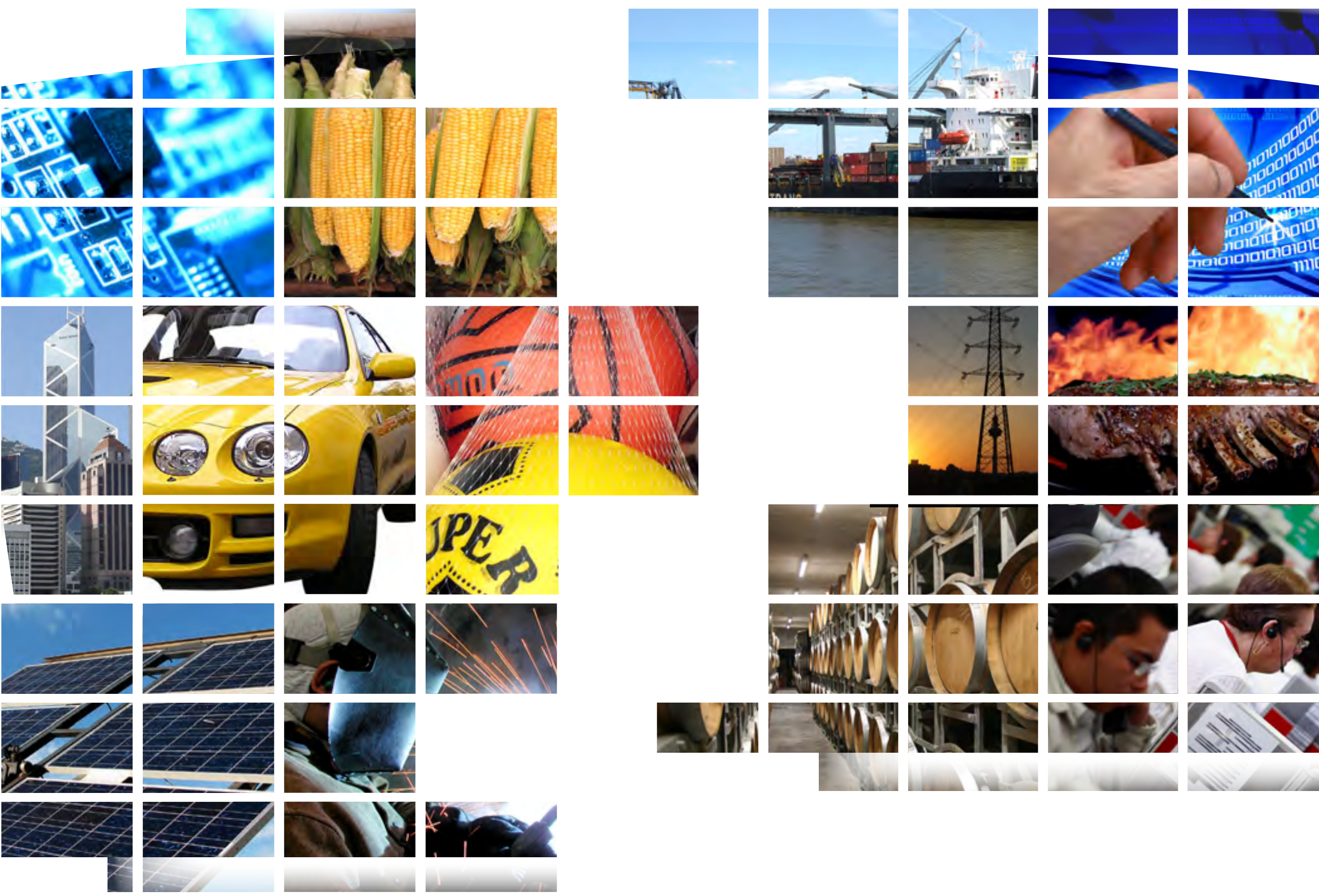
Pathways to China:
The Story of Latin American Firms in the Chinese Market



Integration and Trade Sector
Vice Presidency for Sectors and Knowledge

Pathways to China:

The Story of Latin American Firms in the Chinese Market

IDB
Integration and Trade Sector
Vice Presidency for Sectors and Knowledge

Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library

Estevadeordal, Antoni.
Pathways to China: the story of Latin American firms in the Chinese market / Antoni Estevadeordal, Theodore Kahn.

p. cm. (IDB monograph series; 138)

1. International business enterprises—Latin America. 2. China—Foreign economic relations—Latin America. 3. Latin America—Foreign economic relations—China. I. Kahn, Theodore. II. Inter-American Development Bank. Integration and Trade Sector. III. Title. IV. Series.

JEL Classification: F15, F21, F23, O54
Keywords: Foreign Direct Investment, Multinational Firms, International Business, International Investment, Multilatinas, China, Latin America

http://www.iadb.org

Table of Contents

Acknowledgements

Pathways to China: the Story of Latin American Firms in the Chinese Market was prepared for the **China-LAC Business Summit 2012**, organized jointly by the **Inter-American Development Bank** (IDB), the **China Council for the Promotion of International Trade,** the **People's Bank of China**, and the **Government of Hangzhou municipality** (Hangzhou, China, October 17–18, 2012). It is the product of a collaborative research effort within the Integration and Trade Sector (INT) of the IDB, under the general supervision of Antoni Estevadeordal, Sector Manager. The report was coordinated by Theodore Kahn (IDB/INT), with contributions and comments from Mauricio Mesquita Moreira (IDB/INT), Enrique Dussel Peters (UNAM) and Lourdes Casanova (Cornell University).

Carolina Osorio (IDB/INT) and Sandra Reinecke were responsible for the layout and publication of the document and Kun Li (IDB/INT) and Fan Vanessa Li (IDB/ORP) for the Chinese version.

Introduction

The story of the booming economic relationship between Latin America and the Caribbean (LAC) and China is by now well-known. Over the past decade, trade between the two economies has grown astronomically, driven by China's seemingly insatiable demand for LAC's natural resources and the entry of low-cost Chinese manufactures into LAC markets. Investment flows from China have followed, directed mainly towards mining, energy, and to a lesser extent manufacturing.

While commodities-for-manufacturing trade continues to be the dominant narrative, it is not the whole story. A number of LAC multinationals have undertaken major investments in China, staking a claim to its fast-growing markets. At the same time, LAC firms large and small are selling a range of goods and services in China, from aircraft to IT services to state-of-the-art manufacturing equipment, belying the overriding commodities-for-manufacturing pattern.

This report takes a closer look at those Latin American firms that have successfully entered the Chinese market. The focus is on the *how*: how did firms first explore opportunities in China, how did they gain an initial foothold in the market, and how did they overcome the challenges of doing business in a geographically and culturally distant setting? To answer these questions, we analyzed a sample of 85 major Latin American multinationals with a direct presence in China. The results allow us to propose a basic typology of four categories of LAC firms in China, distinguished by their motivations, activities, and strategies in the country.

The report proceeds as follows. The next section provides an overview of trade and investment between Latin America and China at the macro level. We then briefly discuss several key economic theories of foreign direct investment, before moving on to the analysis of LAC firms' experiences in China and presentation of the typology of LAC firms.

The Big Picture: An Overview of LAC to China Trade and Investment

Part 1

As our economists at the IDB have said, it is difficult to make a meaningful statement about Latin America's economic future without mentioning China. Trade between the two economies has increased at an annual average rate of 25% since 2000, reaching an estimated $236 billion in 2011.[1] For nearly every country in the region, China's share of exports is larger today than in 2000. For several countries, however, the importance of China as an export destination has truly skyrocketed in the past decade.

Figure 1 underscores the uneven geographic distribution of the region's trade with China. The Southern Cone countries, along with Peru and Venezuela, have enjoyed booming exports to China, leading to bilateral trade surpluses in the cases of Brazil, Chile, and Peru. For Mexico and Central America, however, manufacturing imports from China have swamped any gain in exports, resulting in considerable trade deficits with China.

The geographic divide reflects the overall composition of the region's trade with China. A commodities-for-manufacturing exchange has been the dominant pattern of interregional trade, raising concerns on the Latin America side. Even in resource-rich South American countries that have seen the greatest gains, governments worry about the consequences of excessive concentration and parting with raw materials at the bottom of the value chain.

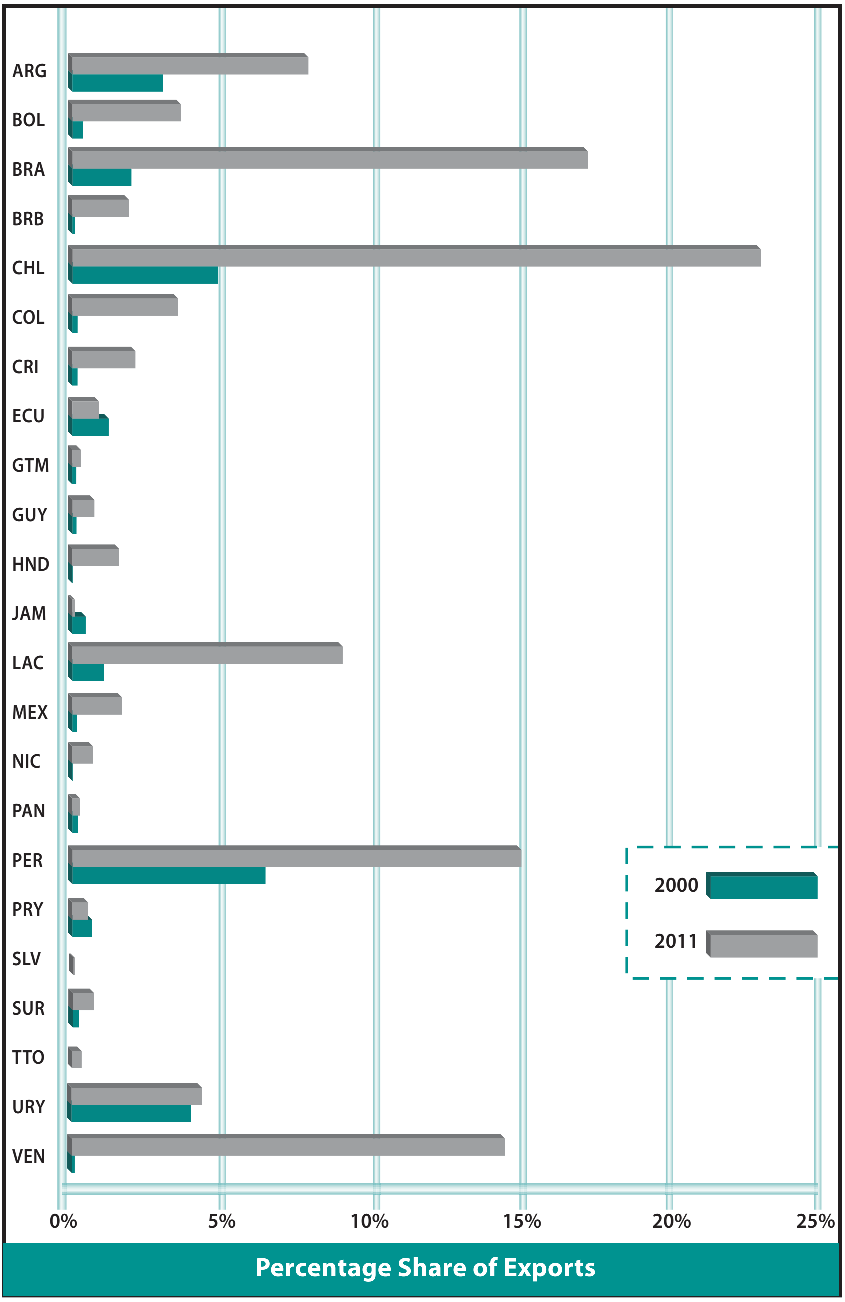
Indeed, LAC's exports to China are heavily concentrated in a small number of basic commodities such as iron ore, copper, soy, petroleum, and paper pulp. Table 1 shows the ten biggest exports from the region to China and their share of the total value of exports.

This export composition does not characterize LAC's trade with other major trading partners. The majority of LAC exports to the United States are in manufacturing (63%), followed by agriculture (22%). Even among other Asian countries, there is somewhat more diversity: the share of manufacturing exports to Japan, Korea, and the ASEAN countries is 16% compared with 8% to China.[2] On the whole, 45% of LAC exports to the rest of the world consist of manufacturing products, followed by agricultural products (24%), fuels (16%), and mining (15%).

[1] UN Comtrade as reported by LAC

[2] For these figures, the following categories are used, based on SITC 3 classification: Manufacturing (5 to 8 –68), Agriculture (0+1+2 – 27 – 28+4), Mining (27+28+68) and Fuel (3). ASEAN consists of Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

FIGURE 1/
Share of LAC countries' Total Exports to China, 2000 and 2011



Given the distribution of factor endowments between the two economies—LAC's abundance of natural resources and China's enormous (and still relatively low-wage) labor force—a commodities-for-manufacturing trade pattern seems likely to persist. The challenge will be to find

TABLE 1/
Share of the Top 10 LAC Exports to China as % of Total Exports, 2010–2011

Products (HS2002, 6 digits)	Share	Accumulated Share
Iron ores and concentrates non-agglomerated	23.6	23.6
Soya beans, whether or not broken	18.6	42.3
Refined copper and alloys: cathodes	12.9	55.2
Petroleum oils and oils obtained from minerals, crude	9.1	64.3
Copper ores and concentrates.	8.4	72.7
Iron ores and concentrates agglomerated	2.4	75.1
Flours, meals and pellets, of fish	1.5	76.6
Crude oil, whether or not degummed	1.5	78.1
Paper pulp, non-coniferous	1.5	79.6
Cane sugar	1.3	80.9

Source: UN Comtrade.

opportunities to diversify and, especially on the LAC side, add value to its products within this overall context.

Investment

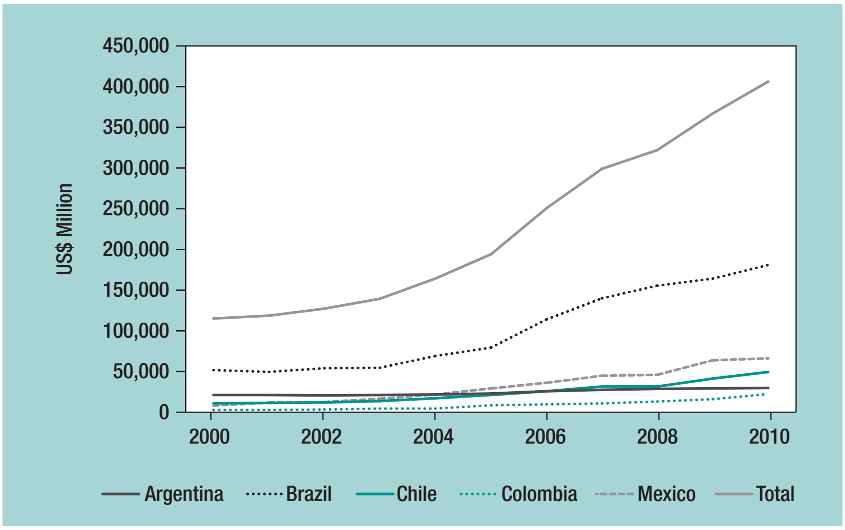
Direct investment offers one way to diversify and deepen an economic relationship, allowing firms to jump trade barriers, reduce transportation costs, and gain better understanding of foreign markets. Given concerns about the concentration of LAC-China trade, as well as persistently high trade costs (including tariffs, non-tariff barriers, and transport costs), investment holds the potential to considerably strengthen economic integration between LAC and China.

How does the picture look on the investment side? It is safe to say that LAC companies making direct investments in China remains the exception rather than the rule. Overall, outward foreign direct investment (FDI) from the LAC region has been on the rise, as Figure 2 shows, driven by Brazil and, to a lesser extent, Mexico. The dynamism of outward investment flows can be attributed in part to the strong performance of domestic economies and improvements in the business climate in many LAC countries, which, somewhat paradoxically, helps firms locate financing and develop the scale needed to invest abroad.[3]

However, despite the recent take-off of outward FDI, significant investments in China have yet to materialize. Table 2 presents official Chinese data on inward FDI from LAC collected by the Ministry of Commerce

[3] Barham, John. "Branching out: finally, Latin America is realizing that more of its companies should invest internationally to harness the forces of globalization and consolidation" *Latin Finance*. December 1, 2008.

FIGURE 2/
Outward FDI Stocks from LAC



Source: Authors' based on UNCTAD FDIStatistics.

TABLE 2/
LAC's Outward FDI in China, Selected Countries 2006–2012, in US millions

Country of Origin	2006	2007	2008	2009	2010	2011	2012*	2006–2012
Brazil	63.75	31.64	38.79	52.48	57.25	43.04	27.13	314.08
Argentina	6.86	11.13	12.66	12.41	0.94	7.32	7.09	58.41
Mexico	12.57	5.66	3.85	0.91	15.25	4.53	5.65	48.42
Chile	5.6	7.19	4.66	3.23	1.46	16.79	8.01	46.94
Bolivia	3.06	1.29	0.99	3.38	4.6	1.89	0	15.21
Venezuela	0.98	2.09	2.37	1.98	3.58	2.09	0.55	13.64
Honduras	1.31	1.68	2.14	0	3.01	2.6	0	10.74
Peru	0.73	5.27	2.67	0.04	0.02	0.87	0.16	9.76
Paraguay	1.58	0.58	2.15	3.01	2.34	0	0	9.66
Uruguay	0.13	0.1	0	2.21	1.32	0.63	0.5	4.89
Ecuador	0.1	1	0.49	0.26	2.03	0.03	0.01	3.92
Guatemala	1.6	1.16	0	0	0	0	0	2.76
Jamaica	0.79	0	0.29	1.1	0.2	0	n.a.	2.38
El Salvador	0.2	0	0	0.63	0	0	0.07	0.9
Colombia	0.35	0.05	0.1	0.14	0.05	0.01	0.03	0.73
Costa Rica	0.1	0	0	0	0.1	0.22	0	0.42
LAC**	130.4	101.5	137.9	121.9	159.45	139.82	67.04	858.01
Share of LAC's FDI Outflows (%)	0.31	0.43	0.37	1.16	0.35	0.62	n.a	n.a.

Sources: MOFCOM and Economic Commission for Latin America and the Caribbean (ECLAC).
* January–June **Not including tax havens.

(MOFCOM). These figures show FDI flows from LAC countries into China follow no clear trend over the past half-decade, represent modest sums, and account for a very small portion of the region's total outward FDI (0.44% for the period 2006–2011). They are also mainly driven by Brazil, which accounts for 37% of the region's FDI to China since 2006.

On the other hand, discrepancies do exist between different sources of FDI data, and the MOFCOM figures are generally lower than other official figures. According to the Central Bank of Brazil, for example, outward Brazilian FDI to China totaled US$400 million between 2009–2011, significantly more than the 153 million reported by MOFCOM for this period. Still, even using the Central Bank of Brazil numbers, investment in China represents just a fraction (0.08%) of the total foreign investment of Brazilian firms during this period.

Another indication of the geographic orientation of outward FDI from Latin America comes from the strategies pursued by the region's major multinationals. Although comprehensive firm-level data is hard to come by, the evidence available suggests that LAC multinationals focus most of their foreign investment within the region. The United States (particularly in the case of Mexican firms) and, to a lesser extent, Europe remain the most common destinations outside LAC. Information reported by the Vale Columbia Center shows that of the 20 largest foreign investments by firms based in Brazil, Mexico, Argentina, and Chile from 2007 to 2010, 60% stayed within the region. Only one investment among this set of 80 deals went to China.[4]

This brief overview of LAC's outward FDI suggests, if nothing else, the potential for growth in the region's investments in China. For one, they are starting from a rather low baseline. More substantively, we see that outward FDI from the region has experienced a mini-boom since around 2004, with the majority of the flows destined for neighboring countries. As firms invest abroad, they acquire a wealth of experiences and capabilities—how to operate in distinct regulatory environments, adapt to unfamiliar business cultures, and market products to customers and clients with different preferences—that facilitate their further expansion into new foreign markets.

Indeed, firms usually invest first in neighboring countries and regions, where they can expect to enjoy the benefits of proximity and cultural affinity. Expansion into far-flung markets generally occurs only after significant international operations already exist, although a new breed of rapidly

[4] See http://www.vcc.columbia.edu/content/emerging-market-global-players-project

CASE STUDY: GRUPO BIMBO

GRUPO BIMBO

Bimbo is the world's third largest baked goods company and one of the largest food companies in Latin America. Founded in 1945 in Mexico City, the company makes over 5,000 products under 150 brand names worldwide and produces and distributes baked goods in 19 countries in Latin America, North America, Europe, and Asia. In 2011 Bimbo realized consolidated sales of $10.7 billion, and the company ranked among Mexico's ten largest firms. Currently, more than 50% of its sales come from outside of Mexico.

Bimbo pursued an aggressive internationalization strategy beginning in the mid-1990s. Focusing on emerging markets, the company invested heavily to acquire smaller brands, accumulating several dozen by 2011. In this context, Bimbo purchased the Beijing Food Processing Center, a subsidiary of Spain's Panrico, in 2006 for US$11 million. With this acquisition Bimbo bought a firm with over 10 years' experience in China, 800 workers, a plant outside Beijing, a distribution network around Beijing and Tianjin—and mediocre results.

The move into China was motivated by the large size of the domestic market and the company's conviction that rising incomes and urbanization would translate into increasing demand for packaged baked goods—a classic market-seeking strategy.

Despite its rapid expansion during the 1990s and 2000s, the decision to enter the Chinese market came only after an extensive period of study. This process included hiring a group of Chinese immigrants in Mexico to taste hundreds of Bimbo products and make recommendations, leading to the selection of five core products to introduce in the Chinese market. Bimbo has proven to be one of LAC's most notable successes in China. Between 2006 and 2010 sales increased fourfold to $35 million, placing Bimbo among the 10 most important bakery firms in China. Bimbo has also expanded its scope in China, buying the local bakery brands Baiwanzhuangyuan and Million Land in 2009 and Jin Hong Wei in 2010.

How has Bimbo achieved such growth? It was not all smooth sailing for the company in China. Despite its extensive prior research, Bimbo found its initial product line in China was too sweet for local palates. The company therefore changed tack and went back to producing Panrico's products while it developed more savory offerings. Bimbo has since introduced a range of popular items tailored to Chinese tastes that diverge from its traditional product line: meat pies, sweet rolls stuffed with beans, and corn sandwiches, among others.

Another key factor has been its distribution network. The nature of the baked goods business requires fresh products, making an effective direct distribution network that ensures just-in-time delivery critical. Bimbo's distribution model has been a hallmark of its success, today encompassing around 50,000 routes, 1,600 distribution centers and more than 2,000,000 sales points worldwide. Developed in Mexico during the 1950s-1970s, before the advent of large supermarket chains, the model is well adapted to delivering fresh products to small neighborhood retail points that are relatively dispersed.

The company brought this firm-level advantage to its China operations. While inheriting Panrico's distribution routes and sales points, Bimbo greatly expanded its distribution capacity in China, building new distribution centers and mobilizing a fleet of bicycles to reach into Beijing's maze-like traditional neighborhoods where motor vehicles are restricted. The company currently sells over 100 products in 27 cities and some products with longer shelf lives even reach remote provinces in the Western part of the country.

Sources: Enrique Dussel Peters "Mexican Firms Investing in China (2000–2011)", company Annual Reports, and press.

internationalizing firms, discussed in later sections, is challenging that paradigm. Latin American firms, after a decade of ramping up investments in the region and beyond, should be better equipped today to make inroads in China.

Finally, the size and dynamism of the Chinese market, its centrality in global production chains, and its relatively low costs should provide ample motivation for multinationals to invest—a theme taken up in more detail in the next section. While the opportunities are considerable, so are the obstacles facing Latin American firms hoping to penetrate the Chinese market: a distinct business culture, the language barrier, different customer preferences, a complex regulatory environment, and geography, among others.

The best way to navigate these challenges will depend on the industry, the firm's strategic priorities, and the nature of its competitive advantages. In fact, there is a large body of economic literature on how these factors impact firms' foreign investments. The next section presents several key findings from that literature, which provide a conceptual framework to orient our analysis of LAC firms in China.

CASE STUDY: STEFANINI

STEFANINI

Stefanini is a leading Brazilian IT services firm that provides outsourcing, systems support, and IT consulting to clients in sectors including financial services, manufacturing, telecommunications, chemicals, government, and utilities. Founded in 1987 by Marco Stefanini as an IT training center, the company rapidly turned itself into one of Brazil's largest technology firms, expanding its business lines to include software production and complete systems support and gaining recognition as one of the top IT outsourcing firms in Latin America. By 2011, total revenues reached over US$400 million, and the company currently boasts a presence in 28 countries, providing services in 32 languages.

Internationalization has been central to Stefanini's growth. The company's first presence in foreign markets came in 1996 through a subsidiary in Argentina, making it the first Brazilian IT company with offices outside the country. The firm's global orientation is reflected in its revenues; for 2011, some 40% came from international operations, and the figure is expected to reach 50% for 2012.

In entering the Chinese market, Stefanini followed a similar path as in other foreign markets, acquiring the US firm Techteam in 2010, which had a small office in Shanghai. An important motivation for the firm in establishing a direct presence in China was to better serve its existing clients—including large multinationals such as Ford Motors and John Deere, the manufacturer of agricultural machinery—that had operations in China. This "follow the client" strategy is typical of firms in highly globalized industries such as IT.

Once installed in Shanghai, the company began filling the specific needs of its clients in the country. To do so, Stefanini partnered with local IT contractors, training them in the firm's approach and way of doing business. In choosing a local partner, Stefanini identified a firm whose US headquarters was located only a half-hour drive from Stefanini's US headquarters. The company had done business for one of Stefanini's key customers and had a good reputation. According to Stefanini executives, having easy access to their executive team was a considerable advantage early on in the partnership.

However, the use of contractors also limits Stefanini's brand visibility in China. Moving forward, the goal is to establish mature operations in China. To that end, in November 2011 Stefanini announced plans to invest US$3 million to establish a new unit in China's Jilin province. The goal is to use its foothold in China to acquire Chinese clients in addition to expanding its business with multinational clients in the country.

The new facility has a strategic location. Jilin is a hub for the auto industry in China, and Stefanini is looking to build its client base in this sector. Jilin also has a large Japanese-speaking population, and the company hopes its office there will eventually serve the Japanese market too. Currently, the Jilin site has one employee who is engaged mainly in business development activities; however, the company has ambitious plans: the site has been envisioned to eventually house 100 employees and offer the full range of Stefanini's services, including a services center for software development, a service desk, and business process outsourcing (BPO) capabilities.

Sources: Information provided by company officials, company Annual Reports, and press.

Setting the Stage: Some Observations on Foreign Direct Investment

Part 2

This section does not attempt a thorough review of the economic literature on foreign direct investment. Rather, its goal is to present a few fundamental ideas from the field that will help orient our analysis of LAC firms' strategies in China. Economists studying multinational firms and FDI have focused considerable attention on i) explaining the motivations for FDI and ii) describing the characteristics of firms and industries with high levels of FDI. Although there is not always a clear division, it is useful to think of these two groups of theories.

Within the first, an important foundation is Dunning's (1993) four basic motivations for direct foreign investments: *market seeking* investments, which aim to capture foreign market share through direct presence in the host county; *efficiency seeking* investments, in which firms locate production where inputs (often labor) are cheap or else seek efficiency gains through vertical integration of production; *resource seeking* investments, directed towards securing natural resources; and *asset seeking* investments, generally associated with research and development abroad.[1]

Another useful distinction that emerges in the literature is between horizontal and vertical FDI. The first refers to production of the same products in different locations; vertical investments by contrast break up the production process among different locations.[2] Generally speaking, market seeking strategies employ horizontal investment while efficiency and resource seeking strategies correspond to vertical investment.

The varying motivations for FDI help explain the choice of destination market. In the case of horizontal investments, Markusen (2002) concludes that a large market in the host county and the existence of significant trade barriers tend to encourage FDI.[3] Here, trade barriers should be thought of as encompassing not just tariffs and other trade policy levers but also transport costs and more intangible cultural differences. For vertical investments, the prevailing concern is the cost and availability of factors across different locations. The presence of low-cost labor, for example, incentivizes locating labor-intensive activities in that market.

In terms of firm and industry-level characteristics, Dunning (1977, 1981) proposed that firms undertaking FDI have i) a product or production process that bestows market power advantage abroad (ownership advantage)

[1] Dunning, John H. *Multinational Enterprises and the Global Economy*, Addison-Wesley, 1993.

[2] See Horstmann, Ignatius J., and James Markusen (1992) 'Endogenous Market Structures in International Trade (natura facit saltum).' Journal of International Economics 32(1–2), 109–129 and Helpman, Elhanan (1984) 'A Simple Theory of International Trade with Multinational Corporations.' Journal of Political Economy 92(3), 451–471.

[3] Markusen, James R. *Multinational Firms and the Theory of International Trade.* MIT Press, 2002.

CASE STUDY: CONCHA Y TORO

CONCHA Y TORO

Viña Concha y Toro (CyT) is a Chilean winemaker that produces a number of award-winning wines under the Concha y Toro and Casillero del Diablo brands. The company, which first began production in 1883, is Chile's leading wine producer and exporter and the third largest vineyard in the world by planted acreage. Concha y Toro had consolidated sales of US$872 million in 2011, selling 29.7 million cases of wine in 135 countries.

The firm was an early mover among South American vineyards in establishing an international presence, relying on a combination of acquisitions and building brand awareness in foreign markets. In 1994, CyT became the first winery in the world listed on the NYSE. The next year, Concha y Toro established the Trivento Bodegas y Viñedos in Argentina, and in 1997 the company launched a joint venture, Viña Almaviva, with Baron Philippe de Rothschild to produce a super-premium wine equivalent to the French Grands Crus Classés.

The winery began pursuing a strategy to capture Asian markets in 2001, when CyT became the first Chilean winemaker to open an office in China. At that point in time, Concha y Toro had already seen considerable growth in exports to Japan and small but consistent growth in Korea. China, however, was still largely *terra incognita* for international wineries, but with seemingly unlimited potential. The emergence of a vast middle class, growing appreciation for wine, low historic wine consumption, and changing consumer preferences in favor of higher end goods all combined to make China a huge target for winemakers.

Concha y Toro's presence in China is aimed at scaling up distribution and establishing strong brand awareness for CyT among China's growing wine drinkers. The firm identified a local partner, the distributor Summergate, which focused exclusively on the wine business—a core principle for Concha y Toro in foreign markets. In 2010 the firm moved its office from Shanghai to Singapore, where it oversees the company's entire Asia strategy.

To build brand awareness in China, CyT has created highly targeted marketing campaigns and advertisements geared towards different segments of Chinese consumers. Another key feature of the strategy is its regional focus—given the vastness and diversity of the country, having a strong distribution network and tailored marketing strategies at the regional level is key.

Examples of Concha y Toro's aggressive marketing and brand awareness efforts in China include Casillero del Diablo's sponsorship of the Manchester United soccer club, an English Premier League team with a large following in China. As part of this campaign, CyT sponsored tours with Manchester United players and in-store promotions in China. The label also sponsored a PGA Tour event in Shanghai to raise brand awareness among China's growing number of golf fans.

At the same time, Concha y Toro faces a challenging competitive landscape, with competitors from Chile and the rest of the world vying for market share. The company is betting on its regional strategy and investment in its brands. The long-term goal is ambitious: to be leaders in value and volume in each of China's regions through the strength of its brands, not on the basis of price.

Sources: Information provided by company officials, company Annual Reports, and press and ii) an incentive to utilize that advantage internally rather than through arms-length licensing or sales (internalization advantage).[4] Markusen expands on this framework by showing that multinationals possess a high degree of knowledge capital—high-skilled human resources, proprietary knowledge, process know-how, patents, and blueprints, as well as marketing assets such as brand names and trademarks. This knowledge capital forms the essence of multinationals' ownership advantage and can be easily transferred to operations in foreign countries, giving firms an incentive to internalize foreign operations. Other authors have similarly found that FDI tends to be important in technologically complex, R+D intensive industries and industries with a high level of advertising and product differentiation.[5]

What do these general findings suggest about the particular case of LAC firms in China? First, given the dynamism of the Chinese market, it is natural to expect a large number of market seekers looking to capture local market share. In terms of firm-level strategies, Markusen's findings suggest that these firms will attempt to leverage knowledge capital—both technical and operational capabilities as well as branding/marketing assets—through their investments in China.

Secondly, it is likely that efficiency gains would be another important motivator for LAC firms, given the lower costs of labor and certain raw materials in China. Especially in labor-intensive sectors like manufacturing, firms might invest in China to achieve cheaper production, using China as an export platform to third markets. Of course, firms could also pursue a dual strategy, investing both to capture the local market and increase exports.

Given their importance for LAC economies, and the presence of many of the region's largest firms in this sector, natural resources should be a focal point of LAC outward FDI. In China, however, with its limited natural resource base, these firms will be more likely to make vertical investments in downstream activities such as processing, refining and marketing, rather than traditional resource-seeking investments.

Finally, investing in China allows firms to participate in global value chains. In a context where China dominates production in industries such as automobiles and electronics, LAC firms that produce intermediate products for these production chains face very strong incentives to establish a presence in China. These investments can be thought of as a special class of efficiency seekers, in that proximity to key customers (generally major international producers with operations in China) is the prevailing motivation.

[4] Dunning, John H. "The Determinate of International Production." *Oxford Economic Papers* 25: 289–330. 1977 and Dunning, John H. *International Production and the Multinational Enterprise.* Allen and Unwin, 1981.

[5] See Caves, Richard E. *Multinational Enterprises and Economic Analysis*, Cambridge University, 1996.

The theory thus provides a broad framework for understanding LAC firms' strategies in China. This framework, of course, still allows for a great deal of variability at the firm level: companies can pursue market seeking investments, for example, in a number of different ways. In order to gain a better understanding of *how* different groups of LAC firms have carried out these strategies in China, it is necessary to look at the experiences of the firms themselves. The next section does just that, through an empirical analysis of 85 LAC firms with investments in China.

Profile and Strategies of Latin American Firms in China

Part 3

A basic challenge in analyzing Latin American firms with investments in China is the lack of systematic data or previous analytical work on the topic.[1] In some cases, public agencies in LAC maintain lists of firms with a presence in China, but this data alone does not tell us much about the dynamics of their experience in the country: when they entered the market, how, and what strategies they have pursued.

Faced with this gap, we identified a sample of 85 LAC firms with a direct presence in China—either wholly or jointly owned production facilities; distribution units; offices to provide services directly to clients; or representative and commercial offices for sales, marketing, or post-sale support. To do so, we reviewed existing data on major exporters to China (a much larger set of firms), lists of the largest and most global Latin American firms compiled by media such as *America Economía* and CNN Expansión, previous academic research on LAC multinationals, and the daily business press. In each case, we independently confirmed whether the firm had investments in China and, if so, gathered additional contextual information such as its year of entry, entry mode, type of presence, and core activities in China.[2] While it does not claim comprehensiveness, the sample should provide a representative portrait of the most important LAC players in China.

Firm Characteristics

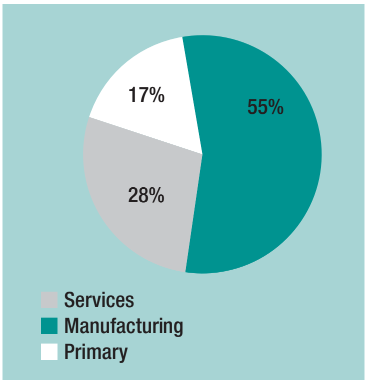
As Figure 3 shows, manufacturing firms comprise the largest sub-group of the sample, with a smaller representation of services providers and firms in the primary sector—those whose activities have a direct link to natural resources. Manufacturing is a broad category that contains a diverse range of firms. The sample features a strong representation of automotive parts producers, steel and metallurgy firms, food and beverage producers, and manufacturers of chemicals (see Figure 4).

The service sector companies also consist of a diverse group of firms representing the transportation, food service, finance, consulting, and IT and software industries. The final group features primarily firms involved in mining, petroleum, and forestry.

[1] One notable exception is a report published by the Brazil-China Business Council in June 2012, which analyzes the experiences of a group of 57 Brazilian firms with investments in China. See Frischtak, Claudio and André Soares. "Empresas Brasileiras na China: Presença e Experiências". Brazil-China Business Council. 2012.

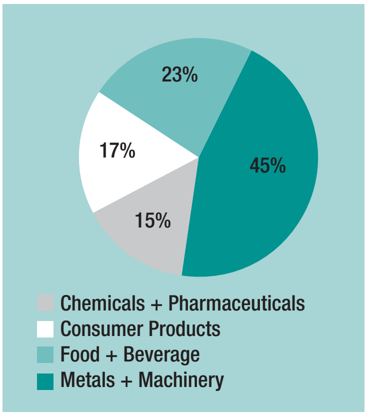
[2] This review utilized a mix of open source information such as company websites and annual reports, financial statements, and news media, as well as information provided by fDi Intelligence and Emerging Markets Information Systems.

FIGURE 3/
Sector Breakdown of Firms



Source: Authors' calculation based on analysis of firms.

FIGURE 4/
Types of Manufacturing Firms



Source: Authors' calculation based on analysis of firms.

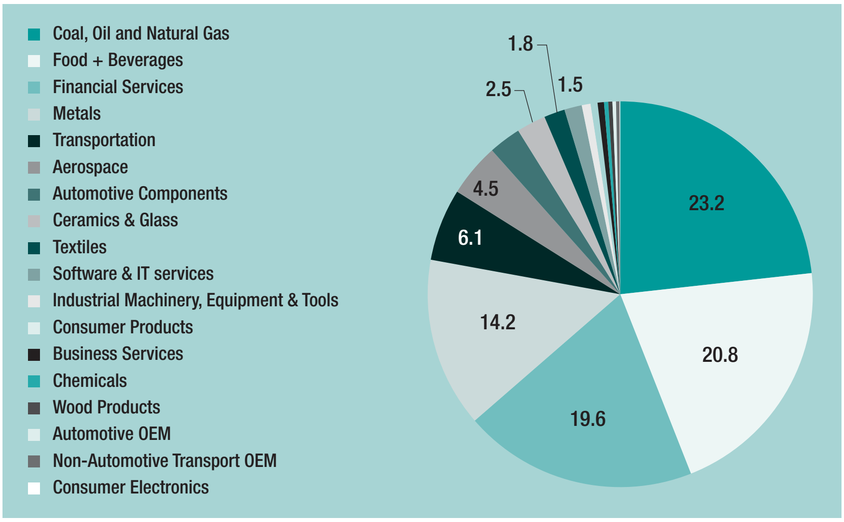
However, a different picture of sector participation emerges if we look at the value of announced investments (see Figure 5). By this metric, the dominant players are in the primary sector (oil, coal, and gas especially), food and beverage production, and financial services. It is important to keep in mind that these shares reflect only announced investments, which often vary considerably from the data reported by official sources like China's MOFCOM. That being said, they should give a general indication of the quantity of investment by sector and suggest that while the number of firms in sectors like oil, mining, and financial services may be small, they could account for a disproportionate share of the total value of LAC investment in China.

Whether large or small, investments in China are, for the most part, a relatively recent phenomenon. More than half of the 85 firms in the sample have entered China since 2007 (see Figure 6). This fact is not surprising, given that i) investment generally follows trade, ii) trade between the economies did not take off until 2000, and iii) Latin America has only in the past few decades developed a large stable of globally oriented firms. The early movers—those that entered the country before 2000—are among Latin America's largest, most globalized firms. Each had established a dominant position in the regional market before entering China.

Activities of LAC Firms in China

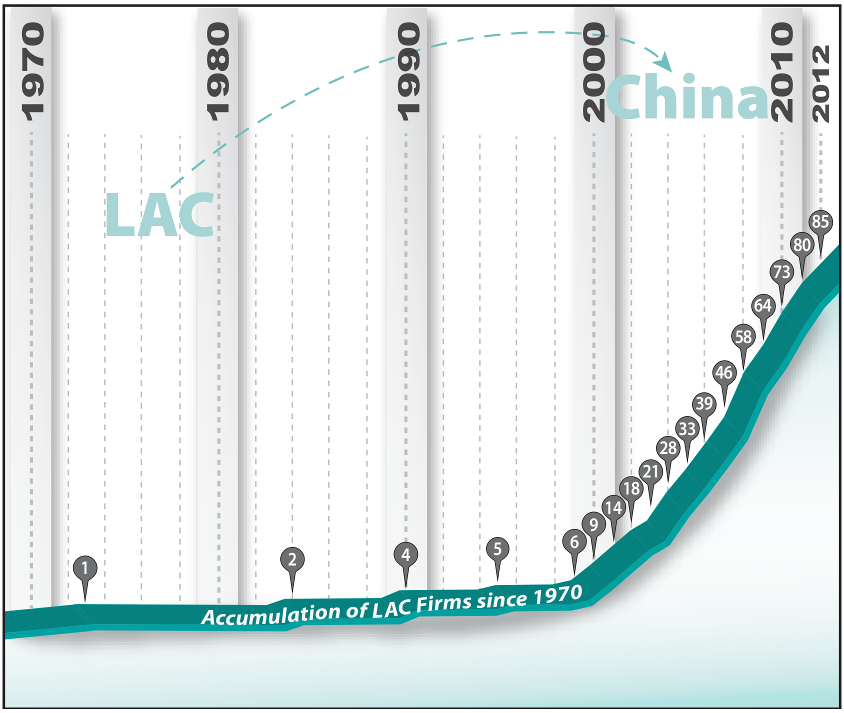
When it comes to the activities of LAC firms in China, a couple of noteworthy trends are evident. First, a large number of firms (47%) carry out

FIGURE 5/
Share of announced investment projects by sub-sector (% of total value of investments)



Source: Authors' calculation based on fDiIntelligence data.

FIGURE 6/
Year of Entry of LAC Firms in China



Source: Authors' calculation based on analysis of firms.

sales, support, and marketing activities, generally through a representation or commercial office in China. These tend to be small operations, often with fewer than 10 employees, and require a minimal investment. This type of presence can give firms a better understanding of their clients and the market, allowing them to provide tailored products, keep abreast of new market niches, and forge stronger relationships with customers.

Production—along with direct service provision, the equivalent for services firms—represents the other major activity of the sample firms. Indeed, a full 64% are engaged either in production or direct service provision in China.[3] We included in the realm of production refining and processing of natural resources, under the assumption that these are value-added activities that transform raw materials into new products.

The primary sector and manufacturing firms with a production presence in China tend to be among the region's largest firms, often diversified business groups. Mexico's Cemex, Grupo Alfa, and Grupo Bimbo; Brazil's Embraco, Embraer, and Vale; Argentina's Tenaris; and Chile's Sigdo Koppers are among the firms in this group.

On the services side, we see that nearly every firm uses its presence in China to provide services directly to clients. The flexible, non-capital intensive nature of many services makes setting up this type of operation far easier than it would be for an auto parts maker to establish a production plant, for example. In addition, some service sector businesses, such as restaurants and transport services, require that provision and consumption occur simultaneously—making direct presence a necessity.

To better understand the strategies employed by different firms in China, we can look at choice of entry mode and ask whether different types of firms prefer particular entry modes (acquisition, greenfield, or joint venture). Overall, greenfield investment (investing in a new, wholly-owned plant, office, or facility) has been the most popular entry mode for firms in the sample, with 55% taking that route. This result partly reflects the fact that opening a representation or commercial office, which we have seen to be a common approach among LAC firms, almost always occurs through a greenfield investment due to the firm-specific nature and low costs of this type of presence. Another consideration is that several firms in our sample started with a representation office (through greenfield investment) and later moved into production or R+D through a joint venture or acquisition.[4]

However, as we see in Figure 8, primary sector and manufacturing firms show more diversity in terms of entry mode. These firms, which are

[3] Because many firms have both a production and representation/commercial presence, the totals in this section of the analysis exceed 100%.

[4] Embraer, PDVSA, Sigdo Koppers, Suzano, Tenova, and Vale are examples of firms that followed this trajectory.

more likely to participate in complex, capital-intensive industries such as steel production, chemicals, or auto parts, have greater incentives to partner, especially with local firms, or (if they have sufficient financing) to acquire an incumbent with operations already up-and-running.

If we examine entry mode by firms' activity, an even clearer contrast emerges between production and service provision firms (see Figure 9). Only 22% of firms involved in production chose greenfield investment, while this was the preferred entry mode for 68% of firms engaged in direct service provision. Joint ventures were the most popular entry mode for producers (47%). Again, this result has a lot to do with the varying start-up costs between production facilities and service provision sites. The former, especially in heavy manufacturing sectors, entails significant investment, making joint ventures more appealing; on the other hand, service provision often requires only a modest office and several employees.

There are also political economy considerations at play here. Every several years the Chinese government publishes guidelines that classify foreign investments as encouraged, restricted, or prohibited depending on their sector (see Box 1). In certain industries, including a number of mining and manufacturing sub-sectors, foreign firms face restrictions on their ownership share or are limited to joint ventures with Chinese companies.

Service sector firms by contrast generally find fewer policy barriers to operating in China. In fact, firms in frontier sectors such as new information

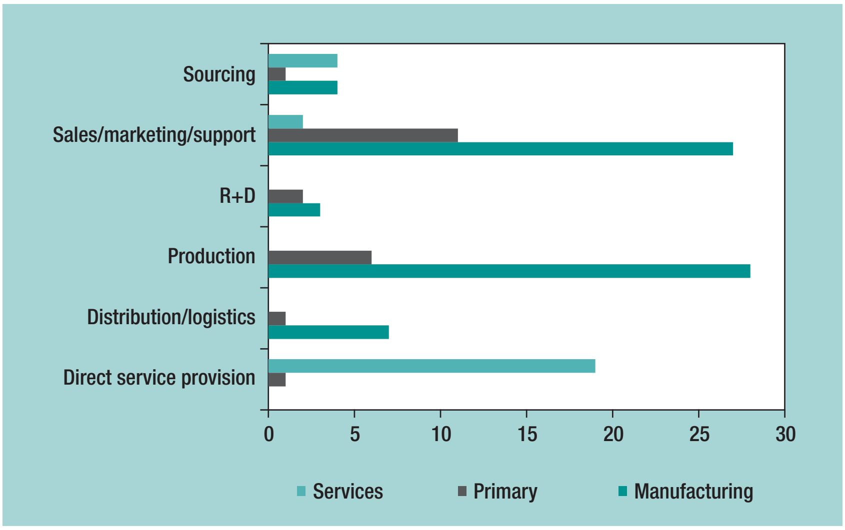


FIGURE 7/
Activities of Firms by Sector (number of firms)

Source: Authors' calculation based on analysis of firms.

BOX 1/ China's Policies on Inward FDI

The Chinese government takes a very strategic approach to foreign direct investment in the country, actively encouraging investment in certain sectors while restricting and prohibiting it in others. Beginning in 1995, China's National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) have published every several years a "Catalogue for the Guidance of Foreign Investment Industries" that classifies investments as "prohibited," "restricted," or "encouraged" based on their sector. Any projects that do not fall into one of those categories are considered "permitted."

These categories affect the degree of regulation and level of approval required for foreign investments. For projects in the encouraged and permitted categories, provincial authorities—the local development and reform commissions (DRC)—have the authority to approve projects up to $300 million. Larger projects in these categories require approval by the NDRC as well as industry regulators, and any project greater than $500 million must also be submitted to the State Council. For projects in the restricted category, the thresholds are lower: $50 million for approval by the NDRC and $100 million for the State Council.

The Catalogue also specifies certain industries where foreign investments must take the form of joint ventures with Chinese firms and others in which Chinese investors must hold a controlling share. In the most recent edition of the Catalogue (which entered into force January 30, 2012), areas with such restrictions include exploration and mining of types of coal, barites, and noble metals; manufacturing of active pharmaceutical ingredients and certain transportation and industrial equipment; construction and operation of urban infrastructure for gas, heat, water, and sewage; and telecommunications and passenger transportation services.

The list of encouraged industries gives an insight into the evolving priorities of the Chinese government. In the current Catalogue, the government added 44 new industries to this category, with a strong emphasis on energy-efficient and environmentally friendly technologies (for example, new-energy automobiles, renewable energy sources, and marine oil pollution clean-up technology), next-generation information technology, and high-end manufacturing. Sectors downgraded from encouraged to permitted included production of complete automobiles, polycrystalline silicon, and large-scale coal chemical products. Here, the government's motivations include developing the local industry and preventing overcapacity in certain sectors.

Finally, the Chinese government offers a range of incentives from tax breaks and lower rents to streamlining approval for investments in encouraged sectors. In the IT and software sector, for example, LAC firms such as Stefanini and Belatrix have taken these incentives into consideration in their China strategies.

From the perspective of encouraging Latin American investments in China, it would be advantageous for firms to align their investments with the priorities of the government to the extent possible. At the very least, it is important for firms considering investing in China to be aware of the regulations and incentives that exist in different sectors, as they will undoubtedly impact the firm's experience in the country. Conversations with LAC executives and media reports suggest that this has not always been the case.

Sources: Ministry of Commerce of China (MOFCOM), WTO Trade Policy Report: China (2012).

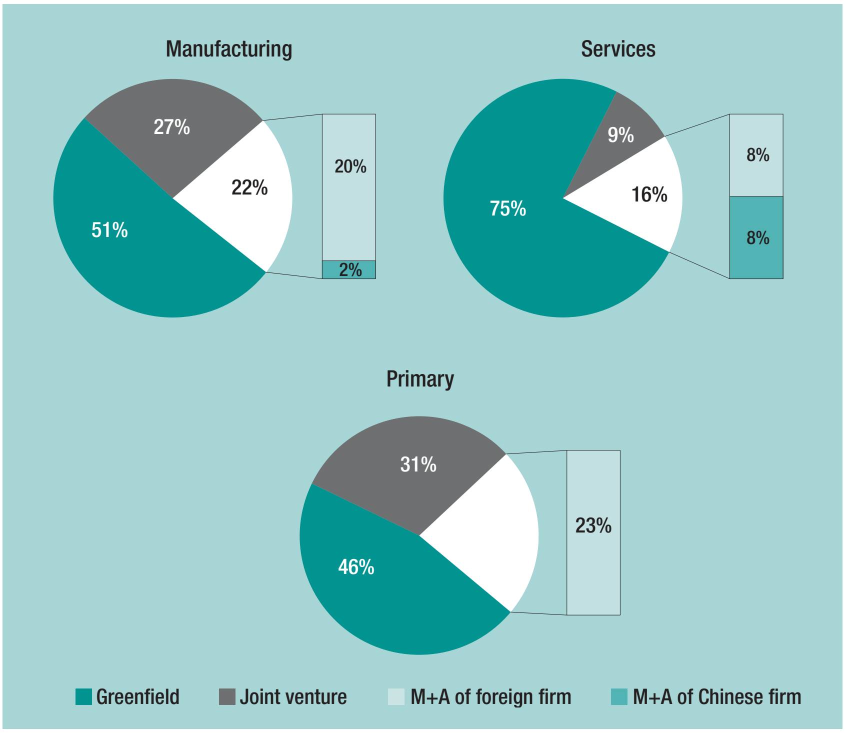


FIGURE 8/
Entry Mode by Sector

Source: Authors' calculation based on analysis of firms.

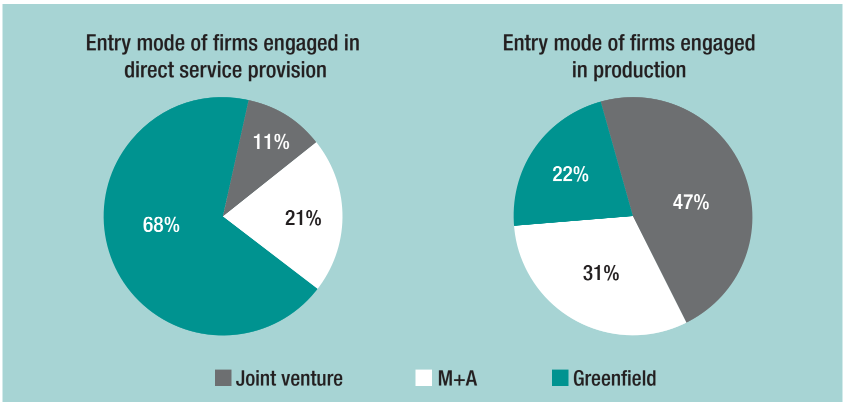


FIGURE 9/
Entry Mode of Producers and Service Providers

Source: Authors' calculation based on analysis of firms.

technology and software often enjoy tax breaks and other incentives to invest in China. The Argentine software producer Belatrix, for example, received capital from the Chinese province of Jiangsu for its joint venture, Eastern Ocean Solutions.

What general conclusions can we draw from our survey of LAC firms? Can we identify distinct types of firms based on their strategies in China? Figure 10 plots a selected group of LAC firms according to their activities, sector, and entry mode.[5] To begin, one can draw a distinction between firms only involved in sales, marketing, or other support activities versus those that have gone a step further and are producing or offering services directly in the Chinese market.

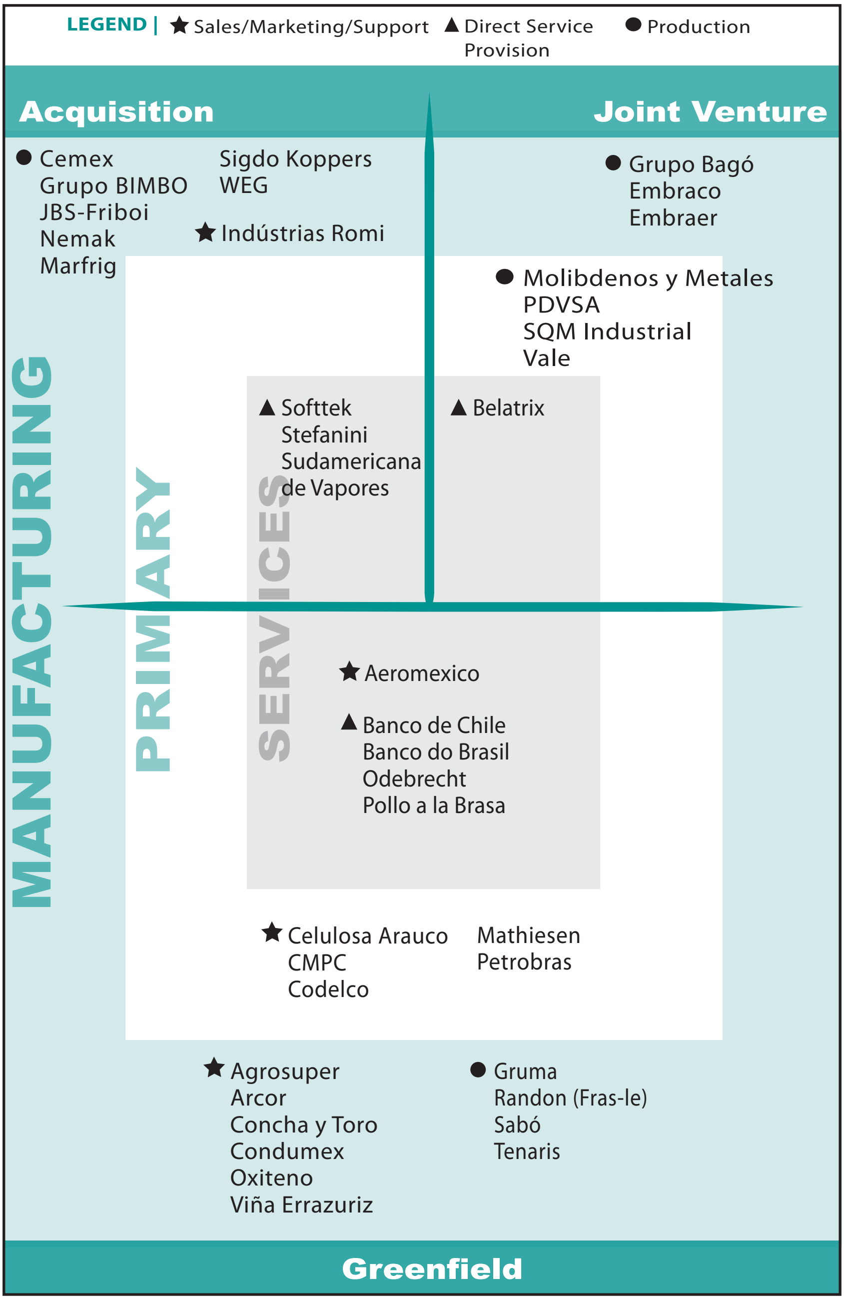
Among the former, which appear mostly in the bottom half of the chart, there is a sub-group of firms in industries such as mining, petroleum, forestry, and wine-making for whom the nature of their business makes production in China less viable. A smaller group consists of mid-sized manufactures—firms like Condumex, Oxiteno, and Agrosuper—who recently established a presence in China. In both cases, the firms in this group are generally pursuing a strategy of consolidating and expanding sales in China through marketing, branding, or client support activities that seek to differentiate their products from competitors. They have almost exclusively entered through greenfield investments, given the limited resources needed for this type of presence.

The firms producing in China display a different profile. They come from the industrial manufacturing, food production, and natural resource sectors. Most are dominant domestic players in LAC with access to significant financing and considerable firm-level competitive advantages. In terms of entry mode, they are more likely to form joint ventures and (to a lesser extent) make acquisitions, usually of foreign firms. This choice depends on firm-level considerations, but we can see a preference for joint ventures in strategic sectors like natural resources or heavy manufacturing, where firms may face regulations concerning their mode of investment. For example, all of the natural resource sector firms that are producing or refining in China participate in joint ventures (Vale, Molibdenos y Metales, SQM Industrial, and PDVSA).

Finally, there is a relatively large group of service sector firms, representing industries such as IT and software, transportation, restaurants, and finance. These firms generally provide services directly in China, taking advantage of the flexibility of their particular sectors, and have utilized both greenfield investment and acquisitions to enter China.

[5] The figure plots around half (39) of the total sample of firms, but reflects as closely as possible the overall distribution of the full sample among the various quadrants.

FIGURE 10/
Entry Mode and Activities of Selected LAC Firms in China



CASE STUDY: WEG

WEG

Weg is a leading producer of electrical motors for a wide variety of industrial equipment as well as other electrical items. The firm, established in 1961 by descendants of 19th century German immigrants to Brazil, had become Brazil's leading exporter of electrical motors by 1975 and today competes in global markets with major players such as GE and Toshiba. The company had sales of US$3.6 billion in 2011, of which 40 per cent came from outside Brazil (including exports).

During an initial phase of internationalization in the 1980s and 1990s, the firm focused on setting up commercial and representative offices abroad to consolidate export markets and establish closer relationships with customers. With this strategy, the company had achieved a presence in 50 markets through exports and had representation offices in nine countries by 1998.

A new phase of internationalization in the 2000s sought to establish WEG as a global producer. In 2004, after research into thousands of Chinese manufacturers, including a two-month visit to various sites in China by a team of WEG executives, the company settled on the Nantong Electric Motor Manufacturing, a local firm that had been slated for privatization but was at the time still state-owned. WEG reached an agreement with the municipality of Nantong to acquire the firm for US$12 million, paid in 100% capital. A critical factor for WEG was its ability to achieve full control of the assets.

WEG's motivations in investing in China were multifaceted. A basic concern was the lower costs—both of labor and certain raw materials—that could be achieved in that market. Logistics were also a factor, given that exports from Brazil took on average six weeks to arrive in China. More than anything, however, China's emergence as a manufacturing center meant that the company had to be present there to learn about changes in the market for motors, according to interviews with WEG executives.

The company encountered Chinese authorities interested in attracting a firm that would bring technological innovation. Relations with the local government have been very positive from the onset of its presence in Nantong, a factor that the company views as essential to its success in the country. In addition to Chinese officials, forging strong, personal relationships with clients and partners has been a major focus for the firm. In this way, the firm has built up "guanxi"—a term that refers to personal networks of trust that are central to Chinese business culture and social relations.

Another key to WEG's strategy has been mass production with differentiation. WEG has a tradition of producing many of its own inputs in-house, bucking the trend towards outsourcing. This practice, a legacy of the lack of suitable suppliers in the firm's early days in Brazil, has helped WEG tailor products to exact customer specifications and win market share in China.

The company has established one of the most significant manufacturing operations among LAC firms in China, with its facility in Nantong employing 620 people. WEG is one of the few producers of high-efficiency motors in China, an advantageous position given the government's determination to promote energy efficiency. With the huge size of the market, the company believes it can achieve rapid growth there over the next five to seven years: its strategy calls for increasing operations in China five-fold over that period.

Sources: Information provided by company officials, company Annual Reports, and press.

Towards a Basic Typology of Latin American Firms in China

Part 4

Based on this empirical analysis, and supported with insights drawn in Part 2 from the literature, we can propose several basic types of LAC firms with direct investments in China. Our suggestion is not that every company from the region must necessarily fall into one of the proposed categories. Rather, we seek to highlight the main strategies of LAC firms in China and the characteristics of firms that employ each one.

Resource Integrators

A first type of firm consists of large natural resource sector firms—petroleum and mining in particular—that have expanded to China primarily through vertical investments to locate segments of their value chains in that country. In general, their activities in China mostly consist of downstream operations: refining, distribution, and marketing of their products. In a few cases however, they have also participated in exploration in China. These firms were major players in their respective industries before expanding into China, benefitting from significant domestic resource bases.

Their trajectory in China has generally been to first set up local representative offices for marketing and sales purposes and to facilitate partnerships with Chinese firms. These initial investments take the form of small greenfield investments. In setting up a direct presence in China, these firms can better manage export sales, secure long-term contracts, and explore opportunities for future joint ventures and partnerships.

Firms such as Vale, Molibdenos y Metales and PDVSA have built upon this initial presence to establish facilities for refining, processing, and (in the case of Vale) exploration. These projects have taken the form of joint ventures, due to regulations on foreign investment in sectors such as energy and metals. Other resource integrators include Brazil's Petrobras and Chile's Codelco.

Global Marketers

The second type—global marketers—features firms that have established a dominant position in domestic, regional, and even extra-regional markets.

CASE STUDY: GRUMA

GRUMA

Mexico's Grupo Maseca (Gruma), founded in 1949, is the leading producer, distributor, and marketer of corn tortillas in the world, as well as a producer of wheat-based wraps and flatbreads, canned foods, and other food products. The company established its national presence as a producer of an emblematic Mexican food and has since captured significant market share in countries such as the United States and Australia. In 2011, the firm realized US$4.6 billion in sales, of which around two-thirds came from operations outside Mexico.

The company was a pioneer among Mexican firms in investing abroad, and it currently has 63 plants in 17 countries outside Mexico. Beginning with investments in nearby markets such as Costa Rica and the United States in the 1970s, the company expanded its presence in Central and South America during the next decade. The inauguration of a production facility in the UK in 1999 and the acquisition of the Mission Foods brand in 2008 represent additional milestones in the company's internationalization. The last half-decade has seen Gruma making acquisitions and new investments in China (2006), Malaysia (2007), Australia (2009), Russia (2011), and Turkey (2011).

In the context of this expansion, Gruma viewed a presence in China as a necessary step. For one, the dynamism of the market and its rising consumption levels made China a strategic priority. In addition, Gruma executives believed that given the complexity of the market, setting up a production facility in the country would be necessary to fully understand the opportunities and realize the firm's potential there. Previously, Gruma had exported to China—mainly tortillas and wheat chips—from plants in the United States.

To enter the Chinese market, Gruma chose to build a new plant in Feng Xian, a district on the outskirts of Shanghai, in 2006. Shanghai, China's largest urban center, features a high-income and cosmopolitan population where openness to foreign foods is high. The location also positioned Gruma to supply the growing number of international fast food chains installed in Shanghai. Gruma invested around $ 100 million, under the brand Mission Food Shanghai, in a facility that produces 15,000 tons/year of wheat tortillas and 7,000 tons/year of corn tortillas.

Mission Foods Shanghai supplies a range of restaurant chains (including McDonalds, Pizza Hut, and Kentucky Fried Chicken) and hotels, as well as supermarkets and smaller retail outlets. In addition to its traditional tortillas, Gruma's product line in China includes ingredients and dough for pizzas and snacks such as fried corn chips. The Shanghai location also serves as an export platform to Hong Kong, Japan, Korea, Singapore, Taiwan, and Thailand. The facility has grown from an initial 60 employees to 232 in 2011.

Gruma has expanded its presence in China beyond Shanghai, investing in new plants in Chongqing, Shenzhen and Dalian since 2008. In these markets, the company is focusing on producing directly for the consumer market, rather than supplying restaurants and hotels. To support this strategy, Gruma has developed a line of wheat-based foods and is promoting adoption of its products through menus and cookbooks.

Moving forward, Gruma's approach in China will focus on establishing plants in other major population centers and tailoring its product offering to the specific demands and preferences of consumers in different regions. The company has made a considerable bet on the country, investing around $200 million so far, which accounts for 11% of Gruma's foreign assets.

Sources: Enrique Dussel Peters "Mexican Firms Investing in China (2000–2011)", company Annual Reports.

In the terminology proposed by Dunning (see Part 2), their expansion to China represents a market-seeking move, often in response to growing concentration of their existing markets. Given their established international presence, and dominant positions in local markets, these firms generally possess considerable knowledge capital—whether it be a technical innovation, process know-how, or brand awareness—that they can exploit in their operations in China. For this reason, this group generally chooses to carry out production directly in China, in order to fully capitalize on their capabilities and apply them on the ground in China.

This group is also more likely to enter China by acquiring existing firms, leveraging their significant resources and access to capital. Joint ventures are also common, usually with a local firm that brings first-hand knowledge of the market.

A prime example is the Mexican bread and baked goods producer Grupo Bimbo, which entered China in 2006 with the purchase of Spanish-owned Panrico's production facility in Beijing (see case study). Other global marketers include another Mexican food producer, Gruma (see case study), and the cement giant Cemex; Brazilian producer of refrigerator compressors, Embraco; and Argentine steel tubes producer Tenaris (see case study). In the services sector, Chilean shipping giants CSAV, CCNI, and Agunsa fit this category.

Product Differentiators

The next group of firms can be characterized as product differentiators—their presence in China serves primarily to differentiate themselves from competitors, both local and foreign, through activities such as customer and post-sales technical support, branding strategies, or investing in marketing and distribution networks. With these strategies, the firms in this group hope to increase export sales in China by consolidating existing client bases, winning long-term contracts, tailoring product offerings to client specifications, raising brand awareness, or finding new market niches. Given their objectives in investing in the region, this group tends to choose greenfield investments to set up small commercial or representative offices.

Why do these firms choose a more limited form of investment? One subset in this group consists of firms whose industry, for a variety of reasons, makes local production less advantageous or difficult to achieve. Here, we can think of wineries and forestry firms such as Concha y Toro, Viña

CASE STUDY: TENARIS

TENARIS

Tenaris is the leading global manufacturer and supplier of tubular products and services used in the oil and gas industry and a leading supplier for power plants and other specialized industrial and automotive applications.

The firm is part of the Techint Group, an Argentine-Italian holding company with subsidiaries on five continents and over $24 billion in consolidated revenues for 2011. Tenaris was formed in 2002 through the merger of Siderca (the original company of the Techint Group) and Techint holdings from South America, Europe, Canada, and Japan.

The story of Tenaris in China goes back to 1976 when the company, then called Siderca, first began exporting steel piping. Its initial customers were Chinese trading firms, who would market the products to the oil fields they represented. Direct access to the firms working the fields remained tightly controlled. Faced with excess capacity in its plants in Argentina, Tenaris sought to expand sales in China; to do so, it would be necessary to have more direct contact with buyers.

In 1990 the firm set up an office in Beijing and slowly established contacts with end clients in the oil sector, taking advantage of loosening regulations that allowed direct sales by foreign firms. The firm encountered strong incumbents in the form of large Japanese firms who had been supplying the Chinese market for decades in some cases.

The first task was to demonstrate that Tenaris seamless tubes and piping were of equal or better quality than Japanese products. This was not a quick process. The firm had to start with lower end, commodity products and then advance to premium products once its reputation had been established. Customer support was an important component of the strategy: the Tenaris office would rapidly attend to clients and provide back-up in the utilization of its products.

These relationships allowed the firm to increasingly tailor products to the specific needs of different oil fields, and make direct sales on a more regular basis. Tenaris thus

Errazuriz, and CMPC. Another group—including Agrosuper, Condumex, and Oxiteno—are mid-sized manufactures who only recently established a direct presence in China. For these firms, setting up a commercial office might be an intermediate step towards future production.

Embedded Globals

Finally, we have a group of firms we can think of as embedded globals that enter China due to the globalized nature of industries such as auto manufacturing, electronics, and IT/software services. Embedded globals establish a presence in China in order to provide products and services to clients, often large multinationals, with significant operations in China.

developed a brand presence in China with its own commercial structure, while other companies continued selling their products through traders.

As conditions in the Chinese market evolved, so did Tenaris' strategy. In the early 2000s, when regulations changed to allow greater service provision by foreign firms, Tenaris began to offer project management and logistics services in oil and chemical projects. The company has since participated in several large-scale projects in China, including the largest petrochemical complex in the country, jointly owned by Shell and the Chinese National Offshore Oil Company (CNOOC).

Facing increasing competition from local producers, Tenaris set out to consolidate its presence by developing production facilities in China. The firm made China its own business unit and started building a local management team. Tenaris initially sought a joint venture with a local producer beginning in 2004. When none materialized, the company decided to build its own facility, inaugurating a threading and connections plant in 2008 in Qingdao. The plant has an annual production capacity of approximately 40,000 tons of premium joints, which are exported to third countries as well as sold in China, taking advantage of lower production costs.

Investing in production has also allowed Tenaris to strengthen its position in the premium tubes market in the face of growing competition in the high-end market. In recent years, Chinese producers have expanded production capacity substantially and increased exports of steel pipe products to the United States, Europe, and Canada. With its longstanding relationships with customers, and experience providing support and logistical services, Tenaris is confident it will maintain its premium market niche in China.

Sources: Information provided by company officials, company Annual Reports and press.

In the case of auto production, it has become a near necessity for suppliers of intermediate goods to follow the leading auto companies into China, the world's largest producer (and consumer) of autos. Mexican auto parts producer Nemak, for example, found that all its major buyers (Ford, GM, Chrysler, BMW, and Hyundai) had set up plants in China that required Nemak products.

Embedded globals can also be found in the IT and software sector, where innovative, young firms from LAC internationalize and enter the Chinese market at a much earlier stage in their development than other groups. A prime example here is Stefanini, the Brazilian IT services firm that has an office in Shanghai and is currently expanding its presence in China, along with other fast-growing, young software firms such as Mexico's Softtek and Argentina's Belatrix.

CASE STUDY: VALE

VALE

Vale is the world's second-largest metals and mining company, with exploration projects in 27 countries and processing and refining facilities on every continent. The company ranks as the world's number one producer of iron ore and iron ore pellets.

After its founding in 1942, Companhia Vale do Rio Doce grew over the next several decades as a state owned company, enjoying the support of the Brazilian government and diversifying into businesses such as forestry and energy.

The privatization of Vale in 1997 led to a shift in the company's strategy. It shed non-core assets to focus on its mining business. The company also invested billions in exploration and other operations outside Brazil, emerging as a truly global player. This strategy coincided with China's economic takeoff and rise as a structural force in the global iron ore and steel markets. Whereas China accounted for 7% of Vale's total revenue in 2002 (equal to US$330 million) by 2011 a full 32.4% of the company's revenue, amounting to US$19.6 billion, came from China.

Vale had established a representation office in Shanghai as early as 1973—the first LAC-based firm to do so—to help coordinate export sales of iron ore. In 2001, Vale entered into a contract to supply Shanghai Baosteel Group Corporation, China's largest steelmaker, with 6 million tons of iron ore a year over a 20-year period. In the ensuing years, the company made several moves aimed at integrating its value chain in China through the establishment of production and refining facilities in the country. In 2004 Vale reached an agreement with Baosteel Group and Yongcheng Coal and Electricity Group for a joint venture coal production plant in Shandong province.

Two years later, Vale announced a US$4 million investment to build an iron pelletizing plant in partnership with Zhuhai Yueyufeng Iron and Steel Company and Pioneer Iron & Steel Group. Around 70 percent of the iron ore used in the Zhuhai plant, which began operating in 2008, comes from Vale's own mines. The company inaugurated another joint venture iron pellet plant in 2011 and also owns and operates a nickel refinery in Dalian that serves China's stainless steel producers.

While Vale's iron pellet facilities in China comprise a small fraction of its pellet capacity and overall sales to China, having a direct presence helps Vale stay closer to its customers and better understand the demands of the market. Vale has emphasized a customer-oriented approach, supplying a specific mix of iron ore and iron ore pellets according to client preferences, as part of its strategy to compete with rivals such as Rio Tinto and BHP Billiton in China. These firms, based in Australia, benefit considerably from closer proximity to China. For Vale, the long distance from its mines in Brazil to China means high freight costs and difficulties responding to price fluctuations. In recent years, Vale has established a port in Malaysia that serves as an iron ore warehouse, mitigating the latter concern. The company has also invested in a new fleet of very large ore carriers (VLOCs) in an attempt to reduce freight costs to China. However, the company has become embroiled in a dispute with Chinese authorities who have yet to permit these Valemax ships to dock in China.

These issues aside, the economic fundamentals seem to dictate that China will continue to be central to Vale's strategy moving forward. Even with a deceleration of China's breakneck growth during the 2000s, its demand for steel should remain strong, making the country a key client for Vale well into the future.

Sources: Company Annual Reports and press.

Conclusion

It is difficult to overstate the importance of China for Latin America's economies and, by extension, its firms. In the space of a mere 12 years, the rise of China has reoriented the region's trade patterns and altered the structure of global markets for many of its key products. With so much focus on the booming trade relationship and the presence of Chinese companies in Latin America, little attention has been paid to Latin American firms making investments in China. While these flows represent modest sums so far, they have an important role to play in strengthening the economic relationship between China and LAC, and should not be ignored. Of course, they can also be profitable and strategically important investments for the firms undertaking them.

As we have noted, there has been little previous analysis of LAC multinationals with foreign direct investment in China. This report therefore represents a first step towards better understanding the dynamics and trends in LAC investment in China at the firm level. What did we find? One conclusion from the survey is the great diversity of firms and of the strategies they have pursued. The sample included global mining giants, niche auto parts manufacturers, producers of fine wine, and newly established tech firms. Clearly, opportunities for profitable investment in China exist for LAC firms in a variety of sectors. In addition, as the typology suggests, LAC firms from different sectors have employed a variety of strategies in China.

Regardless of the sector or strategy, however, we can surmise that patience and adaptability are important virtues for LAC firms in China. A consistent theme from the case studies is that success does not come quickly or easily in China. Firms are well-served by a long-term view, and the flexibility to adapt to a changing environment and unforeseen developments. The examples of Tenaris, which spent years on the ground to prove the quality of its products to Chinese buyers, and Bimbo, which revamped its product line after Chinese consumers balked at its initial offering, illustrate this lesson.

Looking to the future, we find encouraging signs for the trajectory of LAC investments in China. First, the majority of the firms analyzed only entered the country in the last five years, suggesting that investments from these firms could increase in the near future as they develop mature operations. In addition, we saw that a large number of firms had established a commercial or representative office in China. The experience of several firms with a long history in China shows that this type of presence is often a first step to setting up production facilities. Finally, the level of trade between the regions, which shows no sign of abating, means that firms on either side of the Pacific will continue to come into contact with each other, generating opportunities for deeper integration through direct investment for some time to come.