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Bi-Regional Private Sector Networks: Harnessing the Potential of the Private Sector in European Union and Latin America and Caribbean

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BI-REGIONAL PRIVATE SECTOR NETWORKS [1]

Harnessing the Potential of the Private Sector in European Union and Latin America and Caribbean

By

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1. Introduction

There is a long history of successful private partnerships between members of the European Union and countries in the Latin American and Caribbean (LAC) regions. Starting from the colonial era, private firms have exploited the mutual commercial synergies of these two regions. These economic bonds were strengthened and facilitated by close cooperation on the social and political arenas. For example, many of the leaders of the independence movements in Latin America went to France to study the principles of the French revolution. There have also been significant migrations of populations in both directions over the last centuries. Latin American Napoleon Civic Code is more familiar to European firms than the British Common Law system followed in US and many parts of Asia. Both sides of the Atlantic view each other as their 'natural market'. This common view should be leveraged in the Vienna Summit and concrete measures to further enhance bi-regional partnerships should be taken.

The decade of the 90s was marked by the transformation of Latin American economies through trade liberalization, privatization of the public sector, market deregulation and fiscal reform. As a consequence, the region became in the 1990s much more attractive to Multinational Corporations (MNCs), and the net FDI inflows in Latin America grew from US$ 18 billion at the beginning of the 90s to US$72 billion in 2005. Thus it is not surprising to note that Europe overtook the US in foreign direct investments (FDI) in Latin America in 1998 and has remained the most important investor since then. The European Union remains the leading source of FDI and official development assistance and the second biggest trade partner for the LAC region. It is interesting to note that recent crises such as the Argentine crisis have done little to dampen the enthusiasm of investors in the LAC region. European companies continue to find the LAC region attractive for investments.

The interest is not one-sided. Private sector leaders from the Latin America region are also looking at the European Union with interest. The successful enlargement of Europe, the integration of new member states from the ex-Soviet bloc countries, the prospect of increased access to ex-Soviet republics in the future and increased simplification and integration of business practices within Europe are factors stimulating Latin America investment in Europe. The forays of Latin American companies in Europe were led by the initial European purchases of Cemex in Spain in 1992. Cemex wished to diversify risk and lower the price of capital through what it saw as its 'natural market' - Spain. All major multinationals from the Latin America region today have significant European activities. For example, Brazilian steel giant Companhia do Vale do Rio Doce has offices in Switzerland and the leading Brazilian plane manufacturer Embraer has offices in Le Bourget (France). Although Latin America is a source of a quarter of the agricultural imports of Europe, companies (especially Brazilian) from this sector are lobbying for an end to the European Agricultures subsidies.

Governments have been a major catalyst and enabler of many of these bi-regional private sector networks. For example the European Union – Latin American and the Caribbean Summit of Heads of State and Government (launched in Rio in 1999) is about to have its fourth meeting in Vienna in May 2006. The purpose of these summits has been to advance in the consolidation of a strategic partnership of a political, economic, cultural and social and co-operative character between both regions. Started in 1991, Ibero-American Summits have provided a mechanism for consultation and concerted political action in matters of common interest to Spain, Portugal and Latin American countries. It constitutes the mechanism of Spanish and Portuguese speaking America that most resembles the British Commonwealth, through which Great Britain and its former colonies keep their historical ties alive, providing significant benefits to the countries of the English speaking Caribbean.

2. A Framework for Mapping Bi-Regional Networks

Before we embark on a description of bi-regional networks between the EU and the LAC regions, it is useful to consider some definitional and taxonomic aspects of these networks.

There are many definitions of private sector networks in the literature. For example, Rosenfeld defines a business network as "a group of firms with restricted membership and specific, and often contractual, business objectives likely to result in mutual financial gains. The members of a network choose each other, for a variety of reasons; they agree explicitly to cooperate in some way and to depend on each other to some extent. Networks develop more readily within clusters, particularly where multiple business transactions have created familiarity and built trust" (Rosenfeld 1995, p. 13).

A more informal definition of a business network can be found in the online encyclopedia, Wikipedia: “a business network can be defined as a group of people that have some kind of commercial relationship. It could be a boss-employee, buyer-supplier, colleague-colleague, etc.” While this definition is more open and also includes individual actors (besides firms), it tends to limit its focus to commercial (for profit) objectives. We believe that there are also important non-commercial objectives, such as corporate social responsibility which can also act as a trigger for and increase the effectiveness of bi-regional networks.

Thus for the purposes of this paper, we define a bi-regional private sector network (PSN) as “a formal or informal agreement between private sector actors, both firms and individuals, which aims to enhance the achievement of relevant mutual goals, comprising both for-profit and social objectives”.

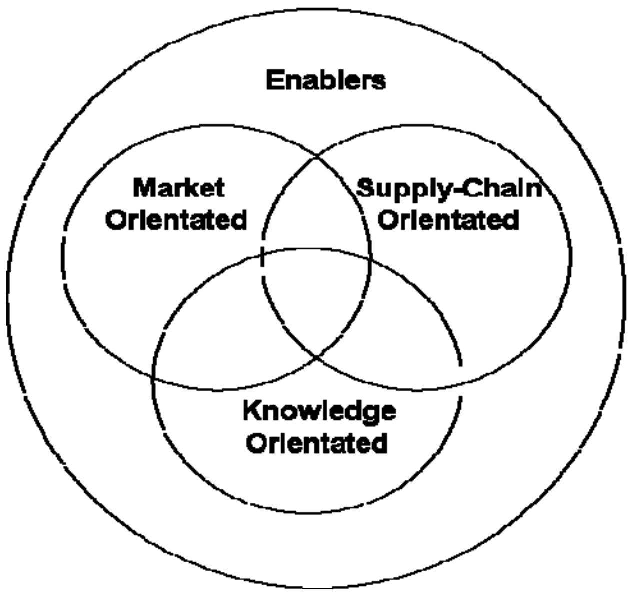

Figure 1: A framework for classifying Private Sector Networks

To aid our understanding of bi-regional PSNs, it is useful to build a simple framework for classifying these networks. The framework proposed in this paper is described graphically in Figure 1. It focuses on two important dimensions:

1. Enablers: These are factors in the geo-political contexts of the network actors which aid the creation and sustain the development of effective PSNs. Typical examples of these conditions would be government sponsored initiatives such as trade agreements which facilitate the creation of private sector partnerships and networks.
2. Purpose: This refers to the overarching goal or purpose for the creation and existence of the PSN. From our study of the literature and existing networks, we see three different purposes in PSNs:
    a. Market: These PSNs exist for the primary purpose of enhancing the level of market access for the actors in the network. This would typically lead to increased sales of products and services to customers for the network actors.
    b. Supply chain: These PSNs exist to complete and enhance the supply chains of the network actors. This would typically include activities such as sourcing raw materials from a region or the setting up of production plants which leads to an ability to produce goods and services more efficiently for the network actors.
    c. Knowledge: These PSNs exist with the primary goal to share knowledge amongst the network actors. The importance of knowledge sharing in today's global and competitive environment is recognized by all.

3. Examples of Bi-Regional Private Sector Networks

The following sections provide examples of PSNs between Europe and the LAC region in each of the categories mentioned in the previous section.

3.1 Enablers

Trade agreements provide a wide range tax, tariff and trade pacts to enhance trade between the signatory countries and, at the same time provide a more efficient, stable institutional and legal framework for business to operate within. The European Commission outlined in a 1995 communication the general policy regarding relations between the European Union and Latin America. Since then, Association Agreements have included free trade area agreements with Mexico (2000) and Chile (2002). An association agreement is currently being negotiated with Mercosur. Political Dialogue and Cooperation Agreements were concluded with the Andean Community and Central America in 2003. A period of evaluation began in May 2004 with a view to opening negotiations on Association Agreements with both regions. Negotiations with Mercosur have been very slow, not easy and are at the standstill for a number of internal reasons and conflicting demands[2]. The Vienna Summit in May 2006 inspires hope of the possibility of a renewal of the focus in a region and reactivation of the Association Agrements.

[2] Analyzing the reasons of the current negotiations is beyond the scope of this paper. For a deeper review of the issue please see Freres, Christian and José Antonio Sanahuja. November 2005.

In the same vein, the investment promotion AL-INVEST Program was launched in 1993 and is the largest European Commission program to foster cooperation between small and medium size companies (SMEs) of the European and LAC regions. The program is a network of actors from Europe and Latin America who co-operate in organizing bi-regional meetings (called ‘sectorial meetings’) between companies active in the same sector. The program has successfully supported thousands of SMEs and business organizations in all sectors of the economy by facilitating trade and investment between the two regions. Eurochambers and Bancomext are full members of AL-INVEST. To consolidate this success, AL-INVEST III was launched in 2004, for a 4-year period with a European Commission grant of € 42 million. One of the most recent events took place in Recife in November 2005 under the title: ‘Europe CONNECTS with Latin America SMEs’.

AL-Invest is considered a success according to opinions from both regions. According to the Brazilian National Confederation of Industry (Confederaçao Nacional da Indústria, CNI)[3] AL-Invest has worked well as a PSN. The strength of AL-INVEST resides in the network of 57 Eurocentres and more than 15,000 Coopecos[4] which have a positive facilitation effect amongst SMEs. Bureaucracy is kept to a minimum and the network allows the development and execution of projects catering directly to SMEs needs[5]. Some European organizations, however, have expressed their reservations about the success of the program due to a lack of interest among European SMEs (who are more interested in other regions like Eastern Europe or Asia) and at times a lack of responsiveness from the Latin American Eurocentres.

There are a number of other bi-regional forums initiated by Eurochambers (Association of European Chamber of Commerce and Industry) which represents 44 national associations of Chambers of Commerce and Industry - a European network of 2000 regional and local chambers with over 18 million member enterprises in Europe. Eurochambers has partnered with AICO (Ibero-American Association of Chambers of Commerce), AILA (Latin American Industrial Association) and CAIC (Caribbean Association of Industry and Commerce) for matters related to trade and business opportunities.

3.2 Market Orientated

An example of a market orientated PSN is Latibex, the only international market for Latin American securities. The market’s creation, in December 1999, was approved by the Spanish government. It is regulated by the Spanish Securities Market Law. Latibex is an ideal way to

3 The National Confederation of Industry System has as its mission the representation of Brazilian industry, in tandem with regional Federations and nationwide associations. It promotes and supports the Country's efforts to attain sustainable and balanced development in both the geographical and socio-economic dimensions.

4 COOPECO stands for Network of European Organizations Supporting Industrial Cooperation and the Promotion of Investments in Latin America. COOPECO is a Euroepan network of bodies which promotes industrial cooperation and investments by European companies in Latin America. It functions under the AL-INVEST. Members are: Chambers of Commerce, professional Associations, industrial federations, regional development agencies and consultants specializing in specific industrial sectors. The members contribute to the improvement of industrial cooperation between the EU and Latin America.

5 CNI contrasts this success with the difficulties in implementing other bilateral projects such as Pyapyme for internationalization of SMEs signed between EU and Brazil and between the EU and Mexico. Governmental entities are in charge of implementing this project and significant effort and time are needed for the bureaucracies to work.

channel European investment efficiently towards Latin America. European investors can buy and sell shares and securities in leading Latin American companies through a single market, with a single operating system for trading and settlement and a single currency, the euro. The market is based on the trading and settlement platform of the Spanish stock market, in such a way that the Latin American securities listed on Latibex are traded and settled like any other Spanish security. Meanwhile, Latibex gives Latin American companies easy and efficient access to the European capital market. In short, it brings European investors close to one of the world's most economically attractive regions, streamlining the operational and legal complexity and reducing risks. And this is all achieved in an environment of considerable information transparency. A total of thirty two companies[6] are currently issuers at Latibex, a third of the number of Latin American companies quoted at the New York Stock Exchange.

Traditionally, many European firms have gone to the LAC region in search of new markets to grow in. A good example is Telefónica, the pioneer for Spanish investments in the LAC region. Starting with a controlling stake in Chile's fixed line operator, Compañía de Telecomunicaciones de Chile (CTC) in 1990; Telefónica rapidly followed this up with the control of Telefónica de Argentina. In 1991, Telefónica participated in a GTE-led consortium that purchased CANTV, the national telecom company of Venezuela. In 1994, it paid US$ 1.8 billion for a controlling 31.5% stake in Telefónica de Perú. Telefónica's Latin American strategy began to crystallize two years later when it used its Chilean and Argentine subsidiaries in a successful US$ 655 million bid for the control of Brazil's Companhia Riograndense de Telecomunicações (CRT). The crown jewel was Telefónica's successful US$ 5.3 billion[7] bid in July 1998 to buy fixed-line operator Telesp, cellular operators Tele Sudeste Celular and Tele Leste Celular. Acquisitions have continued and Telefónica paid €4.7 billion in cash for the acquisition of BellSouth's Latin American assets and operations in 2004. LAC has thus played a critical role in Telefónica's rise from a local Spanish incumbent to the third biggest telecom company in the world[8]. Latin America has very much been a "natural" market for Telefónica where cultural similarities facilitated its PSN in the region.

Leading MNCs from the LAC have also come to Europe and formed their own PSNs. A good example of this is provided by the Mexican cement company, Cemex. From its initial 1992 acquisitions in Spain, Cemex has grown to be the second biggest cement company in the world with 2005 sales of US$15.3 billion and a presence in more than 50 countries. Europe represents 25% of Cemex EBITDA. European operations include besides Spain, UK, Poland, Czech Republic, Hungary, Latvia, Croatia, Ireland, Scandinavian countries, Germany, France

[6] Issuing companies by alphabetical order in Latibex are: Alfa, S.A. de C.V.; América Móvil, S.A. de C.V.; Aracruz Celulose, S.A.; Banco Bradesco S.A.; Banco de Chile; Banco Río de la Plata, S.A.; BBVA Banco Francés, S.A.; Bradespar, S.A.; Braskem, S.A.; Centrais Ele. Brasileira S.A; Elebrobras; Com. Energetica de Minas Gerais-Cemig; Companhia Paranaense de Energia-Copel B; Companhia Vale do Rio Doce; Corporación GEO, S.A. de C.V.; Corporación UBC Internacional, S.A.; Distribución y Servicio D & S S.A.; Empresa Nacional de Electricidad (Chile); Enersis, S.A.; Gerdau; Grupo Elektra, S.A. de C.V.; Grupo Modelo, S.A. de C.V.; Net Serviços de Comunicaçao, S.A.; Petroleo Brasileiro, S.A. (Petrobras); Sadia, S.A.; Santander Bancorp, Sare Holding, S.A. de C.V.; Suzano Bahia Sul Papel e Celulose, S.A.; Suzano Petroquimica, S.A.; Teléfonos de México, S.A. de C.V.; TV Azteca, S.A. de C.V.; Usinas Siderúrgicas de Minas Gerais, S.A.; Volcan Compañía Minera S.A.

[7] After the real devaluation of the Brazilian currency, the real, (Jan. 13, 1999), Telefónica paid US$ 4.1 billion for Telebras.

[8] Source: Financial Times. 28 May 2003.

and Austria. Cemex has built close business relationships with several European firms to optimize global logistics.

3.3 Supply-chain Orientated

The ‘Maquila[9]’ program of Mexico is a good example of supply chain orientated PSNs. The success of the North American Free Trade Agreement (NAFTA) has led to the emergence of Mexico as a manufacturing center for the US market. Many companies have set up manufacturing operations in Mexico to supply the North American market. Many European companies (sometimes through their US subsidiaries) in the automotive and electronics sectors have invested significantly in the ‘Maquila’ program. Dutch (Philips Electronics, and Advance Transformer Co.), German (Siemens), Swedish (Autoliv, Inc.) Finnish (El Coteq Network Corporation and Nokia) and French (Thomson Displays Mexicana, S.A. de C.V. and Bacou-Dalloz, S.A. de C.V.) companies have all invested in the Mexican Maquilas. Philips owns the tenth biggest maquila in Mexico with more than 10,000 employees. Siemens owns the eleventh biggest maquila with a similar number of employees[10].

Many European firms have also formed networks with firms in the LAC region in an attempt to secure supplies of critical raw materials. For example, the Spanish oil company Repsol acquired the Argentinean oil company YPF in 1999 to secure oil supplies for their upstream operations.

The LAC region not only provides a lower cost environment that Europe, but also has large educated populations, especially in countries such as Brazil, Chile, Argentina and Mexico. Thus it has many characteristics that make it attractive for the location of technology services, call centers and business process off shoring units. French company Peugeot and Spanish company Repsol have outsourced web-site design and software development to Argentina. Unilever has set up in-house outsourcing centers for software development, back-office services and call centers in Chile. This is a trend in PSNs which will mushroom further in the future.

3.4 Knowledge Orientated

Networks for knowledge sharing between network actors - private, public and civil society - from Europe and LAC are very common. For example, OBREAL/EULARO is a network set up by 23 academic institutions and research centers in Europe and Latin America with the financial support of the European Commission. OBREAL/EULARO, in keeping with the European Commission’s regional cooperation strategy for Latin America 2002-2006, has set as its main goal “to identify and develop all the opportunities offered by the partnership between the two regions to create a better understanding of the regional and sectorial problems which shape policymaking”. To reach this goal, OBREAL/EULARO not only depends on the work of its members, but also aims to become a platform for the promotion of and a meeting place for the dissemination and research activities carried out in both regions. Similarly, it aims to create synergies between policy formulators and decision makers,

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9 The ‘Maquila’ program of Mexico provides in-bond assembly for re-export, and allows firms to temporarily export parts manufactured in the US for assembly in Mexico. Re-exports to the United States was done with a tariff on the overseas value added component.

10 Source: www.maquilaportal.com.

researchers and civil society actors, to reach a critical mass that can provide answers to common problems.

The Euro-Latin Study Network of Integration and Trade (ELSNIT) was launched by the Inter-American Development Bank (IDB) and aims to be an expert forum to reflect on issues and recommendations on integration and trade between both regions. The IDB launched the first private sector advisory Council in the Annual Assembly meeting in Milan in 2002.

The Mercosur – European Union Business Forum (MEBF) constitutes a business driven initiative, pursuing the enhancement of trade and business relations between the European Union and the Mercosur countries. Leading European and Mercosur companies and the main business associations develop joint trade policy recommendations.

The 'Foro de Biarritz' is an annual meeting (since 2000) in Biarritz or in a Latin American country with the goal to enhance the cultural and commercial activities between Europe and Latin America. This year's meeting will include the first 'Business club" with the purpose of having an informal exchange of ideas about the challenges faced by companies in their bi-regional activities.

4. Looking ahead

As evident, there are multiple successful networks between private sector actors from Europe and LAC. These PSNs are becoming stronger as European investors continue to embrace the LAC region with less aversion to risk and volatility than their US counterparts. There are two additional factors stimulating these PSNs. One, Latin America's hot stock and bond markets are proving to be very attractive for many European private sector actors. Two, the strengthening of the Euro has created a new momentum to invest abroad. Most Latin American firms are still at bargain multiples, compared to other options in Europe or Asia.

European private sector actors should note an interesting trend that started in 2003 in the LAC region and continues even today. If we look at the top 20 mergers and acquisition (M&A) deals across Latin America in 2004, one sees a distinct increase in the strengthening of PSNs within the LAC region. From those 20 deals, only one involved a US company, seven were made by European firms and 12 were completed by Latin American MNCs which started buying cheap regional assets during the Argentine crisis in 2002. Other examples include the acquisition of AT&T's Latin American subsidiary by the Mexican telecom company Telmex and the leveraged management buy-out of Cargil's VET Brands subsidiary in Brazil by a Brazilian management team. European private sector actors need to heed this resurgence of Latin American MNCs. As private sector actors in the LAC region become stronger and more assertive, the nature of the relationship and balance of power in the PSNs across Europe and LAC will evolve. There is a need for greater cooperation between bi-regional PSNs and intra-LAC PSNs which have emerged in the recent past.

Governments in the LAC have also become more assertive in the international arena in recent years and this trend is expected to continue. This is partly due to the increased success of state-owned firms, often linked to the rise in global commodity prices. Privatization is out of fashion in many countries in the LAC and governments have become more important players in domestic and regional markets. According to ECLAC (2005), since 2003 the growth in sales of multinationals has lagged behind the growth in sales for the leading local and state-owned companies. Thus firms from Europe have to approach the LAC in a true sense of partnership, increase their contacts and capabilities to work with the government and go for win-win outcomes in their PSNs.

In the post-Vienna period, Association Agreements should also consider non-trade issues of common interests for both regions such as sustainable development and environmental issues, which have high importance in both public and private sector agendas in the LAC region. There is a strong potential for growth in supply chain networks between the two regions – such as in off-shored software development and business process outsourcing. These domains are of interest as governments in the region have realized the importance of investments in the technology sector for stimulating growth in the entire economy. For example, the government of Brazil has introduced a new industrial policy in 2004. This policy embraces information technology as one of the main pillars of development of the country. Technology focused PSNs are therefore a good way to stimulate the further growth of bi-regional networks.

Bi-regional knowledge PSNs need to also be expanded. Supra-regional institutions such as the European Investment Bank (EIB) and the Inter-American Development Bank (IADB) and the Andean Development Corporation (Spanish Acronym CAF) would benefit from more coordinated action plans. Multinational firms from both regions would gain from an expansion of the IADB’s ELSNET network with a specific Private Sector Study Center to focus on common challenges.

The Vienna Summit is an opportunity for building on past successes and renewing momentum with concrete steps for the future. The opportunity should not be missed.

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