Spain's Multinationals: Reaping the Benefits of their Strategies

William Chislett [*]

Theme: Spain's multinationals are successfully offsetting the downturn in their domestic business, due to the very sharp slowdown in the Spanish economy, with increased activity abroad as a result of their international investments.

Summary: There is nothing like a crisis to test the validity of long-term corporate strategies, and judging by the results of Spain's main multinationals this year the strategies started in the early 1990s are paying off.

Analysis: In less than two decades Spain has consolidated its position as a major net outward investor. The annual average outward foreign direct investment (OFDI) rose from US$15.1 billion in 1990-2000 to a record US$119.6 billion in 2007, according to UNCTAD's latest World Investment Report released on 24 September, and companies are continuing to make acquisitions abroad. Spain's OFDI stock of US$636.8 billion represented 44.3% of GDP, substantially higher than the inward stock (US$537.4 billion, 37.4% of GDP, see Figure 1). The outward stock in GDP terms is higher than Germany's (37.3%) and Italy's (24.7%), but lower than the UK's (61.5%) and France's (54.7%). In the first half of 2008 just under 50% of the revenues of the companies in the Ibex-35 benchmark index of the Spanish stock exchange were generated in Spain compared with 65% in 2003 (see Figure 2).

Figure 1. Spain's Outward Direct Investment (US$ billion and % of GDP)

	1990-2000 (annual average)	2003	2004	2005	2006	2007
Outward	15.1	28.7	60.5	41.8	100.3	119.6
Stock as % of GDP	3.0 (1990)					44.3

Source: World Investment Report 2008, UNCTAD.

Figure 2. Revenues by Geographic Zone of Ibex-35 Companies, 2003 and 2008 (1)

(%)	Spain	EU	OECD	Other
2003	65.0	9.1	5.4	20.5
2008	51.0	18.6	9.4	21.0

(1) First half.
Source: Date sent by companies to the National Securities Market Commission.

[*] *Writer, author of three books on Spain for the Elcano Royal Institute (2002, 2003 and 2005). His last book was published by Telefónica in January 2008.*

In the case of the steel company Acerinox, with plants in the US and South Africa, close to 90% of its revenues in the first half came from abroad, over 70% in the case of Cintra, more than 60% for Abengoa, Telefónica, Ferrovial and Santander and more than 50% for Repsol YPF and Iberdrola (see Figure 3). The sales in the international stores of Inditex, the fashion retailer, accounted for 65.2% of the total. The group's eight concepts opened 249 stores between 1 February and 31 July around the world and commenced activity in two new markets –Ukraine and South Korea–. The share of total sales from stores in Asia and Eastern Europe has risen from 11% to 17% over the last two years.

Figure 3. Spanish Companies and Banks: % of Total Sales from Abroad (1)

Company	Business	% of Total
Acerinox	Steel	89.2
Grifols	Hospital-pharmaceuticals	71.8
Cintra	Managing toll roads and car parks	70.9
Inditex	Clothing manufacturer and retailer	65.2
Abengoa	Biofuels, IT, engineering	64.4
Tecnicas Reunidas	Engineering	64.1
Telefónica	Telecommunications	63.3
Ferrovial	Infrastructure operator, construction	63.2
Santander	Financial group	61.3
Iberia	Airline	59.6
Repsol YPF	Oil and natural gas	54.7
Gamesa	Wind turbines	52.5
Iberdrola Renovables	Renewable energy	52.2
Iberdola	Electricity	50.8
Abertis	Infrastructure management	49.4
Ibex-35	Benchmark index of the Spanish Stock Exchange	48.9
Unión Fenopsa	Electricity	48.4
Banco Bilbao Vizcaya	Financial group	47.9
OHL	Construction	46.5
Endesa	Electricity	44.7
FCC	Construction	39.5
Mapfre	Insurance	36.2
Gas Natural	Natural gas	35.2
Acciona	Energy, infrastructure, water	33.4
Indra	IT and defence systems	33.0
ACS	Construction	26.4
Sacyr Vallehermoso	Construction, concessions	18.5

(1) First half of 2008.
Source: data sent by companies to the National Securities Market Commission.

Santander, Telefónica and Repsol are among the 11 multinationals in the latest Fortune Global 500 largest companies, two more than last year (see Figure 4). A decade earlier there was no Spanish company among the 500 largest. Acquisitions abroad and mergers at home have created a hard core of big Spanish companies who are striding the global corporate world. The turnover of the Ibex-35 companies in Spain grew 14.4% in the first half to €107.6 billion and that abroad by 20% to €103.1 billion. Based on current trends, the international revenues of these companies will soon overtake domestic ones. There are also many small and medium-sized Spanish companies, many of them unlisted, with businesses abroad, but the great bulk of international activity is in the hands of a dozen or so companies, all of which are in the Ibex-35.

Figure 4. Spanish Companies in Fortune Global 500

Country Rank	Company	Global 500 Rank	2007 Revenues (US$ millions)
1.	Santander	58	89,295
2.	Telefónica	76	77,254
3.	Repsol YPF	92	67,006
4.	BBVA	134	51,449
5.	Endesa	258	30,018
6.	ACS	270	29,171
7.	Cepsa	313	25,853
8.	Iberdrola	339	23,910
9.	Grupo Ferrovial	424	20,062
10.	Fomento de Construcciones	440	19,267
11.	Mapfre Group	463	17,984

Source: Fortune.

The downside of this, of course, is that it makes the Spanish stock exchange as a whole vulnerable to crises in parts of the world, such as Latin America, where these companies have a significant proportion of their business. This was more the case, however, a few years ago, although it never happened. Since then there has been a diversification away from Latin America and into Europe and Asia, thereby making some of the largest players, such as Santander, Telefónica and Repsol, less dependent on a particular area. And Latin America's economic fundamentals are generally much better.

But for their acquisitions abroad the share prices of the Ibex-35 companies might well have fallen even more than they have done so this year because without them the profits of these companies would have risen much more modestly, or perhaps even declined, because of Spain's economic slowdown. This is particularly the case of the banks Santander and BBVA which have strikingly bucked the downward international trend in their sector's profits. Another factor behind their success and one whose importance cannot be overstated is that these banks escaped the impact of the American junk mortgage crisis as they did not invest in products guaranteed by subprime assets and they followed very prudent risk management criteria in their lending. In both these areas the Bank of Spain has been a very effective regulator.

Both Santander and BBVA are among the top 50 financial transnational corporations ranked by UNCTAD's Geographic Spread Index (GSI), respectively in 22nd and 35th positions. The GSI is calculated as the square root of the Internationalisation Index (II) multiplied by the number of countries in which a bank has affiliates and the II, in turn, is calculated as the number of foreign affiliates divided by the number of all affiliates (only majority-owned ones). Santander's GSI was 40 and BBVA's 31. Citigroup was top with 70.

Spain also moved up the ranking in UNCTAD's latest outward FDI Performance Index, based on indices derived from three-year moving averages of data on FDI flows and GDP for the three years immediately preceding the year in question including that year. Spain is 13th out of 20 countries in the 2007 index (14th in 2006) and the countries above it are all much smaller. The top ranked is Luxembourg, followed by Iceland and Hong Kong. Three of Spain's companies –Telefónica, Repsol YPF and Endesa– are among the world's top 100 non-financial transnational corporations ranked by foreign assets (based on 2006 figures[1]). Their respective positions are 11th, 43rd and 54th. In the Transnationality Index (TNI), calculated as the average of foreign assets to total assets, foreign sales to

[1] Endesa is no longer a Spanish company as it has been 67% owned by Italy's Enel since October 2007.

total sales and foreign employment to total employment, Telefónica's TNI was 69%, Repsol's 55% and Endesa's 49%.

The Banks
Santander, the largest bank in the euro zone by market value, and BBVA are among the few global banks to emerge from the credit crisis unscathed. Santander reported a 6% year-on-year increase in first-half net profits. Stripping out the €582 million capital gain in the same period of 2007 from the sale of stakes in banks in Italy and Portugal, the annual increase in net profit on a like-for-like basis was 22% to €4.73 billion. Despite the market turmoil, Santander is sticking to its forecast (made last year) of profits for the whole of 2008 of €10 billion (+10.3%). BBVA's first-half net profits before non-recurrent items rose 11.6% to €2.9 billion and, including one-offs, they were 7.9% lower at €3.1 billion. These figures are in marked contrast to the losses of major US banks.

Continental Europe generated 54% of Santander's profits in the first half compared with 59% in 2004 when the bank moved into the UK and bought the mortgage lender Abbey, the UK's sixth-largest bank. The UK accounted for 14% of profits and Latin America for 32% (41% in 2004), with Brazil providing 11% of profits, Mexico 8% and Chile 6%.

At a dinner in the City of London in July, when the magazine *Euromoney* named Santander the world's best bank for the year, Emilio Botín, Santander's Chairman, delivered a tongue-in-cheek lecture on the basic tenets of banking via a video message broadcast that the chairmen of failed banks must bitterly regret not heeding. 'If you don't fully understand an instrument, don't buy it. If you would not buy a specific product for yourself, don't try to sell it. If you do not know your customers very well, don't lend them any money', he said. 'If you do these three things, you will be a better banker, my son'. It is advice that has stood Santander in good stead.

While many of its peers were reeling from the fall out from the subprime crisis and other problems, Santander took another bold step in the UK in retail banking, a business it knows inside out, and last July reached an agreement with Alliance and Leicester (A&L) to buy the beleaguered UK mortgage bank for little more than A&L's book value, once it had fully written down the value of the complex debt securities in A&L's treasury portfolio. As a result of this purchase, Abbey is three years ahead of its expansion plan as it no longer needs to open 300 new branches in order to attain critical mass.

When Santander first negotiated with A&L at the end of 2007 A&L's shares were worth more than double the price implied by its €1.57 billion offer, accepted by A&L's shareholders in September. These discussions broke down and in the intervening months A&L's share price plummeted. The humiliated A&L had no option but to accept the subsequent unsolicited bid. Santander expects the deal to generate a return on its investment of 19% within three years. It would not be surprising if Santander seized more opportunities.

Santander has also strengthened its presence in Latin America as a result of its participation last year (with €19.8 billion) in the Royal Bank of Scotland-led consortium that won control of the Dutch bank ABN Amro. Santander acquired Amro's subsidiary in Brazil, Banco Real. The combination of Santander's Banespa and Real created the second-largest bank in Brazil in terms of deposits and the third by network size (with a market share of 12%). In the south/south-east, the source of two-thirds of the Brazilian GDP, the market share of the combined bank is 16%. Real provides a presence in areas where Santander is underrepresented, such as Rio de Janeiro and Minas Gerais, while Santander is strong in regions where Real is weaker, such as Rio Grande do Sul. Santander and Real also have a complementary business mix: Real is stronger in areas such as mass market, consumer loans and SMEs, whilst Santander is stronger in affluent banking and business/corporate banking. Santander's market share in Latin America as a whole increased to between 10% and 15% in all major products.

BBVA's bank in Mexico, meanwhile, generated 32% of its total profits excluding one-offs in the first half of 2008, its banks in the US 5.6% and South America 12%. While Santander has been focusing recently on Europe for new acquisitions, BBVA increased its presence in Asia in June when it agreed to spend €800 million on raising its stakes in two units of Citic Group, the Chinese financial group. It has roughly doubled its stake in Citic Bank, China's seventh-largest lender by assets, to around 10% and its holding in Citic International Financial Holdings, a Hong Kong-listed subsidiary of Citic Group.

Infrastructure Companies
Spain's infrastructure companies are also obtaining a growing share of their profits from international business. Ten of the world's 100 largest infrastructure transnational corporations ranked by foreign assets are Spanish (based on 2006 figures). The largest is the telecommunications conglomerate Telefónica whose foreign assets represented 71% of its total assets of US$143.5 billion. Solid results from Latin America have enabled the company to weather weak growth in its domestic market. Its first-half net profits in 2008 were 29% higher year-on-year at €3.6 billion, after stripping out extraordinary items. Net client adds in Latin America increased 8.9 million in the year to June.

The infrastructure commitments of Spanish companies amounted to US$65.1 billion between 1996 and 2006 (see Figure 5). Thirteen of the 50 largest foreign investors in infrastructure in Latin America and the Caribbean were Spanish compared with nine US companies.

Figure 5. Spanish Investors in Infrastructure in Latin America and the Caribbean, 1996-2006 (US$bn)

Company	Total	Energy	Telecom	Transport	Water
Telefónica	24,785		24,785		
Iberdrola	8,988	8,775			213
Endesa	6,806	6,806			
Grupo ACS	4,623	378		4,103	142
Unión Fenosa	4,495	2,930		1,565	
Agbar	4,032				4,032
OHL	2,870			2,794	76
Sacyr Vallehermoso	2,041			2,029	12
AENA	1,774			1,774	
Grupo Acciona	1,391			1,391	
Elecnor	1,268	1,268			
Grupo Ferrovial	1,050	1,050			
Abengoa	1,013	1,013			
Total	65,136	22,220	24,785	13,656	4,475

Source: World Investment Report, 2008, UNCTAD.

A consortium including Abertis (part of ACS) and Criteria Caixa, Abertis's largest shareholder, put in the winning bid of €8.3 billion in May for the privatisation of the Pennsylvania Turnpike, the world's largest-ever toll road privatisation.

It is, however, not all plain sailing. Grupo Ferrovial, the most international of Spain's construction groups, diversified into toll roads in the Americas and acquired the UK airport operator BAA, but it has been caught in the credit-crunch vice as a result of becoming heavily leveraged and has struggled to reach refinancing agreements with its creditors. Its first-half net profit plunged 92% to €59 million, due among other things to much lower one-off results. In order to cut its debt, since the beginning of last year the company has sold Budapest airport, Belfast City airport, its stake in Sydney's international airport, its duty-free retail business and part of Airport Property Partnership, the property portfolio of BAA. In Spain it also sold its property development division. On top of this it recently and reluctantly decided to sell Gatwick airport, bowing to pressure from the UK Competition Commission which provisionally ruled in August that BAA should sell two of its three London airports –Heathrow, Gatwick and Stansted– and either Glasgow or Edinburgh in Scotland. The Commission's definitive ruling is not due until next March. By anticipating it, Ferrovial hopes to keep Stansted and Heathrow, the jewel in its crown.

Conclusion: The push abroad by Spanish companies has been clearly successful and will continue. As the Spanish economic slowdown deepens –GDP growth is forecast at around 1% in 2009 compared with a maximum of 1.5% this year and 3.8% in 2007– and affects business more so international activity will gain in importance. Spain's captains of industry must be feeling rather pleased with themselves.

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