Case analysis: Tata Motors' acquisition of Jaguar Land Rover

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Abstract

The existing literature related to multinational enterprises (MNE) neglects the international expansion of multinationals from emerging countries even as they fundamentally shift the multinational map of corporate power. The rise of Indian Information technology companies like Wipro, Infosys, and Tata Consultancy Services among others, or Embraer from Brazil, and Huawei from China, has caused considerable competition for the traditional western MNEs. Emerging Country Multinationals (henceforth, known as EMNEs) are important because they are already becoming the Toyotas or Samsungs of the next decade. Lenovo, the Chinese computer hardware firm is now the second largest PC Company. Huawei has overtaken Ericsson in telecoms equipment. India's Sun Pharma is now one of the world's largest generic drugs firms. Last year Chinese Companies topped the list of Forbes Global 2000, the list of world's biggest companies. The Economist (2014) recently reflected on this trend with stories such as "A World to Conquer" where it illustrates the need for the emerging country firms to aggressively expand in international markets and discusses the competition that these firms provide to western MNEs. In studying multinationals from the developing world, some of the unanswered research questions in this area are 1. What are the factors that lead to a competitive edge for these EMNEs? And how did the home country context help them to shape such advantages? 2. What are their core strategies in international markets? What is the impact of their expansion on international trade dynamics?

*I will use the recent cross-border acquisition of Jaguar Land Rover by the Indian Multination*al Tata Motors Limited to find the answers and provide future research avenues.

1. Introduction

The rapid expansion of multinational enterprises from emerging countries is fundamentally shifting the multinational map of corporate power. The rise of Indian Information technology companies like Wipro, Infosys, and Tata Consultancy Services among others, or Embraer from Brazil, and Huawei from China, has caused considerable competition for the traditional western MNEs. Emerging Country Multinationals (henceforth, known as EMNEs) are important because they are already becoming the Toyotas or Samsungs of the next decade. Lenovo, the Chinese computer hardware firm is now the second largest PC Company. Huawei has overtaken Ericsson in telecoms equipment. India's Sun Pharma is now one of the world's largest generic drugs firms. Last year Chinese Companies topped the list of Forbes Global 2000, the list of world's biggest companies. The Economist (2014) recently reflected on this trend with stories such as "the World to Conquer" where it illustrates the need for the emerging country firms to aggressively expand in international markets and discusses the competition that these firms offer to western MNEs.

The literature has not kept pace with the rise of EMNEs and often neglects the international growth of EMNEs. In studying multinationals from the developing world, some of the unanswered research questions in this area are:

1. What are the factors that lead to a competitive edge for these EMNEs? And, how did the home country context help them to shape such advantages?
2. What are their core strategies in international markets? What is the impact of their expansion on international trade dynamics?

Table 1 describes the broad geographical source and destination of foreign direct investment (FDI) in the post-World War II era:

Table 1

Destination of FDI

		North (Developed)	South (Emerging)
Source of FDI	North	North-North FDI (Market seeking)	North –South FDI (Resource seeking)
	South	South-North FDI (Unanswered)	South-South FDI (Unanswered)

Traditionally, the sources of FDI have developed countries in the North and their destinations are either the North, which is generally a market-seeking based decision or the South, which is generally a resource-seeking based decision. However, with the rapidly growing EMNEs in the "South", the focus of this project is to analyze the two bottom cells of the FDI source and destination table. The fundamental question is to examine whether existing results from the literature on FDI regarding motivation for location decisions, primarily focusing on the top cells, carry over to outward FDIs emerging from developing countries, or whether there are divergent location strategies for the EMNEs.

2. Existing Literature

The Eclectic Paradigm Framework

Because of inherent disadvantages setting up foreign production facilities, it is imperative to identify the advantages and conditions that will make direct investment viable. One organizing framework that received critical academic attention was presented by Dunning (1977, 1981). Dunning noted that there was a growing convergence between the theories of international trade and production, with the same variables being used to explain both trade and non-trade involvement. He thus argued for an integrated approach to international economic involvement. This approach was based on the location-specific endowments of countries and the ownership-specific advantages of firms. His original paper on the eclectic paradigm (1977) outlines a systemic explanation of the foreign activities of firms in terms of their ability to internalize markets to their advantage. This has become known as OLI framework: *ownership*, *location*, and *internalization*. The greater the competitive advantages of the investing firms, relative to other firms, the more likely they are to be able to engage in developing foreign affiliates or increase foreign production. Ownership specific advantages refer to unique characteristics of a particular firm that provides such competitive advantages over other firms. An example of such advantages includes innovative marketing strategy, superior technology, better asset endowment, and strong human resource capacity of such firms.

Location advantages influence the extent to which firms choose to locate production outside of national boundaries. The more the immobile, natural or created endowments, which firms need to use jointly with their own competitive advantages, favor a presence in a foreign location, the more firms will choose to make use of their ownership specific advantage through engaging in FDI. Examples of such advantages can be discussed in terms of the following location specific factors –availability and cheap factor costs, bypassing trade restrictions such as tariff and quota imposed on the foreign goods at a host country environment (Chen, 1983). In addition to location and ownership-specific advantages, another set of choices is available to firms, relating to the way firms generate and use their resources and capabilities. In other words, to fully maintain the ownership-specific advantages the investing firms would like to prevent the knowledge dissipation to the extent possible by internalizing their operations. Dunning refers to these as "*internalization*" advantages since it will allow the firms to produce internally and thus to bypass external markets and the associated transaction costs. In summary, the eclectic paradigm maintains that the extent and pattern of international production are determined by the interaction of three sets of variables (Dunning, 1988)

2.1. General Equilibrium Model of Multinational Firms

Although interesting, dunning's work was more a conceptual framework than a formal model. But it was useful because it had identified elements that should be the ingredients for any full-fledged model of the MNE and FDI, such as imperfect competition (the O of OLI), barriers to trade like transportation costs (the L of OLI), and internalization issues (the I of OLI). The paper of Dixit and Stiglitz (1977) provided a plausible way to incorporate all these elements in a formal model. Two different streams of literature emerged from the Dixit and Stiglitz framework.

Multinational and the theory of Vertically Integrated Firms

Helpman (1984) was one of the first attempts to apply the Dixit-Stiglitz framework to MNEs. The model was constructed such that firms have a single production facility, which could be in a different country than the headquarters. It is assumed that headquarter services and production are characterized by different factor intensities. The absence of tariffs or transport costs means that the firm will never open more than one production facility; this gives rise to multinational behavior if headquarters and production can be separated. The model predicts interfirm trade as functions of relative country size and differences in relative factor endowments. Helpman's model implied a model of a vertically integrated firm that minimizes factor costs. One serious drawback of the model was that horizontal FDI was not possible by assumption.

2.2. Multinationals and the Horizontally Integrated Firms

Markusen (1984) took a rather different approach, assuming the existence of firm-level (as opposed to plant-level) scale economies arising from the joint input nature of knowledge capital across geographically separated production facilities. Markusen's model captured the notion of horizontally integrated firms that undertake the same activity in multiple countries but excluded any motive for vertical specialization.

Ethier (1986) analyzed the emergence of multinational enterprises in a general equilibrium framework. The paper, in the line of Dunning's framework, argued that the core question in understanding direct investment is the nature of internalization and that internalization involves the exchange of information between agents. The central informational issues discussed were the public good nature of information and the size and diversity of the information flows with which agents have to contend. A model was constructed to examine and analyze such concerns with the informational issues. The model contained two variables, research effort, and product quality, respectively and the key parameters were relative factor endowments and dispersion (measured as the degree of intrinsic uncertainty facing agents). The presence of multinational firms is found positively related to the size of the dispersion. The similarity in relative factor endowments makes direct investment more likely, and also provides a basis for intra-industry trade and causes wages to be more nearly equal internationally.

Sufficient endowment similarity (and the presence of a large enough dispersion) causes international wage equalization and two-way direct investment, making intra-industry trade and intra-firm trade large relative to inter-industry trade. These implications are strikingly different from those of the Markusen-Helpman model, which took internalization for granted. Theoretical refinements and extensions of these models can be found in Helpman (1985), Horstmann and Markusen (1987, 1992), Brainard (1993), Markusen (1997), Markusen and Venables (1998), and a comprehensive survey of the literature is found in Markusen (1995).

Papers by Brainard (1993, 1997) and Horstmann and Markusen (1992) have produced models in which horizontal multinationals arise endogenously and in which two-way investment, a characteristic of the North Atlantic economy, can arise in equilibrium. The three key elements of both papers are firm-level activities (like R&D) that are joint inputs across plants, plant-level scale economies, and tariffs or transport costs between countries. Although Brainard modeled firms as producing differentiated products the goods are homogeneous in the Horstmann and Markusen model, the results are quite similar. Multinationals are restored to equilibrium when firm-level fixed costs and tariffs and transport costs are large relative to plant-level scale economies. They are more likely to exist in equilibrium when the countries are large and when the countries have similar relative factor endowments. These papers provide additional support to the "horizontal" view that firm-level scale economies rather than factor-intensity differences between activities provide the more important explanation of direct investment.

Hypothesis

In this context, it would be important to see the acquisition by Tata Motors of the Land Rover and Jaguar Brands from Ford Motor Company. This case analysis will attempt to find the answers to the following questions:

Do emerging country multinationals invest in the developed economies to acquire strategic assets? If so, what firm level factors are required by EMNEs so that they are able to absorb the assets?

3. Case Description

'Market-seeking' motivations have been at the center of the literature on location advantages, suggesting that whether multinational enterprises are emerging from the advanced economies, or the emerging economies, the primary reason of internationalization has to do with the size and prospect of the potential host countries (Flores and Aguilera, 2007; Loree and Guisinger, 1995). Goldstein (2009) illustrates that EMNEs use their investments in advanced economies as platforms for their products to be tailored to the requirements of geographically and culturally distant partners. The investments undertaken in Italy by Haier - a Chinese appliances manufacturer can be used as an example. Pietrobelli et al. (2011) explain the location strategy of Haier as to improve the capability to design, develop and manufacture products suitable for the European markets.

In regard to the "asset/resource seeking" investments, the location strategies of EMNEs particularly become relevant. The literature suggests that the transfer of tacit assets and knowledge is an important factor in the FDI outflow from 'South' to 'North'. The intention is to acquire knowledge, technology, and other strategic assets (such as commercial brand and supply chain networks) as reflected in India's Tata Motors' acquisition of Jaguar and Land rover (formerly British brands). The acquisition of strategic assets is significantly mediated by the technological capabilities of the investing firms. As shown in Makino et al. (2002) EMNEs that do not possess adequate experience are not particularly attracted towards location characterized by technological assets.

In a similar vein, we wish to analyze the location strategies of Tata Motors in acquiring the Land Rover and the Jaguar Brands.

3.1. Case History in Chronological Order

June 2008 (Source: Tata Motors Limited Website, 2008)

Jaguar Land Rover has been acquired at a cost of $2.3 billion on a cash-free, debt-free basis. The purchase consideration includes the ownership by Jaguar and Land Rover, or perpetual royalty-free licenses of all necessary intellectual property rights, manufacturing plants, two advanced design centers in the UK, and a worldwide network of national sales companies.

Long-term agreements have been entered into for supply of engines, stampings and other components to Jaguar Land Rover. Other areas of transition support from Ford include IT, accounting and access to test facilities. The two companies will continue to cooperate in areas such as design and development through sharing of platforms and joint development of hybrid technologies and powertrain engineering. The Ford Motor Credit Company will continue to provide financing for Jaguar Land Rover dealers and customers for a transition period.

October 2010 (Tata Motors Website, 2010)

Page 11 of Tata Motors transformation resource acquisition path claimed the following:

"The JLR acquisition was formally concluded in June 2008 with a final price of US$ 2, 3 million and total cost of over US$ 3 billion to be financed through a rather short-term bridge loan. The operation was 'transformational' for TML in several respects: (i) the acquisition more than doubled TMLs overall revenues and almost quadrupled its revenues from passenger cars; (ii) apart from some more direct product relatedness to TML's SUV segment with the Land Rover part of JLR the acquisition represents a diversification into the segment of larger premium class cars, an entirely new market for a vehicle manufacturer like TML which was predominantly specialized in low cost and small cars; (iii) While TML had some marginal exports of its passenger cars before the company went into a kind of 'instant outward internationalization' in passenger cars. From a company with marginal assets overseas TML transformed into a global player with the majority of its assets abroad."

September 2015 (Retrieved from The Telegraph newspaper)

The Telegraph, a leading British newspaper quoted

1.1. "Although it has taken more than £11bn of investment, Jaguar Land Rover is now one of Britain's most profitable companies."

1.2. "The Evoque soon became the company's biggest seller, accounting for almost a third of sales – and helping provide the funds, momentum, and cachet for the marque to develop new Jaguars. The company also invested heavily in new factories and technology, including expanding the use of aluminum platforms pioneered in the XJ that meant lighter, less fuel- thirsty and consequently greener cars."

1.3. "Sources close to JLR said Tata "had authorized" more funding for production and R&D for a couple of years at about £3.5bn a year, though the Evoque's success and sales hopes for the newest Jaguars mean the company could move towards self-funding."

2. *Conclusion and future research avenues*

Whether the motives behind the recent spate of cross-border acquisitions from the EMNEs are market seeking or asset seeking? This paper explored the acquisition of Jaguar Land Rover by the Tata Motors Limited. The acquisition came with the R&D takeovers of the formerly Ford plants in the U.K. As reported by the Telegraph (2015), Tata Motors' huge R&D expenditures certainly point in that direction. The case study refers to the direction that emerging country multinationals expand in the advanced world through strategic assets acquisition, which provided them with the tacit knowledge of the firms from the advanced countries and also transform the EMNEs to globally recognized entities.

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