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## Research & Development

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*On October 7, 2014, two days after the first round of the Brazilian general election, The Evian Group@IMD organized a one-day event dedicated to the seventh biggest world economy. Twenty-one academics, business leaders and renowned international analysts, shared their perspectives on Brazil's economic prospects, the implications of the presidential elections, the impact of major sports events such as the World Cup and the Olympic Games, and the investment opportunities for multinationals.*

# Brazil: What Next?

## In search of a new cycle of growth

Brazil has always been referred to as a land of opportunity and great potential. Famous Austrian writer Stefan Sweig declared in 1941 that, "Brazil is the Country of the Future." In his welcome introduction, Professor Hooijberg highlighted that Brazil belongs to a unique group of 13 countries that sustained an average growth rate of 7% or more over a 25-year period during the post-World War II era. However, a series of economic and political crises in the 1980s and early 1990s hampered its momentum. It was only in the late 1990s that Brazil returned to growth attributed to political stability and the "Plano Real" of President Fernando Henrique Cardoso's administration. One of the main architects of the Real Plan, Ambassador Ricupero, spoke at the event.

Over the last two decades Brazil has enjoyed "inclusive growth," which led to less inequality and a significantly larger middle class. In recent years, the discovery of offshore oil reserves and the assignment of the 2014 World Cup and the 2016 Olympic Games revived optimism about the country's prospects, something that is shared by foreign investors, who allocated more than US$60 billion per year in 2013 and 2014, making it the fifth most popular destination for foreign direct investment (FDI). Nevertheless, the economy has slowed to between 1% and 2.5% in the last three years, with 2014 forecast to be stagnant. Added to this, surveys about the level of satisfaction of the population and the street demonstrations prior to the World Cup indicated that the national mood about the status of the economy has gone sour.

Professor Braga highlighted that most economists recognize that Brazil's growth potential ranges between 3.5% and 4% and he invited speakers to share their views on what it would take to unleash a new cycle of growth. Experts agreed that Brazil will only be able to achieve high growth if the new government introduces structural reforms aimed at raising productivity (given the negative trend observed in recent years), including improvements in innovation, managerial techniques and education as well as investments in infrastructure. Policies that promote public and private savings should also be introduced as this will encourage investment. Major downside risks include the continuing protectionism in sectors like energy and transportation, the high levels of subsidized credit, the forecast pressure on fiscal budget (given its current weak state) and the accelerating inflation. The need for reforms is also shared by the Brazilian public at large, as demonstrated by the political dialogue that took place before the first election round, and many analysts have raised the alarm, stating that the new government will have to introduce change and improve its handling of the economy in order to raise expectations inside the country and abroad. Some participants expressed skepticism about the ability of a future government led by Dilma Rousseff to pursue bold reforms, others remained more optimistic. Paraphrasing past president Cardoso, one of the participants commented, "Brazil is not a tiger but a whale; we know what we have to do and eventually we will get there."

## The internationalization journey of Brazilian companies

Some participants expressed skepticism about the ability of a future government led by Dilma Rousseff to pursue bold reforms, others remained more optimistic.

The moment a Brazilian company enters the global arena, it realizes that it has to boost its productivity in order to compensate for the added costs associated with being Brazilian, including an appreciated currency, relatively high labor costs, inadequate infrastructure, a complex tax system and bureaucracy, not to mention corruption. All these considerably increase the cost of doing business.

For companies from "less developed" countries like Brazil, communication can help overcome some of the biases and negative stereotypes that still persist in the minds of customers, suppliers and government officials across the world.

Senior managers from Embraer, Vale and Vicunha – three Brazilian companies that have emerged as world class competitors in their respective industries (aerospace, mining and textiles) – and the president of the Latin American Business Council – a network of Latin American entrepreneurs – shared their views on what it takes to go global from a Brazilian perspective. The internationalization journey of Brazilian companies has been neither smooth nor predictable. One of the first things they realize as soon as they step out of their national comfort zone is that they have to get closer to the customer. "You build your brand by delivering fast and reliable service and you can only do this by being close to the customer," one of the participants commented. "Global Latinas" – a term used to describe privately owned, Latin America-based multinational firms – typically expand first to neighboring Latin American countries, then to the US, Asia and Europe. A second realization concerns the "Brazil cost." The moment a Brazilian company enters the global arena, it realizes that it has to boost its productivity in order to compensate for the added costs associated with being Brazilian, including an appreciated currency, relatively high labor costs, inadequate infrastructure, a complex tax system and bureaucracy, not to mention corruption. All these considerably increase the cost of doing business.

Confronting established players on the world stage requires a different mindset and "modus operandi," one that emphasizes constant innovation and adaptation. Vale innovated by manufacturing large deep-water vessels, significantly decreasing the economic cost of transporting iron ore; Vicunha had to find novel ways of distributing its products to Europe; and Embraer had to integrate in the global value chains of the aviation industry as it realized that it could not compete by doing everything alone. Adapting to the local conditions is also key. Successful companies adopt a long-term view and remain humble. Once they establish a footprint in a key market, they continue to invest in it, they hire and promote local talent. "We do not have expatriates," one senior executive proudly declared. They also learn from the companies that they acquire along the way.

Operating in today's volatile world requires flexibility, improvisation and scenario planning. These are skills that Brazilian companies have nurtured over time in response to the uncertainty and constraints of their domestic economic environment. Consequently, when abroad, Brazilian companies demonstrate adaptability and agility, particularly when doing business in countries with similar shortcomings. Communication is another key ingredient, and executives should not hesitate to invest in this area. Additionally, for companies from "less developed" countries like Brazil, communication can help overcome some of the biases and negative stereotypes that still persist in the minds of customers, suppliers and government officials across the world.

While many Brazilian companies have successfully transformed into multinational players (e.g. Gerdau, Marcopolo, Natura, Weg and JBS) there is a lot of room for improvement. Brazil does not have many representatives in the so-called new economies of information technology, internet or biotechnology, and it has a poor record of patents registered and granted. It also lags behind many other countries, including India and China, in the number of companies in the Global Fortune 500 ranking. Looking ahead, Brazilian companies will continue to face challenges that will test their cost structures, business models and commitment to internationalization. As one participant put it, "Brazilian companies should rely on their own strengths and take risks if they want to become global players."

## The economic impact and legacy of mega sports events

Mega sports events like the recent World Cup in Brazil and the forthcoming 2016 Olympic Games in Rio de Janeiro represent a big business opportunity and a chance to leave a legacy. Senior representatives from the International Olympic Committee (IOC) and the Rio 2016 organizing committee described the challenges behind organizing and executing such events.

Mega sports events are highly complex and involve hundreds of small projects, making it difficult to accurately assess their economic impact. Furthermore, their benefits are both short term (e.g. additional tourism revenues) and long term (e.g. upgraded hotels and new conference centers), tangible (new or improved infrastructure) and intangible (event organization knowhow or enhancing a country's international image). Quite often, government officials expand the scope of the event and add projects that are irrelevant and were never requested by the awarding body. Organizations like the IOC advise host cities to think carefully about the legacy that they want to leave behind. To get this right, one needs to have a clear vision that is aligned with all major stakeholders and particularly the citizens of the city or country concerned.

Rio 2016 represents a large transformation project for the city. It has a budget of $15.3 billion, of which 57% is privately funded through a novel approach to public and private collaboration. The legacy of Rio 2016 includes three major elements:

1. A complete change of the city's transport system, with the number of citizens using "high capacity transport systems" expected to rise to 60% in 2016 (from 13% in 2009);
2. Large-scale cleaning of the Rio bay, where the amount of sewage treated is forecast to reach 80% in 2016 (from 11% in 2007); and
3. A comprehensive sports education project destined to reach every student in Rio's schools.

Managing public finances has been a major challenge for the city and state of Rio, and the organizing committee had to introduce some important changes to improve cash availability and spending efficiency. It had to invest significantly in information systems, recruit staff with the right skills and reexamine the way it allocates resources. In the words of one executive, "A modern and professional approach to public financial management is the legacy of the games for us. Rio 2016 taught us how to best work with deadlines and guidelines."

## Investing in Brazil

Professor Aluisio de Lima Campos opened the discussion stating that FDI grew from about US$12 billion per year in 2003 to over US$60 billion in 2013 and asked the panel, "Why invest in Brazil?" Three main drivers of a country's FDI were identified: its market size, its natural resources and its efficiency. Brazil scores well in the first two but still has challenges ahead in terms of efficiency. It needs to enhance its infrastructure; reduce the tax burden; make the labor market more flexible; and review the length and complexity of administrative procedures. The way foreign long-term investors regard Brazil can only be improved if consequential efforts are made in these sectors.

Humberto Antunes, shared his experience in investing in Brazil, one of the largest markets in the world in the dermatology sector. The operational side of the business is very fruitful, but after two attempts, Antunes decided to stop investing in R&D in Brazil because it was too expensive, the bureaucracy was mindboggling and the patent policy dysfunctional. "If after spending 5 to 12 years developing a medical product you can't patent it, someone in China will find a way to do it quicker and you will have lost it. You need to have a proper intellectual property framework to generate sustainable and long-term investment in R&D," said Antunes. "If the Brazilian government were to provide the proper incentives for investments in R&D, it would be different," he concluded.

Benedikt Schwartz stressed the opportunities in Brazil for Swiss enterprises. In the energy and transmission sector, public funding is expected to double the existing capacity by 2017. Additionally, the Brazilian government will inject US$8 billion into highway concessions and build

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**"A modern and professional approach to public financial management is the legacy of the games for us. Rio 2016 taught us how to best work with deadlines and guidelines."**

9,000 km of railways. Another US$6.2 billion will be invested in port concessions. Grasping these opportunities is a "good" challenge for Swiss businesses.

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## Brazil and the BRICS

Are the BRICS anything more than an acronym? And does Brazil have any objectives in common with Russia, India, China or South Africa? Professors Lehmann, Narasimhan and Strebel, and Dr Marc Laperrouza shared their views in a panel discussion. A first observation is that there are similarities among these five countries, including: fast economic growth (in the first ten years of the new millennium), a rising middle class and an ambition to play a bigger role in the global political scene. However, a closer look shows that often they compete with each other and pursue different geopolitical agendas. As one contributor observed, the BRICS do not carry significant geopolitical weight, mainly because the parties involved have not identified a list of common interests, with one notable exception: the creation of global financial institutions, an area that has gained some traction (e.g. the creation of the BRICS bank). In addition, there is growing evidence that some of them feel uncomfortable with China's increasingly assertive stance; "BRICS should be renamed the Chinese forum for emerging markets!" Professor Strebel proposed highlighting this development. Perhaps the greatest contribution of the BRICS to the world and certainly its member countries is what Professor Narasimhan called "the power of categorization." It is a label of integration in the global economy, a sign that the country is determined to pursue a growth agenda and catch up with the rest of the developed world.

## What next?

According to a senior representative from the banking community, the fundamentals of the Brazilian economy are in good shape. Brazil is a large, populous country, rich in natural resources, an agricultural powerhouse and nearly self-sufficient in oil. It is an open society with a stable democracy, an active press, a functioning judiciary and a well-capitalized banking system. Given all the above, it is no surprise that it is the fifth largest recipient of FDI in the world. The size of its market, its rising middle class and expectations about its prospects draw foreign investors. But scholars, executives and entrepreneurs participating in the event seemed to agree on one thing: The winner of the presidential election will have to regain the confidence of both the public and the investors to put the country back on the fast-growth track. This can only be achieved by introducing structural reforms, fighting corruption, re-establishing fiscal discipline and addressing the productivity challenge.

Professor Braga concluded the day by quoting famous "bossa nova" composer Tom Jobim: "Brazil is not for beginners," he said and added, "At the end of an event dedicated to this fascinating country I hope you don't feel anymore like beginners."

## External speakers

- Humberto Antunes, CEO, Galderma
- Werner Baer, Professor, University of Illinois at Urbana-Champaign
- Fidel Blanco, President, Vale International
- Carlos Bronzatto, Executive Director, WAIPA
- Otaviano Canuto, Senior Adviser, BRICS, The World Bank
- Artur Coutinho, COO, Embraer
- Thomas Dislich, CEO Vicunha Europe
- Simon Evenett, Professor, University of St. Gallen
- Elizabeth Farina, CEO, UNICA
- Gilbert Felli, Senior Olympic Games Advisor, IOC
- Leonardo Gryner, Deputy CEO, Rio 2016, Organizing Committee/Olympic Games
- Marc Laperrouza, Lecturer, EPFL
- Aluisio de Lima-Campos, adjunct Professor of Law at the American University
- Ingo Plöger, President, The Business Council of Latin America
- Murilo Portugal, President, Febraban
- Rubens Ricupero, Director, FAAP
- Fabio Schvartsman, CEO, Klabin S.A.
- Benedikt Schwartz, Senior Consultant, Switzerland Global Enterprise
- John H. Welch, Executive Director, Macro Strategy, Latin America, CIBC World Markets Inc.
- Renato Augusto Zagallo Villela dos Santos, CFO, Rio 2016, Organizing Committee/ Olympic Games