

International: How to Succeed at Entering the Brazilian Market

THIS ARTICLE EXPLORES THE CHANNEL PRACTICALITIES OF ENTERING AND THRIVING IN THE BRAZILIAN MARKETPLACE.

The world is becoming “flatter” everyday, and companies need to develop channel strategies on a global, regional and local basis.

Cultural, legal and economic conditions can vary significantly around the globe.

The notorious “Brazil Cost”, which broadly refers to the cost of doing business in Brazil, is comprised of such issues as—high taxation, infrastructure inefficiencies, logistics costs, and workers benefits, among others. Brazil Cost has always been a burden on the country, oftentimes diminishing foreign investment interest. However, while causing numerous disadvantages locally, the negative impact of the Brazil Cost on local manufacturing can still generate opportunities and competitive advantages for foreign companies, and their products in the country, especially when they are the first to enter.

A recent study conducted by ABIMAQ (The Brazilian Association of Machinery and Equipment Industry), has managed to quantify this Brazil Cost in two key sectors. According to the research, Brazil’s industrial sector suffers from an additional cost burden of 36% relative to products manufactured in developed countries (including such factors as raw material costs, cash-flow interest rates, logistics costs, etc.). Likewise, the machines and equipment sectors are burdened with over 40% in added costs relative to foreign counterparts. This situation has resulted in a rise of product imports in these specific sectors. The competitiveness of locally-manufactured products is also being exacerbated by the valuation of the Brazilian Real in recent years, debilitating the country’s ability to compete effectively in export markets. From January to September 2010, Brazil’s exports decreased by 40% relative to the same period in 2009, which indicates the pressure on local industries. These conditions play into the favor of companies pursuing an initial Brazilian entry strategy relying on imports.

In 2007, according to a United Nations economic report, Brazil became a middle-class nation with an impressive 52% of the population being classified at this socio-economic level, while the poor population

decreased by 10% over a two-year period (from 2004 to 2006). The rise in the middle class has supported a relative sophistication of the Brazilian market, which should generate greater opportunities for higher-end foreign products and innovative technologies in the country. For example, in September 2010, Anatel (Agência Nacional de Telecomunicações) reported that there are 189.4 million active mobile phones in the country today, with a penetration rate of 98%. Brazilians are also among the highest active participants of social online networking in the world, with a penetration rate of over 80% amid residential internet users. This year Brazil will be the 4th largest market for automobiles reaching about 3.7 million units; local production is breaking records as well as imports.

Differentiated products benefit from less lobbying by domestic producers, generally lower import tariffs (if the product has no locally-manufactured alternatives), and opportunities to capture a population with elevated interest in new and existing foreign technologies.

The lesson learned over the years by foreign companies entering this market is that there are great returns on investments, mainly over the past 16 years when stability was finally reached; however, manufacturers must still ask themselves some key questions.

What should be considered as far as product lines and entrance channels in order to get an edge?

The market needs and welcomes advanced technology products— manufacturers of more commodity-like products will compete with well-established local companies. While market entrance doesn’t follow a rigid approach, a standard method is to import at first and conquer the market, although taxation will throw the cost sky high, you will be the only one in the market and the Brazilian market normally pays two or three times the U.S. price for cutting-edge products, or any other products not yet available. Importers typically will sell through local distributors or their own sales team. By the time competitors enter the country, the first-mover

already knows the market and the market knows the brand. At this point, the importer should open up its own, local production facilities. The advantage, aside from market loyalty, is a higher tariff protection and possible tax benefits, especially if the product is labor intensive.

Brazilians are very brand-oriented and loyal. Products such as Coke have over 90% of the cola market. Ibev/ Ambev, the largest beverage company in Brazil, has sold Pepsi for decades, invested billions of U.S. dollars, but without success. Coke came in before Pepsi, which made all the difference. The same story holds true for car makers; VW, Ford, GM, and Fiat have been in Brazil for decades with great success. Nine other makers came (from Europe and Asia) in the 1990s, but after 15 years their combined market share is less than 35%.

What else should a foreign company think about or do to ensure success when they target Brazil?

Companies eyeing the Brazilian market should develop a long term strategy based on market research, while leveraging their experience in other corners of the world. If time is short, new companies should consider a venture or arrangement with a local rep firm, distributor, or another manufacturer operating in the same channel segment. However, any contract should include terms that allow for local production whether through a new plant, joint venture or acquisition.

What are the risks and how to avoid them?

The major risk is entering the country without market and cultural knowledge. When entering through a joint venture or acquisition, companies should always undertake a complete due diligence assessment, including customer and channel analysis, keeping in mind that potential partners or sellers tend to overestimate their image and hide problems. Without a good overall due diligence effort, companies are almost asking for an investment disaster.

Over the last decade, Brazil has become an increasingly attractive and profitable market for foreign companies, as long as they ask (and answer) the right questions.

SUMMARY

If you'd like to discuss a channel entry plan for Brazil or other countries, or consider other aspects of multinational channel strategy, please contact John Henderson at 312.558.4828 or hendy@franklynn.com. Jorge Frederico Landmann is the CEO of Magnus Landmann Consultoria Empresarial in São Paulo Brazil and Sandra Di Si is the International Director at Magnus Landmann.