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The Internationalisation Process of German Enterprises in Brazil

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Abstract:

The exchange between Germany and Brazil encompasses social, economic and cultural aspects. However, there is still a great economic potential to be leveraged from this partnership. The Brazilian government is searching for international investors to boost the economy and take the country out of recession. In return, it promises to fight the main obstacles: high bureaucracy and corruption. With one of the world's largest consumer markets and an abundance of natural resources, the country offers attractive conditions, especially for enterprises undergoing an internationalisation process. This study will analyse the recent economic history of Brazil, describe the major macroeconomic indicators and the social conditions of the country. With the collaboration of a number of German enterprises that have expanded their business to Brazil and reported on their experiences, relevant empirical cases will be presented and new investment perspectives discussed.

JEL Classification: C14, R13, R32

Keywords: FDI in Brazil, German investment, Brazilian economic perspectives.

1 Introduction

The relationship between Germany and Brazil encompasses historical and sociological aspects that touch on the lives of thousands of families, especially in southern Brazil where the majority of German immigrants settled. Fortunately, these bonds have been strengthened through the implementation of developmental, economic and political agreements. Since 2002, the two countries have been strategic partners, and in 2015, this bilateral partnership created a mechanism of "High-Level Intergovernmental Consultations" (Brazilian Ministry of Foreign Affairs, 2015). This consultation mechanism aims to boost bilateral political dialogue, allowing the development of economic, technological and commercial ventures. Economic development is a fundamental component of the Brazilian-German partnership. Since 1974, the German-Brazilian Economic Meeting has brought together governmental authorities, business leaders, researchers and entrepreneurs from both countries annually to discuss the expansion of investments and new forms of bilateral cooperation (DBWT, 2019). Thus, the relationship between Brazil and Germany has a long and prosperous history. Although these countries have major economic, developmental and social differences and Brazil has been suffering as a result of an economic crisis in recent years, there is still a great interest among German companies in investing in Brazil (AHK, 2018, p. 2). This interest might increase over the next few years due to economic changes and foreign direct investment (FDI) incentives promised by Brazil's recently elected president.

One outcome of this strategy of the new Brazilian government in connection with international trade and FDI incentives is the recent European Union and Mercosur states trade agreement, led by Brazil (EC, 2019). In the light of the current trade wars involving China and the United States, Brazil has chosen a different economic path and, together with Paraguay, Argentina and all EU member-states, has demonstrated to the world that it is possible to find a diplomatic and mutually beneficial solution to economic issues. Brazil is not only the leader country of Mercosur, but also the seventh largest consumer market in the world, and by 2023 will be the fifth-largest (CNI, 2019). Brazil has the eighth largest gross domestic product (GDP) in the world, which is equivalent to around 40% of the whole Latin American and Caribbean economy. Brazil is also the largest exporter of meat, coffee and sugar worldwide and the second largest exporter of soya beans and iron ores. In 2018, the country was the sixth main destination for FDI flows worldwide. In terms of GDP, the 1980s was a period of stagnation, not only for Brazil but for the whole of Latin America. Between 1995 and 2011, neoliberal politics were implemented, attracting international investors back to Brazil. The growing foreign demand for raw materials led to the so-called commodity boom where the national economy flourished rapidly and governmental social incentives took millions out of poverty, expanding the Brazilian middle-class, increasing consumer buying power, and enlarging the national consumer market. The Brazilian GDP is still recovering from the last recession caused by the 2008 world crisis and corruption scandals evolving former government members. Nevertheless, the economy is still very dependent on agriculture and exploitation of raw materials since the years of high inflation for commodity prices contributed to a deindustrialisation process that in turn led to a loss of competitiveness in terms of manufactured products, innovation, and technology (World Bank, 2019 b).

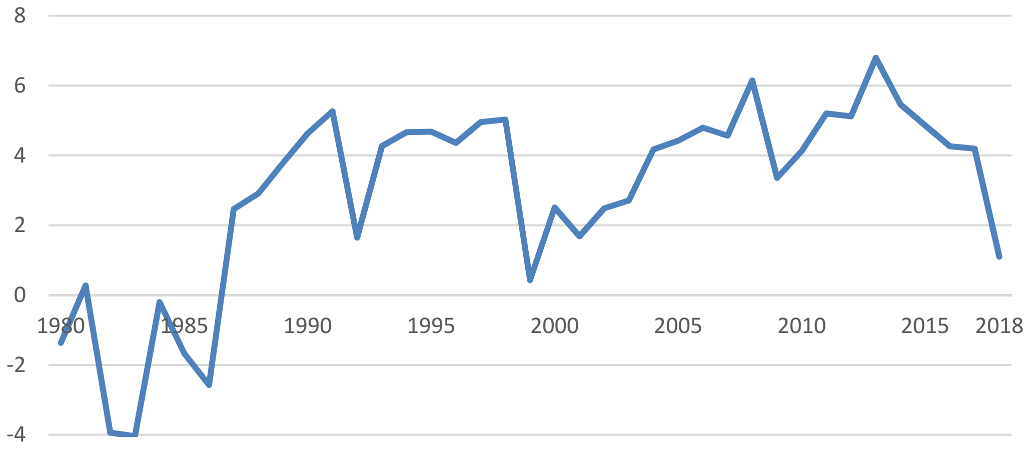

Figure 1: GDP annual growth of Brazil from 1980 to 2018

Modern Brazilian economic history is marked by one major problem: inflation. The volatility of the Accumulated Broad National Consumer Price Index (IPCA) was destroying purchasing power and throwing the country into a deep recession. This situation lasted until 1994 when the Real plan finally stabilised the chaotic inflation taxes, and successfully established a new national currency, the Real (IBGE, 2019).

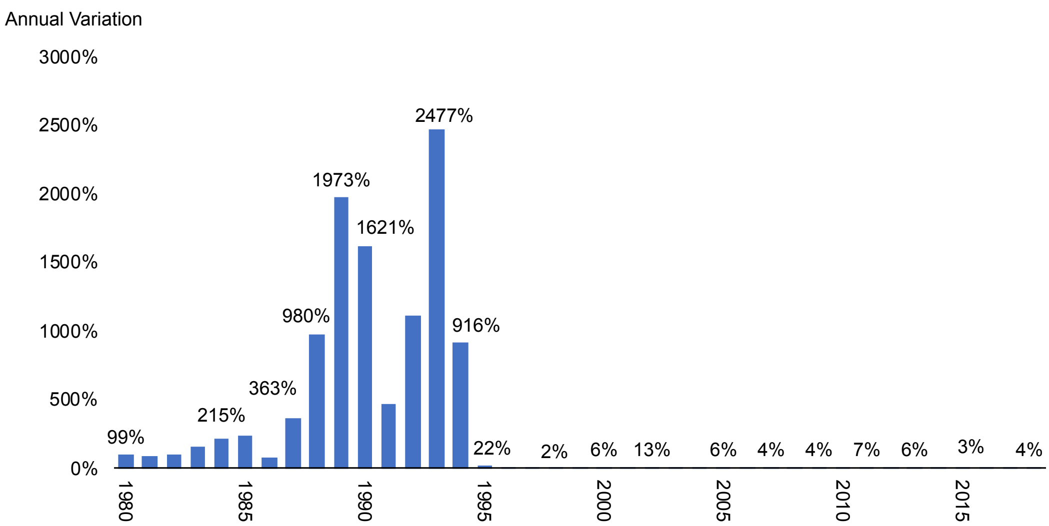

Figure 2: IPCA annual - Inflation in Brazil from 1980 to 2018

The Brazilian trade balance surplus is mainly based on the exportation of agricultural products, meat, iron and other raw materials. The desire for a trade surplus at any cost has left Brazil dependent on its economy of scale and its comparative advantage in commodities and has also increased the national debt. Dictatorship governments promoted Brazilian exports at the expense of the public sector, with subsidies, credit, and fiscal incentives exponentially increasing the Brazilian public debt throughout the 1980s. In the next decade, the Real plan led to an appreciation in the value of the Real as a measure to contain inflation. Consequently, imports grew and exports were reduced, causing subsequent trade balance deficits up to the year 2000. The trade balance recovered during the commodity boom cycle (2000–2014) when the expansion of the Chinese economy increased the prices of primary products, where Brazil has a comparative advantage.

The favourable international scenario, together with governmental social programs promoted higher employment which in turn increased the purchasing power of the population. During this period, both exports and imports grew due to the rise of commodity prices together with the appreciation of the Brazilian Real. In 2018, after a long recession period, Brazil presented the second-best trade balance result of the last 40 years (MDIC, 2019).

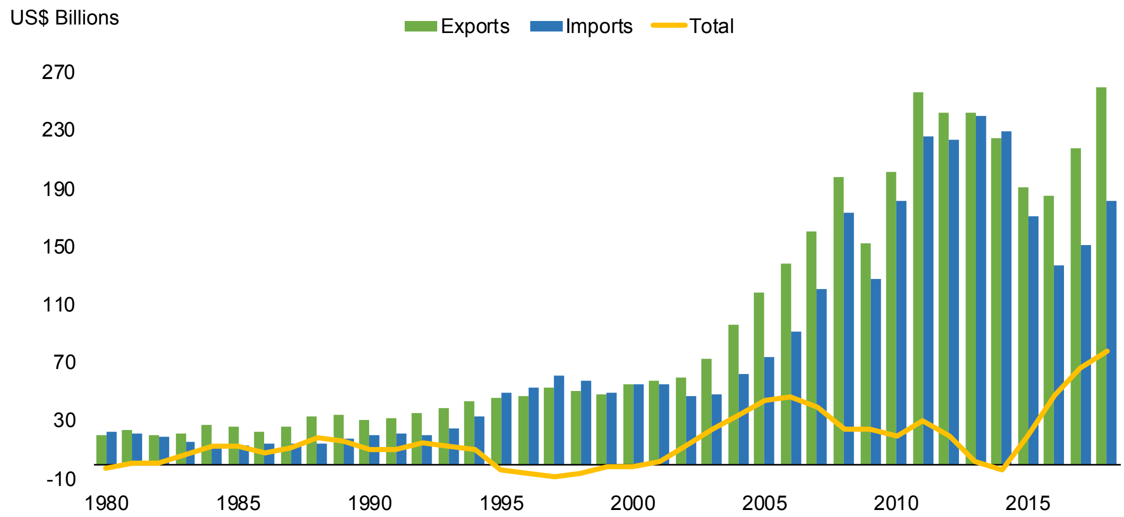

Figure 3: Trade balance of Brazil from 1980 to 2018

In the area of foreign direct investment, Brazil still has a long way to go to regain the trust of international investors. Because of political instability provoked by the last presidential elections, Brazil absent one position in the competition for global FDI attraction. Nonetheless, it is still one of the main destinations for capital and investment worldwide. Germany is nowadays the third largest investor in Brazil, following the Netherlands, which is heavily involved in oil extraction financing, and the United

States which invests in diversified sectors, including technology, computing, financial services, communication and capital goods. German investments in Brazil on the other hand mostly flow into the automobile industry, machinery, chemicals, communication, and technology in general (World Bank, 2019 a).

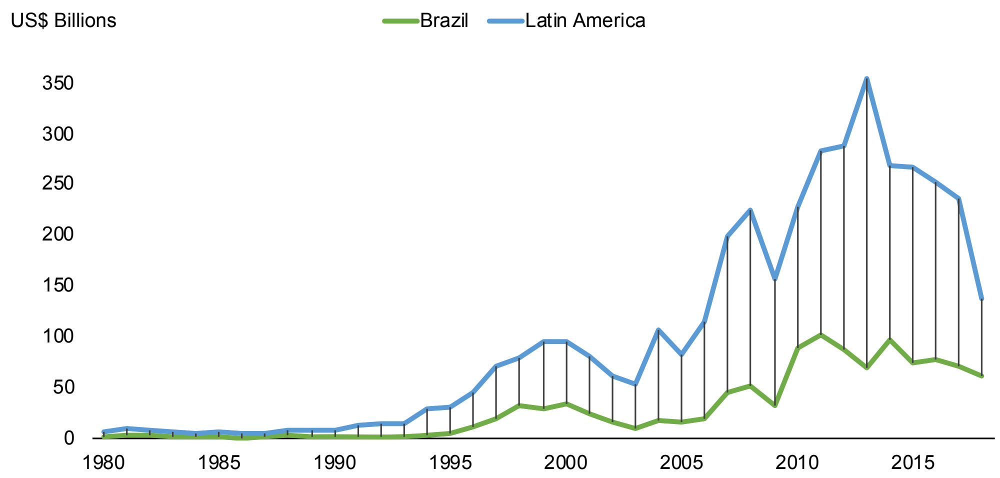

Figure 4: FDI in Brazil and Latin America (net inflows) from 1980 to 2018

2 The Internationalisation Process of German Enterprises in Brazil

The motivation of German companies to cross borders and expand into Brazil can be explained using clear internationalisation cases analysed through questionnaires and with a qualitative-inductive approach. Due to its exploratory character, qualitative methodology does not aim to obtain quantifiable statistics or values as outcomes; instead, it strives to collect data in order to better understand and interpret decision-making processes, as well as the motivation and opinions of the group surveyed. Furthermore, the chosen survey design looks at various examples of internationalisation and therefore seeks to establish a pattern of association between all cases, regardless of companies' specificities.

In addition to an extensive theoretical framework, this research employs questionnaires as a means of approaching German companies and obtaining valuable information on strategies and experiences. As a result of this collaboration, a questionnaire with five closed questions and two open questions was developed. The five closed questions are designed to rate the importance of various aspects of the decision-making process leading to internationalisation among the companies surveyed. Hence, the five questions are pre-coded using a numerical horizontal Likert scale ranging from zero to five, in which zero is the lowest score and five the highest. The respondents are then asked to evaluate different aspects using this scale to determine the most crucial factors in terms of business expansion to Brazil. The two open questions are designed to obtain subjective responses and thus assess the individual opinions, possibly adding new relevant facets to the research.

The respondent enterprises are Koelnmesse GmbH (large enterprise[1]) and its subsidiary in Brazil, Koelnmesse Ltda., Conekt UG (small enterprise), KL GmbH and its subsidiary in Brazil – KL Brazil (small enterprise), Hey Projects KG (medium-sized enterprise), Acai GmbH headquarters in Berlin and their responsible office for trade with Brazil (medium-sized enterprise), and, lastly, Dannemann GmbH (large enterprise). All these German companies are or have recently been involved in business expansion and international trade with Brazil and have been able and willing to share their experiences. Furthermore, all research respondents hold high positions as managers, directors or CEOs and therefore possess proven expertise and experience.

According to the researched companies, the biggest advantage of Brazil in comparison to other South American countries is its larger consumer market. Brazil has more than 200 million inhabitants and due to the expansion of the middle-class over the last decade, the domestic consumer market has grown exponentially. Official estimates calculate that the middle-class represents around 44% of the Brazilian population, and in the year 2022 will increase to up to 57% (OECD, 2019). Global integrated multinational companies (MNC) that plan to escape from saturated and highly competitive markets can find attractive and lucrative opportunities in Brazil. Differences in the pace of economic growth, economic development, consumption per capita and local habits are being leveraged to achieve new target markets and increase the profits of MNCs.

Other benefits in connection with internationalisation to Brazil have also been considered. Brazil has a stronger economy and a better infrastructure compared with other South American countries, which is also recognised as a relevant benefit. Subsidies or tax facilities played a role for companies with close lobbying relationships with the Brazilian government and which have well-established subsidiaries with local employees and no language difficulties or physical distance. A stronger currency and a stronger economy were considered as obstacles rather than benefits for enterprises that buy large amounts of raw materials and commodities from Brazil, since an appreciation of the Brazilian Real increases products prices.

[1] Large enterprises comprise over 500 employees; medium-sized enterprises over 100 employees; and small enterprises less than 100 employees.

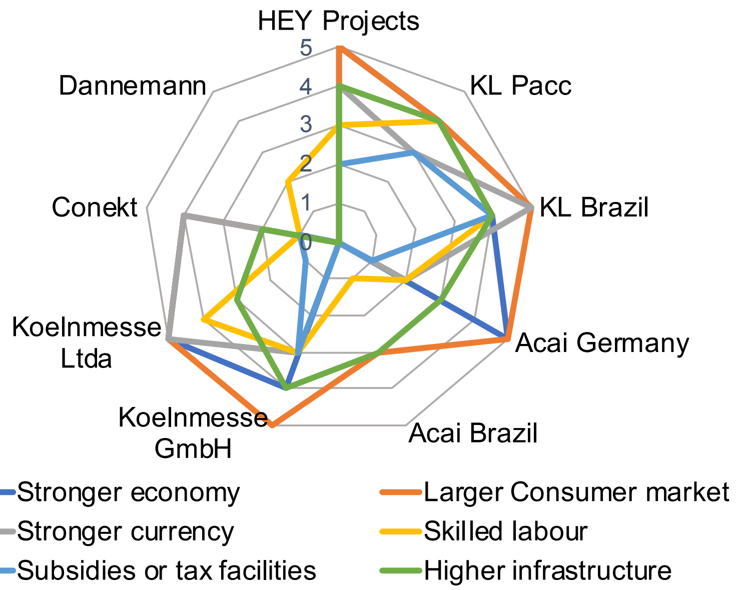

Figure 5: Advantages of Brazil compared to neighbouring countries

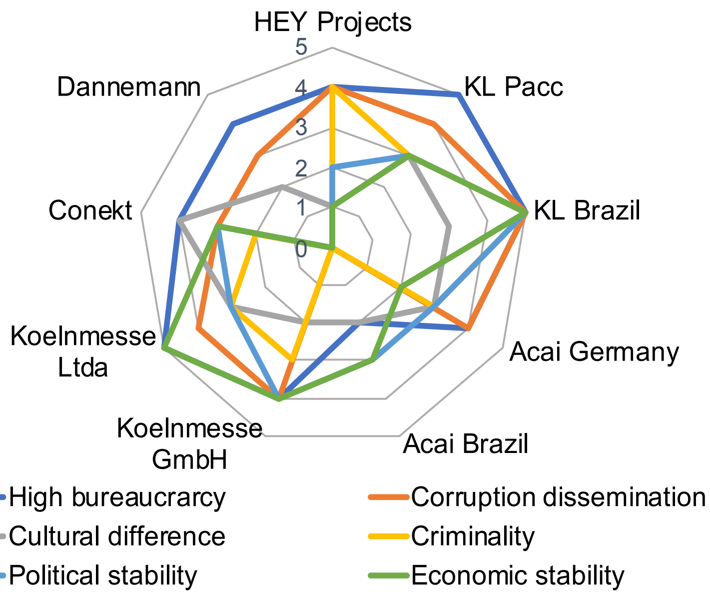

Figure 6: Biggest challenges when doing business with Brazil

Nonetheless, enterprises considering international expansion should also think about the possible risks and pitfalls associated with this decision. Looking at the biggest challenges when doing business with Brazil, there are certain weaknesses associated with the country. Reports by the German-Brazilian Chamber of Commerce and Industry in São Paulo (AHK) and the Chamber of Commerce and Industry for Ruhr in Germany (IHK), both responsible for advising German entrepreneurs, warn of criminality, corruption and high bureaucracy. From the perspective of the researched companies, all these issues are a cause for concern in their business ventures. However, regardless of size and industry, all respondents identified high bureaucracy and widespread corruption as the major problems in Brazil.

On one hand, these findings show that economic and political instability are not such a great concern for international investors any more, a fact that corroborates the recovery of the Brazilian economy and democracy. On the other hand, it evidences serious socio-cultural problems that might demand profound changes in society. Corruption scandals weaken investors' trust in Brazilian institutions. According to data available from the World Bank, Brazil is the 109th (of 190 countries) most difficult country for doing business. In addition, high bureaucracy is an especially great challenge for companies that import raw materials from or export machinery and equipment to Brazil. These companies reported delays in delivery deadlines, lack of information from public authorities and excessive demands among other issues, resulting in production delays and revenue losses. Additionally, cultural differences and criminality impacted companies that have subsidiaries in the country.

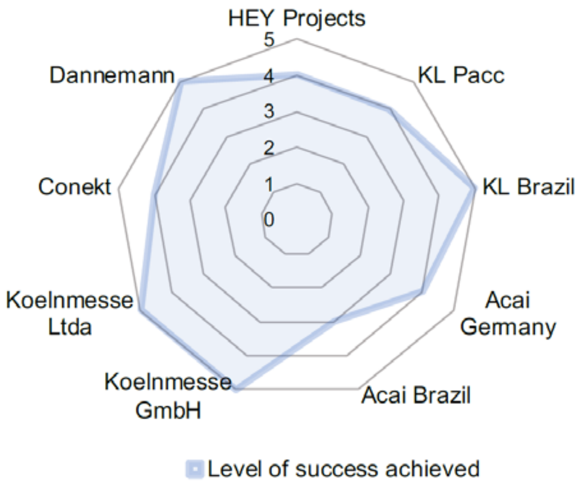

Figure 7: Level of internationalisation success obtained

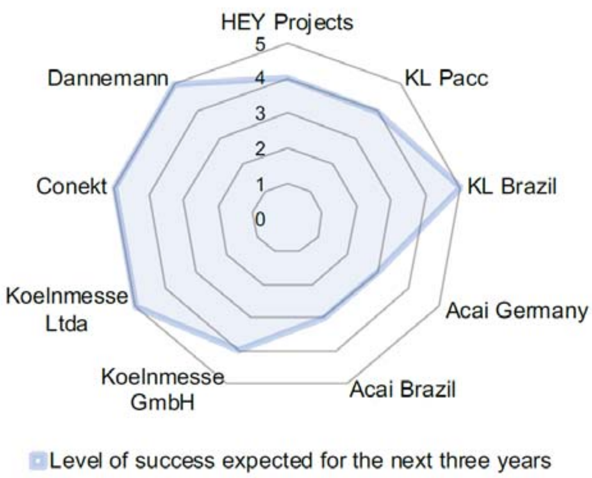

Figure 8: Perspectives for the company in Brazil in the next three years

A similarity can be identified between figure 7 and figure 8 since the perspectives of the companies for the near future are guided by the success level already achieved. Almost all companies maintained a realistic forecast for their future perspectives based on past results. This corroborates economic theories which state that internationalisation is a gradual and progressive process in which companies learn from their own experiences and increase their investment and commitment only after acquiring sufficient market knowledge. The enterprises surveyed in this study have shown that they base their future strategies on previous experience rather than on other external sources of information or forecasts.

The majority of the respondent companies expect the same degree of success over the next three years or an even higher degree in the short-term. Naturally, enterprises that invested heavily in Brazil over the last year expect the near future outcomes to match their high investments. Likewise, solid enterprises that are no longer in the growing phase or smaller companies will adjust their predictions to a rather moderate degree of expectation.

In summary, from the perspective of the researched German companies, it can be seen that their expectations of Brazil concord with the public opinion of specialists and the media. Despite the recent political changes, investors are optimistic about Brazil and so are the majority of the companies surveyed in this study.

3 Conclusion

The analysis and results presented thus far make it possible to understand the motivation of German enterprises in broadening their trading ventures with Brazil. Empirical results reveal Brazil's growing consumer market as the driving force behind international capital inflows and also as the main benefit for multinational companies that choose Brazil as a business partner in preference to other South American nations. As far as the biggest challenges of conducting business in Brazil are concerned when, from the perspective of German MNCs all obstacles described in the set of possible answers represented real threats to a company's investment. Furthermore, the respondents emphasised the negative effects of excessive bureaucracy and corruption on a nation's ability to attract foreign direct investment. Both issues were reported as the main hindrances to trade with Brazil in all industry sectors that cooperated in this study. Problems of criminality seem to affect only companies with subsidiaries in the country, while cultural differences have not played a significant role, especially for the respondent CEOs and managers who travel frequently to Brazil. Better communication and understanding are responsible for shortening physical distances and facilitating the process of internationalisation. Moreover, political and economic instabilities were not seen as the most serious current obstacles faced by the country, corroborating the positive forecasts about Brazil's near future and confirming a certain degree of trust in the new government's ability to rule the country.

For German enterprises seeking to expand their international business to South American countries, Brazil is still the most promising prospect offering high returns on investments. Despite particular advantages in certain industrial sectors, the industries particularities of certain sectors, the most attractive incentive for German companies in Brazil is related to the growing population and expanding middle class that has led to a larger domestic consumer market, continuously exceeding its consumption levels year after year. Undoubtedly, there are still some critical aspects of the country that will need to be addressed, as the research results demonstrated. However, Brazil is still a young country, with a new democratic system and an industrialisation process that is developing slowly. The challenges experienced in Brazil in recent years are the same as the ones overcome by most of the developed nations decades ago. Nevertheless, Brazil appears determined to become a worldwide competitor, especially in terms of FDI attraction.

The recently elected President has started his term of office with the intention of strengthening ties with international governments, industrial sectors, and financial investors, all signs of forward-looking economic prospects for Brazil and foreign entrepreneurs. Based on the current conjuncture and the findings of this research, the Brazilian economic and political scenario can be described as encouraging. Under the circumstances, enterprises seeking to gain larger consumer markets with an abundance of natural resources can profit enormously from the benefits that Brazil has to offer.

Future studies could investigate other factors that might be influential in establishing successful businesses in Brazil. An interesting question, for instance, could be whether market adaptability plays an important role, or if leveraging the own business core competencies would exert higher emphasis in this given context. Some internationalisation strategies implemented by foreign companies might have a higher correlation with the country's characteristics than with their own companies. This would, therefore, create a direct link between market adaptability and successful international expansion. Furthermore, future studies could also confirm whether the political measures promised by the Brazilian President have been implemented and if so, whether the goal of attracting international financial capital was achieved.

Ultimately, future perspectives for Brazil seem to be very optimistic. As demonstrated in this study, an increase in the volume of international trade, foreign investment, and further expansion of national consumption is expected both nationally and internationally. If all predictions are fulfilled, Brazil and its trading partners, especially Germany, can enjoy bright business opportunities.

Nevertheless, a careful analysis is required before any company decides to make large investments in a particular country. The present study has demonstrated the huge importance of market knowledge and experience, which were far more decisive for the respondent companies in achieving business success than financial indicators or forecasts. In view of these findings, this study is highly relevant since it explains Brazilian economic history, presents a wide theoretical framework for internationalisation and also provides real examples of successful German enterprises in Brazil. All these aspects must be considered when expanding to the country; for it is a well-known fact that "Brazil is not for beginners."

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