

Foreign direct investment in Brazil: navigating the labyrinth

Speyside Insights, 2009

Attracting over US\$ 45bn in foreign investment in 2008 and US\$ 41bn in the 12 months to June 2009, Brazil is by far the leading destination for foreign investment in Latin America, with new flagship investments announced weekly. This is not a new trend. Brazil has long been one of the world's most internationalised economies, with investment focusing on heavy industry and manufacturing until the 1990s but spreading to the service sector in recent years.

Whether attracted by new markets or new efficiencies, through privatisation, M&A or greenfield investment; most would agree Brazil offers a huge upside with relatively low risk. While no federal foreign investment framework is in place, strong fiscal and financial incentives exist for greenfield investments, including tax holidays, site preparation and infrastructure development. But there are downsides.

As the World Bank recently noted, there are serious issues in relation to law and order and bureaucracy, with Brazil ranked 125 out of 181 for "ease of doing business". It takes an average of 18 procedures and 152 days to start a business; an average of 411 days to secure a construction permit, versus the OECD average of 157.

Furthermore, in "strategic sectors" – media and communications, transport, aviation and mining – investors face strong restrictions on ownership and highly complex regulatory frameworks, with many opting for joint ventures to minimise restrictions. The new national energy strategy is expected to present huge restrictions on the oil & gas sector, with suppliers required to commit upfront to local R&D facilities and workers, and exploration and production partners for the new sub-salt deposits in the Santos Basin required to enter joint ventures, with discrete terms and conditions.

In other words: Brazil presents huge challenges and opportunities and these require careful navigation. Companies entering the market or scaling-up operations need to intelligently manage regulatory issues and risks, building relationships with the key stakeholders and securing third party support at municipality, state and federal levels.

Such an approach not only manages the downside - it is also crucial to maximising incentives, as students of the automotive sector will attest. Volkswagen is reported to have secured incentives equivalent to \$54,000–\$94,000 per direct job created at its Rio de Janeiro site in 1995; Renault secured an estimated \$133,000 per job from Parana State the same year; and Mercedes reportedly secured incentives of \$340,000 in 1999 from Minas Gerais State.

These huge variations in incentives can partly be attributed to choice of location, with northern less industrialised states willing to pay more to offset higher cost to market. They are also undoubtedly the product of unhealthy competition for investment among the states. But it is unquestionably also the case that the system is malleable and those with a clear understanding of the process and can significantly improve the terms of investment.

More and more voices are challenging the consensus: companies such as Shell, who have publically announced that concerns over political and regulatory risk mean that they will not look to increase their Brazilian operations until the outlook improves. In our opinion, this is pessimistic, but investors must beware.

For investors foreign investors entering or increasing presence on the Brazilian market – especially those operating in strategic sectors – hiring one of the big four, local legal counsel & engineering or real estate support is not sufficient: intelligent corporate communications and public affairs on-the-ground is key.