

# ISSUE BRIEF **11.05.14**

## **Brazilian Multinational Companies: Investing in the Neighborhood**

**Pedro da Motta Veiga, Ph.D.**, Nonresident Fellow, Latin America Initiative

Since the beginning of the 21st century, a growing number of Brazilian companies have been expanding internationally. They have shifted their international strategy from being based exclusively on exports to becoming foreign investors. Neighboring countries in South America are now a priority for these companies. Initially, Argentina benefited from this trend, but the Pacific Alliance nations (Chile, Colombia, and Peru) are also attracting more Brazilian capital.

### **THE (TIMID) EMERGENCE OF BRAZILIAN MULTINATIONALS**

Throughout the 20th century, two factors historically characterized global foreign direct investment (FDI): 1) the high level of investment flows between developed countries, and 2) the fact that developing countries were essentially hosts of FDI. This state of affairs has been changing significantly since the beginning of the 21st century.

On the one hand, following the 2008 financial crisis, the share of developing countries in total FDI inflows increased from 29.4 percent to 53.6 percent between 2007 and 2013. To a large extent, this evolution is explained by the brutal reduction of FDI flows towards developed countries as a result of the crisis. In 2013, these flows represented only 43 percent of the total for 2007. But the importance of developing countries in this context also

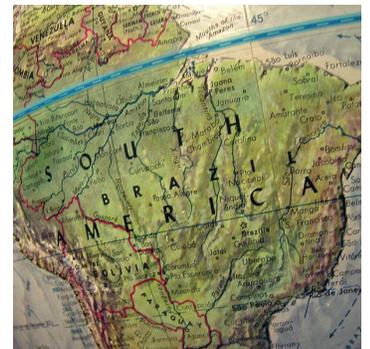
comes from the growth, in absolute value, of the flows directed to those countries: in 2013, they were 32 percent above their pre-crisis level (2007).

On the other hand, developing countries also became the source of FDI outflows. In 2013, close to one-third of global FDI outflows came from developing countries in comparison to just 15 percent in 2005. Both private and public large business groups from developing countries contributed to this expansion.

Brazilian companies are part of the transformation reshaping the global investment environment. Traditionally an important recipient of FDI, in recent years Brazil has received close to US\$60 billion per year. This high level of FDI inflows is evidence that Brazil has contributed to the increasing importance of developing countries as a destination of FDI.

However, in the Brazilian case, what is new is the growth of investment flows abroad (FDI outflows), a consequence of the internationalization of a group of large companies. In contrast with China, the leaders of this process are not state-run companies but private groups that are strongly consolidated in the domestic market and have a long export tradition.

A comparison of outflows from Brazil with those from other emerging countries suggests we should not exaggerate this phenomenon. Even among emerging economies, Brazil is still a small player when it comes to FDI outflows. The country plays



**Brazilian companies are part of the transformation reshaping the global investment environment.**

**For the majority of Brazilian companies that decided to internationalize their production, South America was the preferred geographic option for their first subsidiary.**

a marginal role in comparison to China, India, and even smaller economies, such as Turkey. From 2010 to 2013, the net outflows of FDI from Brazil amounted to only US\$4.2 billion, well below the performance of other emerging countries, such as India (US\$38 billion), South Africa (US\$8.2 billion), Turkey (US\$10.9 billion), and Malaysia (US\$59.3 billion). Over the same period, FDI outflows from China reached the impressive amount of US\$312 billion.

This underperformance could be attributed to a few factors. These include the historic protectionism of Brazil's trade and industrial policies—which remains strong—and public policy disincentives to the internationalization of production, such as the tax system on the profits of Brazilian multinationals.

Despite these factors, close to 100 Brazilian companies representing different sectors started the internationalization process. Some advanced significantly in this direction and today are present in more than a dozen countries. Large Brazilian companies, although still few in number, have become particularly active in South America.

---

### **BRAZILIAN INVESTMENT AT THE BEGINNING OF THE 21ST CENTURY: THE IMPORTANCE OF DOMESTIC MARKETS AS A FACTOR OF ATTRACTION**

After South American countries—Brazil included—overcame the “lost decade” of the 1980s, stabilized their economies, and launched economic integration projects, Brazilian exports to neighboring countries grew considerably, benefiting from the establishment of Mercosur.<sup>1</sup> What is noteworthy is that Brazil exports mostly industrial goods to the region, in contrast to the agricultural and mining commodities that have increasingly dominated the country's worldwide exports. In recent years, this favorable regional scenario began to change. Argentina, the main Brazilian partner in Mercosur and its chief market in the region, is going through a long period of economic crisis. The Andean countries

multiplied their trade agreements with countries outside the region, including the United States, the European Union, and China. Trade preferences that benefited Brazil in the region's markets are gradually eroding, and Brazilian exports of manufactured goods have lost competitiveness in the regional markets.

Even before feeling the impact of these negative effects on exports to South America, Brazilian investment started growing in the region, driven by large companies with a long tradition in exporting goods.

For the majority of Brazilian companies that decided to internationalize their production, South America was the preferred geographic option for their first subsidiary. In 2014, 52 percent of Brazilian multinational companies listed in the ranking established by Fundação Dom Cabral<sup>2</sup> indicated South America as their preferred destination for investing in their first subsidiary abroad; North America came in second, with 33.3 percent.

A study published in 2007 by the National Confederation of Industry of Brazil pointed to Argentina and Chile as the two main markets for investment by Brazilian industrial companies in the first few years of the century.<sup>3</sup> In the case of Argentina, the study interpreted the country's strong economic recovery from the 2001–2002 crisis and the potential of its domestic market, with a high percentage of middle-class consumers, as the main motivations for Brazilian investment. In the case of Chile, the study attributed investments made by Brazilian companies “to the friendly regulatory environment and the discipline and stability of rules the country offers.”

As the destination of Brazilian investment diversified in the region, access to the domestic markets of South American countries and to natural resources became the drivers of those investments. Brazilian investment largely occurs through the acquisition of local companies and trademarks when it comes to consumer and intermediate goods.<sup>4</sup> In the case of natural resources, there is an increasing number of greenfield projects.<sup>5</sup>

## THE POST-CRISIS PERIOD: THE WEIGHT OF POLITICAL FACTORS

The dynamics of Brazilian investment in South America were affected by the credit crunch that resulted from the international financial crisis and by a reduction of economic growth in the region, which reached its nadir in 2009.

However, beginning in 2010, there was a recovery of Brazilian investment in South America. These investments privileged three countries: Argentina, Colombia, and Peru. In the case of Argentina, some companies invested to retain access in a market increasingly protected by government trade measures. For these companies, investment became a means of overcoming tariff and non-tariff barriers increasingly imposed by the Argentinian government. Other companies sought access to natural resources in the meat production and mining sectors. But Peru clearly came in first place during that period: the country received two of the three most significant investments by Brazilian companies in the region during the post-crisis period. The first was from the company Vale do Rio Doce in the amount of US\$566 million; the second was from Votorantim in the amount of US\$420 million. Both investments related to the exploitation of natural resources and energy.

Between 2010 and 2014, the impact of political factors and domestic policies adopted by regional countries became more important to investment decision-making by Brazilian multinational companies. However, these factors were not entirely absent in preceding years. For instance, Petrobrás Bolivia was expropriated by the government of that country at the beginning of President Evo Morales' administration. In Ecuador, President Rafael Correa banned from the country a Brazilian engineering and construction company with a long history in the region, accusing the company of negligence in the construction of a hydroelectric dam.

Despite these precedents and the expropriation of foreign companies in Argentina and Venezuela, Brazilian companies have maintained investment

in the two countries. This has been based on the assumption that political alignment between the Partido dos Trabalhadores (the Brazilian governing party) and its leaders on the one hand and the governments of Argentina and Venezuela on the other would serve as a guarantee of the companies' assets and investments.

In recent years, however, the worsening economic situation in Argentina and Venezuela has led not only to the cancellation of investment projects by Brazilian companies but also to the decision by some companies already established there to pull out. Thus, a huge investment project for potassium exploitation in Argentina, led by Vale, was cancelled due to the company's refusal to fulfill growing demands by the central and provincial governments. In addition, a project to establish a petrochemical complex in Venezuela, planned by Braskem (Brazil's largest company operating in the sector), was dropped or at least postponed. One example of an important "divestment" by a company with a longstanding history in the Argentine market is Petrobras's decision to sell its assets there, due to constant regulatory intervention and price controls by the government. In addition, a large Brazilian brewery ceased operations in Venezuela. There are other cases of Brazilian companies "pulling out" of Argentina and Venezuela that involve smaller projects.<sup>6</sup>

In contrast, regulatory stability and pro-FDI policies seem to increasingly influence the decisions by Brazilian companies to invest in countries such as Peru, Chile, Colombia, and—outside South America, but still in Latin America—Mexico. These factors are particularly relevant for companies investing in infrastructure and in sectors related to the extraction of natural resources. The potential for conflicts associated with foreign investments in mining and other natural resource-intensive sectors involves not only the governments of receiving countries, but also civil society groups and communities directly affected by the investments. Investment in natural resource sectors is highly sensitive to "resource nationalism," a political tradition in the region.

**As the destination of Brazilian investment diversified in the region, access to the domestic markets of South American countries and to natural resources became the drivers of those investments.**

**Regulatory stability and pro-FDI policies seem to increasingly influence the decisions by Brazilian companies to invest in countries such as Peru, Chile, Colombia, and Mexico.**

It is therefore not surprising that new investments by Brazilian companies involving sensitive “political and regulatory risk” sectors are directed to Peru, where conditions are favorable for FDI. Colombia is also receiving increasing attention from Brazilian industries. Outside South America, Mexico has established itself as an important market for industrial investment by Brazilian companies.

In conclusion, foreign investment by Brazilian companies has increased significantly since 2000. Several companies took their first steps through the internationalization of production in South America. Others, already present in the region since the 1990s, expanded and diversified their investment. In the early years of this century, Argentina consolidated its position as the main destination for Brazilian investment in the region, which is not surprising in view of the size of its domestic market and the strong recovery of its economy after the 2001–2002 crisis.

However, in the past decade, with the geographic diversification of Brazilian investment in the region and the progressive deterioration of Argentina’s economic situation, the latter’s importance as a destination for investment by Brazilian companies has been decreasing. Between 2010 and 2013 alone, Argentina’s share in Brazil’s portfolio of foreign investment fell by almost half, according to statistical data from the Brazilian Central Bank. In contrast, the role of Peru, Chile, Colombia, and Mexico has increased. During 2008–2009 and 2012–2013, flows of direct investment from Brazil to the four Pacific Alliance nations nearly doubled, from 6 percent to 11.2 percent.<sup>7</sup>

As the data demonstrate, the differences between the prevailing political and regulatory environments in Argentina and Venezuela and the countries of the Pacific Alliance increasingly define the direction of Brazilian investment in the region. The data also show that the political alignment between the governments of Brazil, Argentina, and Venezuela no longer seems to offer security for Brazilian investors and their assets in the region.

## ENDNOTES

1. Mercosur’s original members are Argentina, Brazil, Paraguay, and Uruguay. Venezuela has recently joined the group and is still going through the process of adapting its trade regulations to the group’s rules.

2. Fundação Dom Cabral is a Brazilian business school that produces an annual publication since 2007 of the ranking of Brazilian multinationals.

3. Roberto Iglesias, *Os interesses empresariais brasileiros na América do Sul: investimentos diretos no exterior* (Brasília, Brazil: Confederação Nacional da Indústria, 2007).

4. Between 2005 and 2007, Brazilian participation in international mergers and acquisitions in Argentina reached 25–35 percent of the total. This confirms the importance of Brazilian investment in Argentina during that period as well as the preference of Brazilian companies for purchasing assets and brands in this market instead of investing in greenfield projects.

5. A greenfield investment occurs when the foreign investor creates a brand new project or production unit. It differs from the acquisition of existing facilities and companies.

6. In this process, there are decisions to divest that are not solely or mainly due to the political climate in the countries where the investment is located. In the case of Brazilian investment in the region, companies in the Group X (owned by Eike Batista) sold assets in Chile and Colombia because of serious financial difficulties. Petrobras has already sold 100 percent of the shares of its wholly owned subsidiary Petrobras Energia Peru and 100 percent of the shares of Petrobras Colombia, as well as a stake in Uruguay, due to its strategic decision to concentrate investment in pre-salt in Brazil.

7. These percentages seem quite small. The explanation is based on the fact that most of Brazilian FDI is channeled through companies or entities based in tax havens or in European countries with favorable tax systems for investors. The Netherlands and Austria are the main destinations

of Brazil's outflows. The statistical data from the Brazilian Central Bank take into account the "immediate" destination of the investment outflows, not the "ultimate" destination. The result of this bias is that the data underestimate the share of the ultimate destinations of the outflows while overestimating the share of "intermediary" destinations, such as the Netherlands and Austria.

---

## AUTHOR

**Pedro da Motta Veiga, Ph.D.**, is a nonresident fellow at the Baker Institute [Latin America Initiative](#). He is also the director of CINDES (Centro de Estudos de Integração e Desenvolvimento), a think tank based in Rio de Janeiro, and a partner at Ecostrat Consultores, a Brazilian consulting firm. [Motta Veiga](#) earned a bachelor's degree in social and political sciences from the Pontifical Catholic University of Rio de Janeiro and a Ph.D. from the École des Hautes Études en Sciences Sociales in Paris.

Rice University's Baker Institute for Public Policy

**LATIN AMERICA INITIATIVE**

See more issue briefs at:

[www.bakerinstitute.org/issue-briefs](http://www.bakerinstitute.org/issue-briefs)

This publication was written by a researcher (or researchers) who participated in a Baker Institute project. Wherever feasible, this research is reviewed by outside experts before it is released. However, the views expressed herein are those of the individual author(s), and do not necessarily represent the views of Rice University's Baker Institute for Public Policy.

© 2014 Rice University's Baker Institute for Public Policy

This material may be quoted or reproduced without prior permission, provided appropriate credit is given to the author and Rice University's Baker Institute for Public Policy.

Cite as:

**Veiga, Pedro da Motta. 2014. *Brazilian Multinational Companies: Investing in the Neighborhood*. Issue Brief no. 11.05.14. Rice University's Baker Institute for Public Policy, Houston, Texas.**