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Latin America 2011: Expert Q&A

Latin Business Chronicle asks leading Latin American experts about the region's business outlook in 2011.

BY LBC STAFF

What will be the main challenges facing business in Latin America in 2011? Latin Business Chronicle asked four prominent Latin America experts. Our panel includes:

Rogelio Caceres, Latin America vice president, Frontier Strategy Group, USA

Jerry Haar, associate dean and professor in the College of Business Administration at Florida International University, USA

Peter Rösler, deputy general manager of Lateinamerika Verein, Germany

R. Viswanathan, India's ambassador to Argentina, Paraguay and Uruguay



Rogelio Caceres, Latin America vice president, Frontier Strategy Group



Jerry Haar, associate dean and professor in the College of Business Administration at Florida International University

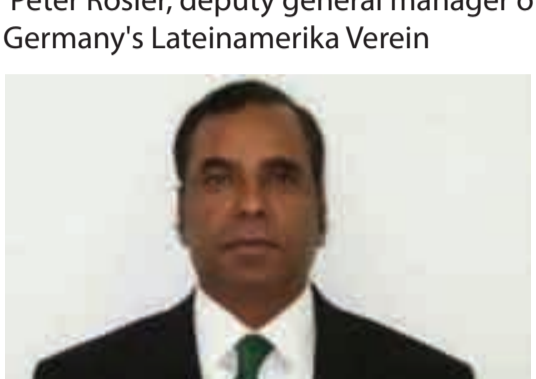
Latin Business Chronicle: How do you view the outlook for business in Latin America in 2011?

Caceres: Now is the moment to invest in Latin America. The last 15 years have seen impressive reform and policy continuity that have solidified the region's fundamentals. As the dust from the financial crisis settles, we foresee a long period of sustainable growth. Our view is informed by our focus on four drivers: decreased exposure to commodities shocks, growth of domestic consumption, policy continuity, and low inflation (by historical standards). Growing recognition of the sustainability of these drivers is going to result in an improved global recognition of Latin America as a newly redefined, highly attractive market. The downside of this recognition is that executives should therefore expect greater competition—from multinationals, as well as from multilatinas, Chinese, and other emerging market-based multinationals. To capture the opportunity, leading companies are exploring and investing in creative distribution strategies and the extension of non-traditional credit to stay ahead of the competition and reach new consumer segments first. One particular trend to watch will be how the region responds to global economic shifts such as the inexorable rise in wages in China. FSG believes countries with sophisticated manufacturing bases stand to gain from this trend. The Chinese wage differential over Mexico is quickly eroding, creating many major manufacturers to consider overhauling their sourcing and production model, including possibly relocating to Mexico.



Peter Rösler, deputy general manager of Germany's Lateinamerika Verein

Haar: While the region's 6 percent GDP for 2010 will not be matched in 2011 (estimated to be around 4.2 percent according to UN projections), this growth rate is respectable, especially in light of the 1.9 percent contraction in 2009. Driving growth will be global economic recovery (although uneven, of course), countercyclical measures, expansive monetary policy, and the continuing insatiable demand of China and India for commodities from the region. Increases in private consumption—especially for consumer goods—and an upswing in investment, both local and foreign, create a bright picture for the coming year.



R. Viswanathan, India's ambassador to Argentina, Paraguay and Uruguay

Rösler: The overall outlook [for German companies] is very good as the region as a whole will most likely grow again at a rate of approx. 4 – 5 percent. That will definitely be more than our own growth rate or that of Europe. 2009 proved to be just a short interruption of Latin America's boom phase. That is an impressive performance that entices many German companies to expand their activities in the region. But in reality, we can only talk about the outlook in specific Latin American countries. German entrepreneurs' favorites are Brazil, Mexico, Colombia, Peru, Argentina and Chile. Because of obvious reasons (size, wealth of natural and agricultural resources, BRIC status, soccer world cup, Olympic Games etc.), Brazil remains number one on the agenda of German companies. Mexico is interesting because of its internal market and its function as a gateway to the U.S. market. Colombia and Peru have become targets for German entrepreneurial activities because of growing stability, liberal economies and interesting growth rates. Argentina offers relatively good conditions for industrial and mining companies. And finally, Chile has the most liberalized and open economy of Latin America; its only drawback is limited market size. In all of these countries and in some other, smaller ones the activities of German companies will increase. Counter-examples are countries aiming at reintroducing nineteenth century socialism into the twenty-first century. German companies are pulling out of these countries or limiting their activities there purely to trade. A special case is Cuba: The German private sector is closely monitoring recent developments in this country and preparing itself for action in the case of a further opening-up of the economy.

Viswanathan: The outlook for Indian companies in Latin America in 2011 is brighter than 2010. India's trade with Latin America which had gone down in 2009 has recovered growth in 2010. It is expected that the trade will grow by about 20 percent in 2011. The way the Latin American economies have withstood the global financial and economic crisis and have resumed their growth have given renewed confidence to Indian companies. They are even more optimistic seeing that the Latin American growth is to a large extent driven by domestic demand which means the growth will be more sustainable. Indian companies will increase their investment in the region especially in areas such as IT, BPOs, manufacturing, mining, agribusiness and energy sectors.

BRAZIL OUTLOOK

Latin Business Chronicle: How do you view the outlook for business in Brazil in 2011?

Caceres: From a macroeconomic perspective, Brazil will enjoy strong growth in 2011 and may see record FDI for several reasons: China is still spending heavily on Brazil's natural resources and shifting from a purely trading relationship to investing in-country, the World Cup and Olympics are drawing nearer, and more oil blocs are being auctioned off. Despite the impressive GDP growth, however, multinational corporations are unlikely to see any reduction in Custo Brasil—the notorious red tape, burdensome tax regime, confusing regulatory environment, and crumbling physical infrastructure that result in high costs for doing business in Brazil.

Haar: With GDP projected at 8 percent, massive oil discoveries, large inflows of foreign investment, a rapidly growing middle class, and continuing high demand for commodities, Brazil is poised to have a stellar year. But these fortuitous developments do not tell the whole story. The part of the glass that is half empty includes an increase in inflation, especially of staples, that may exceed 10 percent; continuing high interest rates—among the highest in the world; a strengthening real which is seriously hurting local manufacturers and exporters; a prospective raise in the minimum wage; and either spending contraction (which would have negative social effects) or spending expansion (which would not be surprising given Dilma's ideological predilections), which would increase the public debt. Public safety will remain a huge issue in 2011 and beyond; income inequality and the need for more job creation are other challenges facing Brazil. It is all well and good that high commodity prices are benefitting Brazil; but the last time I checked, those who live in favelas and the gangs that control these shantytowns do not harvest soybeans for a living.

Rösler: Brazil is one of those few countries in the world bound to grow whatever happens. According to forecasts, in 2035 this country might become the fourth largest economy of the world, after China, the United States and India. The German private sector is aware of this and recently took steps to expand its cooperation with Brazil. Among other measures, under the aegis of the Confederation of German Industries (BDI) several leading German industrialists founded the "Brazil Board." One of its functions will be to give advice to small and medium German companies on how to successfully enter the Brazilian market. Another instrument is the initiative "WinWin 2014/2016" in cooperation with the Brazilian Confederation of Industries (CNI). This initiative aims at supporting the activities of German companies who want to supply goods or services for the soccer world cup or the Olympic Games. There are also other initiatives, for example regarding the booming Brazilian marine sector. It is no coincidence that in the first half of 2010 German exports to Brazil grew by 61 percent to 5 billion euros [US\$6.1 billion at end-June 2010 rate] and that German FDI in the last two years increased by more than 7 billion euros. The before-mentioned initiatives should contribute to further improve the outlook for German companies in Brazil.

LATIN AMERICA CHALLENGES

Latin Business Chronicle: What will be the main challenges facing business in Latin America in 2011?

Caceres: The main challenge for executives in Latin America is internal to their own companies. How can a Latin American-focused executive convince the corporate center that Latin America deserves prioritization in the face of meteoric growth in Asia Pacific, and China specifically? At FSG we hear constantly from our Latin America executives that they continue to miss growth opportunities due to inadequate resource allocation, because corporate still favors APAC and China. Corporate still views Latin America the way it was 15 years ago: a fragmented collection of markets, wrought with volatility and run by governments with populist tendencies and unfriendly business policies. The challenge for executives in 2011 will be to balance the conversation and demonstrate the Latin American opportunity as it really is today.

Haar: The key business and economic challenges in the region in 2011 will be to convince governments to increase and hasten measures that the private sector needs to maintain and expand business. That includes a pursuit of prudent fiscal and monetary policies, wider and deeper implementation of the (unfinished) "Washington Consensus," keeping a lid on inflation, and ensuring that pro-market tax, regulatory, and investor protection laws and policies are actually implemented. Expanded credit and any and all measures that will facilitate small business creation and expansion should be given highest priority.

Rösler: German industrial companies occupy a strong position in Latin America, in third place only after indigenous and U.S. companies. But life in Latin America is getting tougher every day. Competitors from China, South Korea or India are pushing into the markets of the region. And they offer unbeatably cheap financing. This is certainly the main challenge for German companies in Latin America. Another challenge is to overcome the limitation of German entrepreneurial activities in Latin America to the industrial sector. Up to now, about 90 percent of all German direct investment in the region is investment in industry. But the largest investments in Latin America in the oncoming years are planned in infrastructure and mining.

Viswanathan: The Indian companies are now looking more at the opportunities than the challenges, as part of their new mindset. In the past they looked at the challenges and risks first and hesitated to explore the opportunities. Now they see the opportunities first and have the confidence that challenges could be overcome. They are also entering the market with long term vision and strategy. Having worked and succeeded in equally challenging and competitive environment in India, the Indian companies are not unduly deterred by the structural challenges of Latin America. Indian companies find that Latin America is at this moment less challenging than the markets of many developed countries who are still going through the post-crisis pains and fears of new crisis in some countries. The success of the early movers from India has encouraged others, as seen from the example of the success of TCS which has inspired other IT and BPO companies.

BRAZIL CHALLENGES

Latin Business Chronicle: What will be the main challenges facing business in Brazil in 2011?

Caceres: Executives managing operations in Brazil face a challenge in managing and communicating expectations to corporate headquarters, which expect tremendous growth on the back of high GDP growth numbers without understanding the massive obstacles to profitability and a playing field increasingly tilted against foreign firms in certain industries. The new Dilma government is unlikely to remove these obstacles, and may indeed increase them. One solution will be to partner with domestic firms to gain access to government loans, projects, and contracts. Companies without access to these partnerships face entrenched competition from Brazilian firms. Additionally, savvy executives are aggressively communicating their difficulties to corporate to set realistic goals. More tactically, talent recruitment and retention will be more difficult across Brazil, and few companies are prepared to face the brewing talent war in 2011. The small pool of local professionals from which multinationals generally recruit is very aware of its bargaining power and will continue to extract ever greater salaries and concessions from employers. In response, leading companies will aggressively redesign HR strategies, including revising salaries at faster intervals, investing in training and non-salary compensation, and exploring new talent markets away from the overheating São Paulo area.

Haar: The key business and economic challenges confronting Brazil are the same ones that have confronted the country since time immemorial: institutional reform, including taxes, pensions, social security and business regulation; education and employment generation; upgrading the skill levels of workers; access to credit; and improving income distribution. Another challenge will be to refrain from mortgaging the future with public projects tied to the Olympics and World Cup, irrespective of the anticipated windfall that will come from the Tupi oil exploration finds.

Rösler: We expect the new president Dilma Rousseff to basically continue the economic policy of her predecessor. So, contrary to the opinion of some experts, we do not see a challenge here. We are also not afraid of an overheating of Brazil's economy. However, the strong Real is a problem for all Brazilian companies that are export-oriented as their goods get more and more expensive on the world market. At the same time, imports get cheaper and hurt domestic producers. Also many German [subsidiary] companies suffer by this development. In 2011 there exists the danger that the Real might reevaluate even more. We cannot see a solution to this problem in the near future as the value of the Real reflects the revaluation of an economy and the significance of a country. Should the Central Bank increase the Selic interest rate again in order to fight inflation, more money would come into the country and further push up the value of the Real. It will also be difficult for German companies to compensate the loss of competitiveness of locally produced goods by importing more from Germany. High Brazilian import duties and other import barriers, bureaucratic hurdles as well as high taxes have up to now not favored imports. But recently BNDES president Luciano Coutinho announced that the Brazilian government intends to take further measures to slow down the growth of imports.