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Artigo

BRAZIL: RAPID DEVELOPMENT, INTERNATIONALIZATION, AND MIDDLE CLASS FORMATION

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Abstract: Some three decades ago, the business world was focused strictly on such post-industrial economies as the U.S., Germany, UK, and Japan. It was thought that there was no place beyond the western markets. Fast forward to today, the marketplace has been transformed radically. The forces of globalization brought about a highly competitive and crowded landscape, featuring numerous new players from the so-called Emerging Markets (better referred to as 'growth markets' since the most common element of these rapidly transforming economies is sustained growth). The center of economic gravity has now shifted to east Asia. Yesterday's poor and developing countries have profited from the globalized information and communication technologies. These countries have been experiencing rapid pace of economic development, market liberalization, industrialization, modernization, and urbanization.

Key words: Brazil; development; internalization of markets.

Introduction

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Some three decades ago, the business world was focused strictly on such post-industrial economies as the U.S., Germany, UK, and Japan. It was thought that there was no place beyond the western markets. Fast forward to today, the marketplace has been transformed radically. The forces of globalization brought about a highly competitive and crowded landscape, featuring numerous new players from the so-called Emerging Markets (better referred to as 'growth markets' since the most common element of these rapidly transforming economies is sustained growth). The center of economic gravity has now shifted to east Asia. Yesterday's poor and developing countries have profited from the globalized information and communication technologies. These countries have been experiencing rapid pace of economic development, market liberalization, industrialization, modernization, and urbanization.

One reason for the center of economic gravity to be shifting to growth markets of Asia is market saturation in developed economies. First, the market boom from the 1960s until 1980s in the advanced economies has now matured. As consumers in industrialized countries had the opportunity to fulfill their wishes over the years, with little population expansion, growth rate has been negligible. Without a doubt, the slowdown of consumer spending in the home market has forced companies to seek new rentable markets. Thus, the solution to achieve growth lies with rapidly developing emerging markets.

Second, for years, consumers in today's emerging markets lived in closed, protected economies. These markets were shaped by politics of restrictions on imports, and insulated from foreign competition. Such policies hindered free competition and few monopolistic companies tended to dominate economic sectors. Lack of a liberalized market resulted in products with inferior quality and limited variety. Deprivation of global standards in products over the years led to immediate acceptance of foreign brands; their arrival was celebrated by local consumers.

Emerging countries have relatively large populations and higher rates of population growth. The growing middle class points to enhancement of life standards and an increase in purchasing power by consumers. For instance, some 46 million are expected to join the ranks of middle class households, which are defined on households with an annual income above $10.000 in China, and 6 million more in Brazil from 2010 by 2015 according to Boston Consulting Group (Jin et al. 2010).

Emerging countries are attractive for trade, investment and sourcing because of high customer acquisition and purchase intention. According to UNCTAD, there was a FDI inflow in amount of $336 billion to East and Southeast Asia in 2011. That was 14 percent more than the figure in 2010, and accounted for 22 percent of the world's total FDI (WSJ 2012a).

In addition to increasing customer demand, valuable resources such as young, dynamic, talented human resources, and rich natural resources, make emerging markets attractive to foreigner investors (Sheth 2011). For example, according to United Nation's Economic Commission for Latin America, 57 percent of foreign direct investment in South America (excluded Brazil) was in the natural resources sector in 2011 (ECLAC 2011).

Although increasing demand and valuable resources in emerging markets sharpen the appetite of foreigner investors, investors have to seriously consider the business environment in these countries. The environmental factors such as political system as well as the way of the working and dealing in business may substantially differ from those of developed countries. Several country specific factors such as political instability, corruption, ease of doing business, openness to the foreign investors, infrastructure, protection of intellectual property rights should be carefully analyzed.

For example, although the GDP growth rate[3] is relatively high in Argentina, foreign direct investment inflow has decreased about 32 percent from 2000 to 2010 according to World Bank. The governmental policies to protect the national economy are closing the trade doors to foreigner investors. For instance, an oil company has been nationalized in April 2012 (Economist 2012; Financial Times 2012a). Moreover, there are many import restrictions from Barbie dolls to cheese (Financial Times 2012b). According to economists, Argentina is one of the most protected economies in the world. Clearly, investors ought to be cognizant of the risks of doing business in emerging markets and develop appropriate risk mitigation strategies.

Additionally, by now, emerging markets now feature numerous homegrown companies that are trotting global markets. These new global players – known as the new multinationals – are now looking for acquisition and investment opportunities in advanced economies (Ramamurti 2012). In 2012, the number of companies from emerging markets in *Fortune's Global 500* reached 125, an increase of 11 companies compared to the previous year. Moreover, some of them have high rankings. For example, Brazilian oil company Petrobras ranks 23rd on the list thanks to its revenues of about $146 billion (Fortune 2012).

The main triggers of global competition are the internationalization process and asset management of these companies. First, companies from emerging markets are rapidly internationalizing mainly through acquisitions (Tsai & Eisingerich 2010). For example, Burger King was bought by a Brazilian company, 3G Capital, for $3.3 billion in 2010 (Bloomberg 2010). Second, reallocations of assets in these companies strongly focus on aggressive growth. They use capital to catch up new business opportunities and are operating in diversified sectors (Cavusgil et al. 2013).

For example, the Indian Tata Group operates in seven sectors from consumer products to engineering. Its over 90 companies are operating in more than 80 countries. Since these companies use capital for additional investment, they pay fewer dividends than the developed-market companies. According to McKinsey, earnings flow to shareholders is 39 percent in emerging market companies compared to 80 percent returning rate in developed market companies (Atsmon et al. 2012). Their internationalization strategy is typically through acquisition, compatible with the asset management of emerging markets companies. They are acquiring foreign companies to gain access to such strategic assets as know-how and technology. These strategic assets enable them to operate in new sectors (Rabbiosi et al. 2012; Luo & Tung 2007). For example, South Korea's Samsung Electronics recently bought the mobile business of a British company, CSR. This acquisition offers Samsung valuable technological assets such as patents in Wi-Fi and Bluetooth connectivity components as well as chips of the satellite positioning systems (Financial Times 2012c).

Considering the importance of doing business in emerging markets, marketing practitioners should have deep insights on the market environment and country-specific development, and build risk mitigation strategies to gain profits. Thus, the characteristics of each emerging market should be well known. Based on this assumption, the purpose of the paper is to highlight developments in Brazil, which is regarded as one of the prime markets for foreign investors.

The remainder of this manuscript is organized as follows: First, economic development in Brazil is discussed to expose its prospects. We share the findings of research we conducted about the Brazilian middle class. Second, challenges in Brazil will be examined to highlight

[3] Growth in GDP from 2010 to 2011 has been realized by 8%. Thus, Argentina has a second place after China among other emerging markets. (Source: CIA 2012)

the risks of doing business. Finally, implications are offered based on our findings and observations.

Economic Growth in Brazil

Foreign direct investment inflow into Brazil was $65.5 billion in 2011, an increase of about 35 percent in comparison to previous year. It has become the largest destination for FDI flows among other Latin American countries and the second-largest destination after China among emerging markets (UNCTAD 2012).

Key factors attracting investors to Brazil include increasing global demand for commodities such as iron ore, soybeans, etc., and the rising class of middle-class consumers elsewhere. First, Brazil has long been known as a destination of rich national resources. It has the biggest renewable fresh water supplies (14 percent of world's reserves) and the largest tropical forests. Its land is rich with mineral and hydrocarbon such as iron ore, manganese, bauxite, nickel, uranium, gemstones, oil, and aluminum (Economist 2009a; U.S. Department of State 2011). Furthermore, Brazil is the world's biggest producer of coffee and orange juice and has a significant share (about 25 percent) of soybean production worldwide (PwC 2010a). Some 39 percent of total foreign direct investment inflow in Brazil was realized at natural resources sector in 2010. Some 22 percent of this was in oil and gas and 14 percent in metal mining extraction (UN 2010).

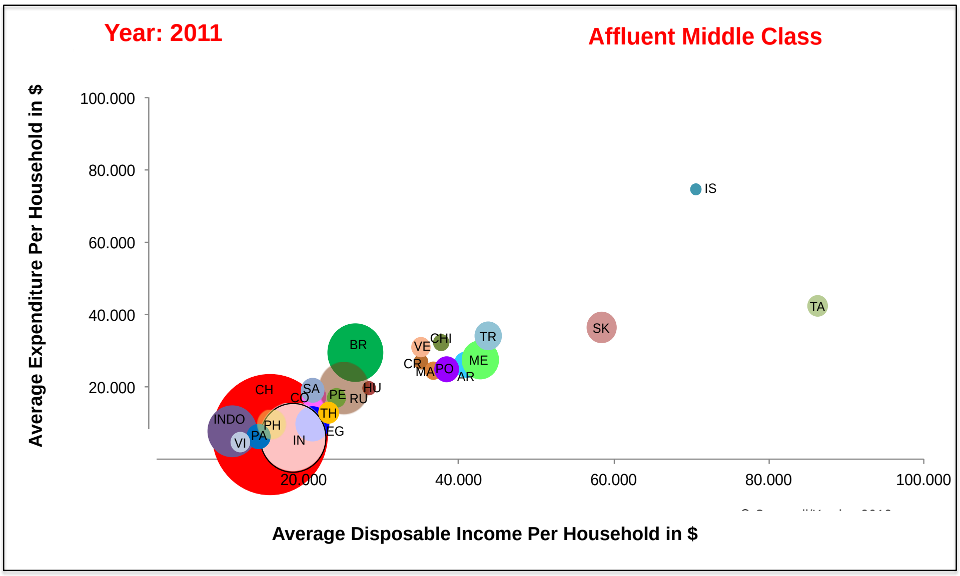
Second, Brazilian GDP per capita was at $12,594 in 2011 (World Bank 2012) and growing in recent years (Economist 2011a). Brazil has become the world's seventh biggest economy in 2011 and overtook the United Kingdom (CIA 2012). According to the *Economist*, even individual Brazilian cities are comparable to some countries in terms of the GDP per person. For example, GDP per person in Sao Paulo ($13,331) was almost equal that of Poland ($13,887) in 2008 (Economist 2011b).

The economic growth is a result of the economy policies by Brazilian governments. Almost 30 million people have joined the middle class in the past decade (EY 2010) thanks to economic development, lower inflation and unemployment rates, and improvements in income distribution. The size of the middle class in a country is important to business, because serving this social class is profitable. There is room for more companies thanks to the potential of serving the rising middle class households. Those companies that are targeting luxury segments and offering luxury goods will also gain from the affluent class.

Considering the importance of middle class to business, a middle class scorecard developed by Professor Dr. Tamer Cavusgil and Dr. Ilke Kardes of Georgia State University (GSU) CIBER presents a relative indicator of middle class formation in emerging markets. According to this research, Brazil placed 2nd behind China in terms of the market size as of 2011. The market size has been calculated considering average annual disposable household income, average annual expenditure per household, and the number of urban household.

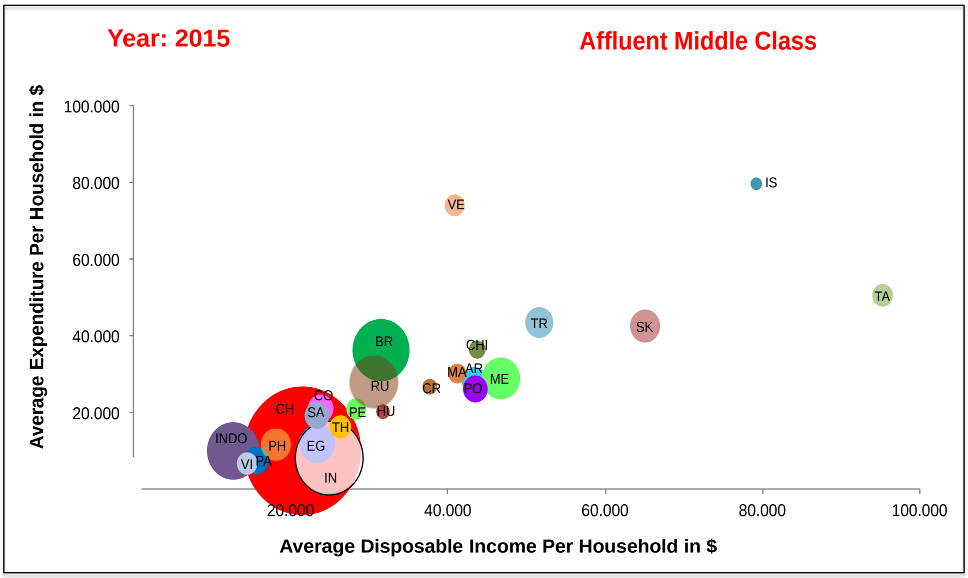
Figures 1 and 2 present *GSU-CIBER Middle Class Scorecard* for the years 2011 and 2015. The vertical axis refers to average household expenditures in U.S. dollars. The horizontal axis refers to average disposable income per household in U.S. dollars. The size of the circles represents the number of urban households in each country. The green circle with the sign "BR" represents Brazil.

Figure 1: Affluent Middle Class in 2011[4]



Calculated from Euromonitor International data, 2012

Figure 2: Affluent Middle Class in 2015

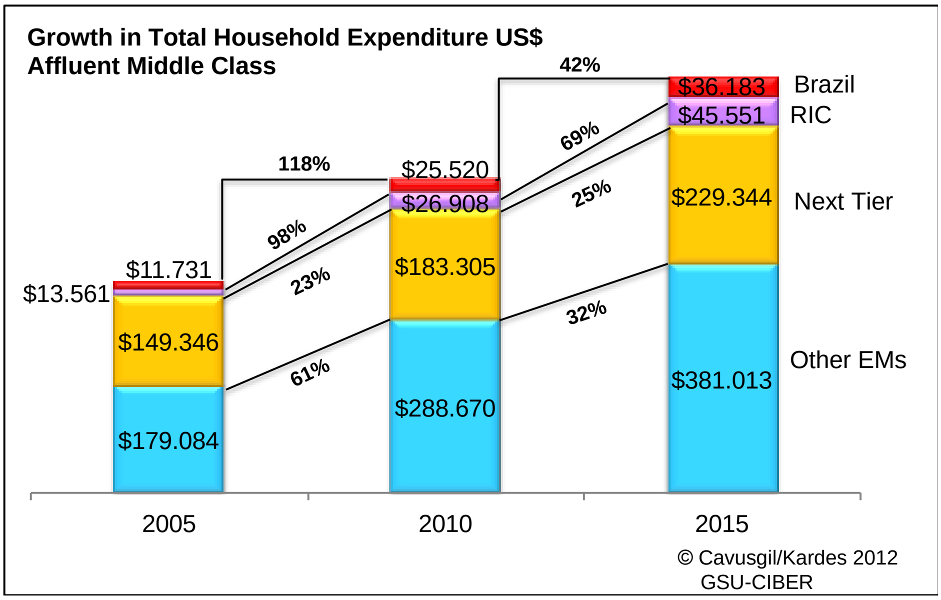


Calculated from Euromonitor International data, 2012

The growth in household expenditures by Brazilian affluent middle class is expected to be 42 percent during the period 2010-15. The anticipated share of household expenditure by Brazilian affluent middle class ($36,183) in BRICs this should be about 44 percent by 2015 (Figure 3).

[4] AR=Argentina, **BR=Brazil**, CH=China, CHI=Chile, CO=Colombia, CR=Czech Republic, EG=Egypt, HU=Hungary, IN=India, INDO=Indonesia, IS=Israel, MA=Malaysia, ME=Mexico, PA=Pakistan, PE=Peru, PH=Philippines, PO=Poland, RU=Russia, SA=South Africa, SK=South Korea, TA=Taiwan, TH=Thailand, TR=Turkey, VE=Venezuela, VI=Vietnam

Figure 3: Growth in Total Household Expenditure (US$) by the Affluent Middle Class[5]



Calculated from Euromonitor International data, 2012

The expected growth in expenditure will surpass the anticipated increase in household disposable income by about 20 percent during the period 2010-15. Moreover, Figure 4 indicates that household expenditures exceeded the household income since 2010, presumably due to the availability of consumer credit, the informal economy, and other factors.

The informal economy refers to the economic activity that is captured by official statistics. In other words, some transactions escape taxation, a well-known fact in emerging and developing economies (Andrews et al. 2011). Thus, household expenditures often exceed official income statistics. The informal economy in Brazil is still high and is estimated to 17 percent of GDP. Some estimates put this number at 40 percent of GDP (WSJ 2012b).

Second, consumer credit increased by 28 percent a year in nominal terms from 2007 to 2009 (PwC 2011a). Moreover, the usage of store cards, co-branded credit cards of Brazilian retailers partnering with banks, increased by 146 percent between 2005 and 2010. The value of transactions by these cards grew about 160 percent during the same period. Brazil takes second place after the U.S. regarding the volume of store cards worldwide. (Euromonitor 2011).

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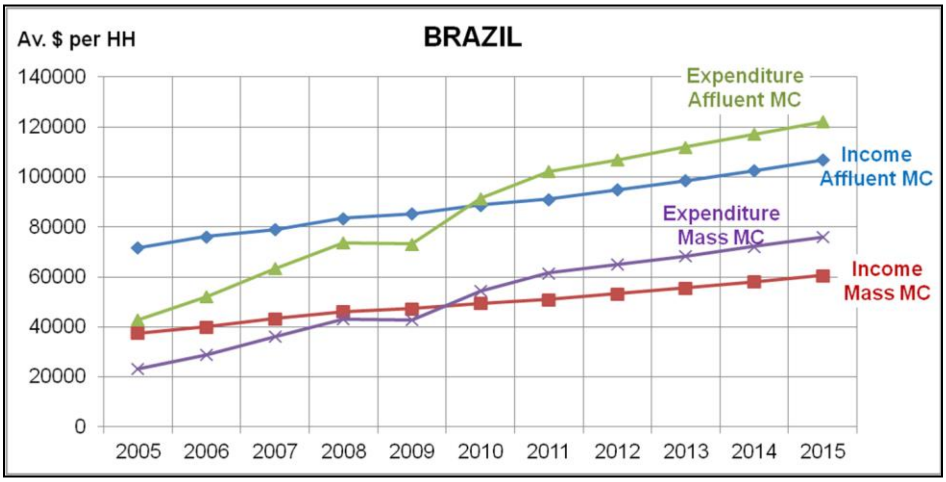
[5]**RIC**=Russia, India, China; **Next Tier**=Argentina, Indonesia, Mexico, Poland, S. Korea, Taiwan, Turkey; **Other EMs**= Venezuela, Egypt, Thailand, Colombia, Pakistan, Israel, S. Africa, Philippines, Chile, Czech Rep., Malaysia, Hungary, Peru, Vietnam.

Figure 4: Comparison of Household Expenditure and Income per Household by Brazilian Middle Class

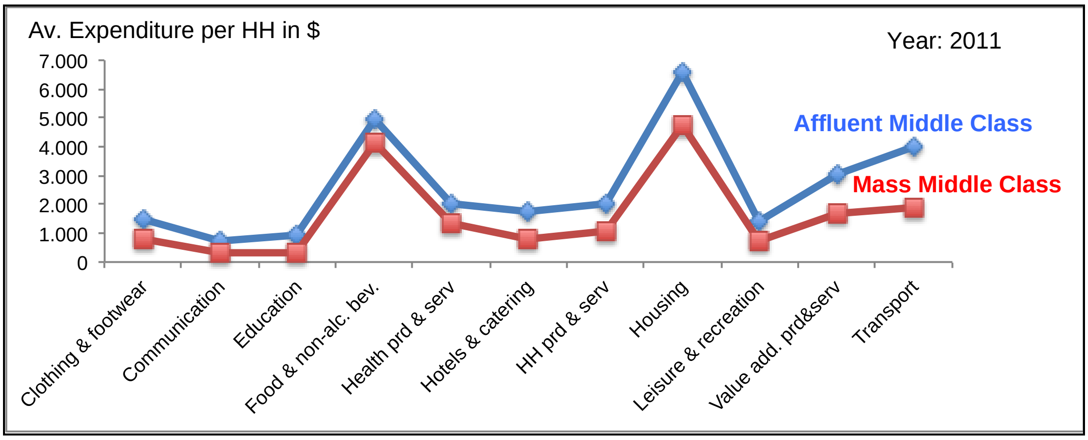


Calculated from Euromonitor International data, 2011

Growth in GDP (2.7 percent in 2011) along with decrease in unemployment (from 9.3 percent to 6 percent during the period 2005 and 2011) and rising salaries create customer confidence for further consumption (CIA 2012, World Bank 2012). For example, the jeweler company, Tiffany has the biggest number of stores in São Paulo among all countries. São Paulo shops of Louis Vuitton produced the company's highest profits per square foot among all other markets in 2009 (Economist 2009b).

According to GSU-CIBER research, as illustrated in Figure 5, housing and food & non-alcoholic beverages dominate the spending of Brazilian middle class consumers. The affluent middle class outspends the mass middle class by a significant margin across housing, transport, and value added product & services such as jewelry, silverware, financial services, etc. Spending across other product/service categories is very consistent between the affluent (upper) middle class and the mass (lower) middle class.

Figure 5: Average Expenditure per Household by the Brazilian Middle Class in 2011[6]



Calculated from Euromonitor International data, 2012

In related research, we also examined the share of wallet and its growth across product/service categories by Brazilian middle class. Although the amount of spending is

[6] Av.: average, HH: household, non-alc. bev.: non-alcholic beverages, prd: product, serv: service, value add.: value added

largest on food and non-alcoholic beverages, its growth in share of wallet decreased from 39 percent to 37 percent during the period 2005-10 by mass middle class. This declining trend is expected to continue until 2015 not only by mass middle class but also by affluent middle class. In the same period, the share of spending on housing is expected to decline from 16 percent to 15 percent by affluent middle class and to stay stable as 18 percent by mass middle class. Thus, growth in housing sector will be limited.

Interestingly, the share of spending in transport has an upward trend since 2005 by the affluent middle class. The anticipated share of wallet to transport will be about 14 percent in 2015. For mass middle class, the share of spending in transport grew from 8 percent to 9 percent during the period of 2005-10. It is projected to stay stable at 9 percent by 2015.

Another important category accounting for a large share in wallet by Brazilian middle class is value-added products. However, the growth of this category is uncertain. The growth rate by the affluent middle class was about 15 percent both in 2005 and 2010. It is not expected to change in 2015. Moreover, the growth of expenditure by mass middle class is fluctuating. Although the share of wallet for value added products & services decreased from 13 percent to 12 percent during the period 2005-10, 13 percent of the entire expenditure is expected to flow into this category by 2015.

Challenges Facing Brazilian

The growing middle class, high purchase intention, and huge amount of natural resources attract the foreign investors in Brazil. However, the grass is not always green on the other side. Relative to some other dynamic economies, Brazil is lagging behind in terms of business environment and social development.

First, investment in education is inadequate to support social and economic development in Brazil. The share of wallet in the mass middle class is almost the half compared to that of the affluent middle class. Some 3 percent of household spending was allocated for education by mass middle class in 2010, whereas this number was 7 percent in affluent middle class. Since mass middle class represents larger part of the population, this represents a vulnerability to sustained growth of Brazil's economy.

Inadequate educational achievement translates to shortages of qualified employees. According to a recent report, the shortfall for the qualified graduates in the IT sector will be 45,000 people by 2014. Some 33,000 students are expected to graduate with information technology training. However, the required number of employees in this sector will be about 78,000. The problem is that 87 percent of students can not pass IT courses due to a lack of basic mathematic and high dropout rates (Financial Times 2011). Similarly, *Talent Shortage Survey* by ManpowerGroup shows that 71 percent of companies operating in Brazil have difficulties in finding adequately trained employees. Brazil ranked at 2nd place among 41 countries in 2012 (ManpowerGroup 2012).

It is also interesting to note that, relative to other dynamic countries, Brazil sends fewer university students abroad. According to the *Institute of International Education*, Brazil ranked 14th in terms of the number of incoming international students in the United States in 2011. China was in the 1st, India 2nd, Saudi Arabia 6th, and Vietnam 8th place on the same list (IIE 2011).

Second, reluctance by university students shying from seeking education abroad – and a similar lack of interest by Brazilian managers in working outside of Brazil – tends to have an adverse impact on national competitiveness of Brazil in global business. It is interesting to note that there are more internationally recognized Brazilian soccer players (and fashion models) than well-known global business leaders! Relatively few large Brazilian companies are well known outside of Brazil. In discussions of global competition in research organizations' publications have fewer references to Brazilian firms (Deloitte 2012, PwC 2011b, PwC 2011c).

These reports also refer to new entrepreneurial activity by homegrown companies of India (Economist 2011c), China (World Bank 2012), etc., yet such references are far fewer for Brazil. Brazil placed behind India, China, Korea, Singapore, Malaysia, and Russia in terms of creating new multinationals in 2008. Although GDP of Brazil was seven times bigger than that of Malaysia, Malaysia featured 25 more new multinationals than Brazil did in the same period of time (PwC 2010b). Furthermore, total early stage entrepreneurial activity in Brazil decreased from 17,5 percent to below 15 percent in the period of 2010-11, while it grew among other BRICs and many other dynamic economies (GEM 2012).

Eight companies represented the country in *Fortune's Global 500* in 2012, compared to only Brazilian company in the previous year (Fortune 2012). Nevertheless, these are impressive performers, for example, Petrobras (the largest energy company in Latin America), Vale (one of the world's largest mining companies), and Embraer (third-biggest producer of passenger jets worldwide). Others are well know in their respective sectors: Gerdau and CSN (steel), Brasil Foods and JBS Friboi (food), WEG (electrical components), Odebrecht (construction), Natura, (cosmetics), Votorantim (an industrial conglomerate), Havaianas (textile, especially flip-flop), and AbInbev (beer) (Economist 2009c, Interbrand -undated).

Global prominence by a relatively limited number of Brazilian firms also has an impact on the nation's image abroad. On the list of *Nation Brand 100* by *Brand Finance*, Brazil ranked at 10th place in terms of the national brand value in 2011. The country's image existed in soft dimensions like "a sexy, youthful, and athletic society". It doesn't express any economic value, which is a case, for example, by the brand equity of Turkey perceived as one with "a stable and business-friendly government" (Brand Finance 2011). Similarly, Brazil ranked at 21st place on the list of *Nation Branding Index* in 2008 (NBI 2008). The country disappointingly ranked 53rd by *Global Competitiveness Index* behind South Africa, Malta, and Sri Lanka; just before Mauritius in the period of 2011-2012 (WEF 2012).

Third, a closer look at dimensions of *Global Competitiveness Index* points to potential challenges in the Brazilian business environment. The overall ranking of 132nd out of 142 countries is not at all impressive. Quick and extensive reforms are needed in several areas but especially in taxation (142nd), import (142nd), duration to start a business (138th), and foreign competition (137th) (WEF 2012). Similarly, there is room for improvement for the tax system, along with government regulations and infrastructure development (OECD 2011, EIU 2011).

In Table 1, we compare Brazil to China, India, Russia, and the next tier of emerging markets in terms of such relevant business factors as infrastructure, ease of doing business, economic/trade/investment freedom, corruption, and income inequality (GINI). The U.S. is included as a reference country.

Table 1: Brazil Compared to Some Emerging Markets and U.S.[7]

	Infra-structure Score (↑ better)	Ease of Doing Business Ranking	Economic Freedom Ranking	Trade Freedom Score (↑ better)	Investment Freedom Score (↑ better)	Corruption Ranking	GINI Index (↓ better)
Brazil	3.10	126	113	69.8	50	69	51.8
China	3.54	91	135	71.6	25	78	51.3
India	2.91	132	124	64.2	35	87	39.5
Indonesia	2.54	129	116	73.8	35	110	37.5
Mexico	2.95	53	48	81.2	65	98	48.3
Poland	2.98	62	68	87.6	65	41	36.2
Russia	2.38	120	143	68.2	25	154	42.3
S. Korea	3.62	8	35	70.8	70	39	36.6
Turkey	3.08	71	67	85.4	70	56	39.2
U.S.	4.2	4	9	86.4	75	22	47.1

Brazil follows China and South Korea in terms of infrastructure. This is the only high ranking for Brazil. The country is lagging others in terms of the analyzed factors. Poland, South Korea, and Turkey offer more investment-friendly business environment to the foreign companies. These countries place higher than Brazil in terms of ease of doing business, economic/trade/investment freedom, and corruption. Trade freedom is the most challenging issue in Brazilian business environment. In addition to Poland, South Korea, and Turkey, the other countries such as China, Mexico, Russia, and Indonesia are more open to the foreign investors than Brazil.

Similarly, doing business in China and Mexico along with in Poland, South Korea, and Turkey is much easier. Regarding the degree of hurdles to set up a business, Brazil ranked at 126th place out of 183 countries on *Ease of Doing Business* rankings by the World Bank. Its place was just before Tanzania and behind Uganda or Bangladesh, which are not counted in the group of the emerging markets but as developing countries. The country compares unfavorably in terms of tax burden (150th place). Foreign investors need to pay 41 percent of revenues towards labor taxes, which is about 15 percent across Latin America (DB 2012).

Finally, Brazil disappoints when it comes to income inequality as measured by the GINI coefficient. Although income inequality is improving (by an average of 1.2 percent a year), the gap between the richest and the poorest households is highest in Brazil among all others.

In conclusion, Brazilian market faces some challenges, which may create a negative impact on not only foreign investment but also nation image. The major challenges arise from poor education, insufficient global presence by Brazilian companies, and obstacles in business environment for foreign investors such as taxation, government regulations, and infrastructure.

Conclusion and Implications

[7] Sources of information: Infrastructure: World Bank 2010; *Ease of Doing Business*: World Bank 2011; Economic/Trade/Investment Freedom: Heritage 2011; Corruption: Transparency International 2011; GINI-Index: Euromonitor International 2010.

This article offers some insights into the fascinating economy of Brazil. The purpose is to highlight developments, business opportunities as well as point to remaining challenges if the country is to enhance its competitiveness and emerge as an even stronger global economic power. We presented our *Middle Class Scorecard* to contrast Brazil among other emerging markets in terms of middle class development.

According to the GSU-CIBER's Middle Class Scorecard, Brazil ranked at 2nd place behind China in terms of market size of middle class in 2011. The growing population and increasing GDP continue to boost the middle class. The expected growth in household expenditure by Brazilian affluent middle class is 42 percent for the period f 2010-15. Household expenditure has surpassed household disposable income since 2010. Primary contributor to this phenomenon is the existence of informal economy and the extensive use of consumer credit.

Food and non-alcoholic beverages, housing, transport, and value added products & services account for the biggest share of wallet by Brazilian middle class. The consumption of food & beverages is expected to decline and that of housing expected to remain stable by 2015. On the other hand, transport and value added product & services might provide big opportunities to investors because of the anticipated future growth in consumption. Based on these results, we can assume that consumer demand for particular goods and services such as personal cars, air travel, luxury goods, and financial services may increase in the future.

Brazil offers big investment opportunities thanks to the growing middle class, rich natural resources, and rapid economic development. On the other hand, Brazil unfortunately suffers from some unfavorable country-specific conditions. Major reforms are required in education, global presence of Brazilian companies, and the business environment.

Inadequate educational achievement contributes to a shortage of qualified talent. Thus, companies may outsource the required skills and/or may implement training for existing staff. Regardless, all this contributes to high cost of recruiting and employing qualified employees in Brazil. Moreover, talent shortage may also have a negative impact on the country itself. Unemployment and inequality may increase when companies outsource economic activity. Entrepreneurial proclivity of Brazilians is also relatively low among all other key emerging markets.

In terms of the business environment, global *Competitiveness Index* of the World Economic Forum and *Ease of Doing Business* ranking of World Bank clearly show that Brazil still fall behind those of counterparts like China, India, Russia, and next tier. Tax system, government inefficiency and bureaucracy, inadequate legal framework, as well as the infrastructure need immediate overhaul and streamlining.

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BRASIL: RÁPIDO DESENVOLVIMENTO, INTERNACIONALIZAÇÃO E FORMAÇÃO DE CLASSE MÉDIA

Resumo: A introdução do projeto de pesquisa deve introduzir o leitor acerca do tema que se discute ao longo do projeto. Assim, ela deve ter como dinâmica fundamental a apresentação de elementos que permitam caracterizar minimamente o universo da pesquisa que se propõe. Reforçamos que não se deve dividir os conteúdos em tópicos; a organização do texto cabe a cada grupo, pois os projetos e até os estilos de redação podem imprimir diferenças. De qualquer modo, o tema precisa estar explicitado (embora isso não deva ser feito de modo abrupto, mas construído brevemente) e as partes constitutivas do documento (ou seja, que itens compõem o projeto de pesquisa) enunciadas. Esta articulação sobre as partes do projeto demonstra a lógica por trás da construção dos conteúdos do trabalho.

Palavras-Chave: internacionalização; poder de compra, mercado consumidor.

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