Strategic Consulting

Investing in Brazil: Policies, Regulations, and Investment Targets

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Investing in Brazil: Policies, Regulations, and Investment Targets

Brazil has experienced tremendous growth in the past two decades that has attracted significant international attention. As a result of its large market, growth potential, natural resources, domestic demand, and stable government, it has become one of the fastest growing emerging markets and the biggest economy in Latin America.

PART I: Brazilian Policy Overview and Current Obstacles

Brazil's hallmark economic success has been rooted in a framework based on primary fiscal surplus, inflation-targeting, and a floating exchange rate. Brazilian policy used the control of inflation to promote competitiveness through open currency exchange and strict monetary policies. This policy met with much success in the 2000s as Brazil experienced fast paced growth of an annual average of 4.5% between 2003 and 2007 and reached 5.2% GDP growth in 2008.[1] While the effects of the international crisis manifested in a small set back in GDP growth in 2009 (-0.6%), Brazil recovered exceptionally well with a 7.5% increase in 2010. A driver of this development has been strong domestic demand and private consumption, which has experienced higher growth than that of GDP since 2004. Similar positive indicators in the late 2000s include:

- record infrastructure investments in 2010, which reached almost triple the growth rate of that of GDP for the same year;
- a record high of foreign direct investment of US$45 billion in 2008, which fell by 42% in 2009, but recovered to US$38 billion in 2010;
- a rising trend of e-commerce activity, which reported 20 million e-commerce consumers in 2010, up over 50% from 2008;
- and the largest increase in mergers and acquisitions in the country's history in 2009 and 2010. This is due to many cross-border deals dominated by local Brazilian company takeovers of both foreign firms (46.6%) and domestic competitors (21%). Foreign company takeovers were led by the Asian, particularly the Chinese, market with 20% of M&A volume in the same period.[2]

However stagnant policies and recent financial externalities, like rising commodity prices and increasing global liquidity, have taken their toll on the Brazilian economy. Brazil currently faces a fear of an overheating economy, as manifested in uncontrollable currency appreciation, excessive credit expansion, rapid GDP growth, inundation of foreign capital inflows, and perpetually rising inflation, the last of which has been a platform priority of President Rousseff. Similarly as private consumption continued to outpace investments in late 2010, Brazil began to experience a mismatch between supply and demand resulting in disproportionate import growth over that of exports. Into the second quarter of 2011, the trade balance was further weighted as a

[1] World Trade Organization, "Trade Policy Review: Brazil." February 2, 2009.
[2] Barreto, Elzio. "Brazil M&A volumes seen jumping to record in 2010." Reuters.com. August 18, 2010.

decrease of 3.2% in exports outstripped the 1.6% drop in imports. Moreover, the current lack of opportunities in developed markets and sustained high commodity prices have resulted in foreign investment inflows of US$42.2 billion in January to April of 2011, five times the figure for the same period in 2010.

2011 Outlook: Political and Trade Policy

The 2010 election of President Dilma Rousseff shows continued political stability with the extension of the left-wing Partido dos Trabalhadores (PT) administration. In addition to an economic focus on tightening fiscal policy, easing inflation, and increasing public savings, during her first term Rousseff will aim to consolidate socioeconomic policies, address poverty issues, improve labor qualifications and education, and reform the tax system.

A major political challenge for the new administration will be to control political infighting within the ruling party. However through such political conflict and consolidation, we have observed another recent priority of President Rousseff. She has been targeting corruption and bribery that has long penetrated the Brazilian political and economic system. In June 2011, Rousseff removed her chief of staff, Antonio Palocci, from office after a corruption scandal exposed corruption the exponential growth of his personal wealth during his legislative service between 2006 and 2010. Again, in July Rousseff acted quickly to remove Transportation Minister Alfredo Nascimento from office, as well as over twenty supporting ministry officials, due to corruption allegations of kickbacks and overbilling. This no-nonsense and all-business demeanor appears to be a key strength of the new president and suggests maturing democracy and stability in Brazil.

President Rousseff has also launched a more pragmatic foreign policy. A first signal of this was when the then President-elect publicly disagreed with the Brazilian Foreign Affairs ministry's abstention from the UN vote regarding the stoning of an Iranian woman. Rousseff distinguished between an economic and energy affiliation with the often controversial Iran and a foreign policy alliance. This was reinforced by Brazil's 2011 United Nations vote in favor of monitoring human rights in Iran. The nuanced stance supports a more open, Western perspective and suggests a marked change for Brazilian foreign policy. This has been further evidenced by warmer relations with the U.S., as seen in April of 2011 when President Obama signed a trade and economic co-operation agreement in Brazil. The agreement encourages bilateral economic ties and facilitates commerce between the U.S. and Brazil. This renewed relation comes after China surpassed the U.S. to become Brazil's leading trade partner in 2009, sustaining that position through 2011.[3] (See *Brazil's Leading Trade Partners 2011* table below.) While recently the total percentage of Brazilian exports has decreased, that of exports to China has increased. Average trade between the two countries has been growing exponentially: two-way trade increased from approximately US$40 billion in 2009 to US$62 billion in 2010, and is expected to increase a minimum of 30-40% in 2011.[4] In addition to growing trade with China, Brazil also prioritizes its trade agreement with its South American neighbors; however MERCOSUL (*Mercado Comun do Sul*) only accounts for 10% of Brazilian merchandise traded.

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[3] World Trade Organization Statistics Database. "Brazil." March 2011.
[4] China-Brazil Chamber of Economic Development. "Presentation by Chairmen Tang Wei." June 17, 2011.

Brazil's Leading Trade Partners 2011
(Minesterio do Desenvolvimento, Secretaria de Comercio Exterior)

	Country	Participation
1	China	15.41%
2	United States	12.20%
3	Argentina	8.27%
4	Germany	5.24%
5	Japan	3.76%
6	The Netherlands	3.41%
7	South Korea	3.06%
8	Italy	2.54%
9	Nigeria	2.39%
10	Chile	2.26%
11	France	2.04%
12	Russia	1.90%
13	Mexico	1.89%
14	Spain	1.76%
15	India	1.73%
	Other Countries	32.13%

In addition to strengthening ties with major trade partners, Brazilian trade policy has undergone significant reforms. The Chamber of Foreign Trade (*Secretaria de Comercio Exterior*, SECEX) has modified and simplified customs procedures and import regulations, as well as increased overall tariff protection. Currently, Brazil's trade policy is led by manufacturing and primary products. It continues to be a leading exporter of oil and its derivatives, mineral ores, and soya beans and products. The dominance of Brazilian exports drives its trade surplus, on which the country relies. While the trade balance has experienced recent declines – in 2010 it dropped to US$20.3 billion from US$25.3 billion in the previous year – it is expected to pick up. In the first half of 2011, Brazil's trade surplus reached nearly US$13 billion, up 65% from the same period in 2010. And while the surplus could be diminished by the rising national account deficit, which will increase from 2.5% of GDP in 2010 to 3.7% in 2011, foreign investments and inflows are expected to support much of this deficit.[5] Therefore, trade growth will continue to increase with the help of international demand and high commodities prices. To further develop its trade economy, Brazil will likely continue to reduce import barriers and solidify trade relations with major bilateral partners.

2011 Outlook: Fiscal and Economic Policy

The changing economic conditions and the new presidential administration have shifted Brazilian policy in early 2011. A new macroeconomic framework, committed to overall policy tightening, launched a series of "macro-prudential measures" to prevent an effective overheating of the economy. By replacing previous stimulus policy measures maintained in place through the 2010 elections, the new framework supports a more heavily managed exchange rate policy. These initiatives aim to slow GDP growth, control appreciation, manage credit expansion, reduce financial system risk, and stabilize demand. A target of 4% growth has been set for 2011 and

[5] Economist Intelligence Unit, "Country: Brazil." August 2011.

2012. Thus far, the SELIC interest rates have increased five times to 12.5% in an effort to calm inflation that is exceeding the upper limit of 6.5%. President Rousseff also announced a budget reduction of US$50 billion to reduce public expenditure and government spending.

The Central Bank of Brazil (*Banco Central do Brasil*, BCB) similarly began its own tightening policies in late 2010 which will continue into 2012. These policies include restricting reserve requirements, shrinking liquidity, and tightening currency regulations. In July 2011 the Bank reduced exposure to bets against the dollar with a new requirement for all banks, specifying that 60% of short dollar positions over US$1 billion must be deposited directly at the BCB. An additional 1% transaction tax on currency derivatives was also implemented to deter long positions on the Real. While the recent strength of the Real has helped the government counteract rising inflation to a certain extent, it also undermines the competitiveness of the industry market.

As capital inflows persist, the administration and the Central Bank have increased taxes on foreign capital in an effort to reduce speculative inflows. Explicit capital controls, however, are unlikely.[6] In the past Brazil has successfully relied on high annual interest rates to attract foreign finances, the BCB now must control excess inflows via tightening policies that reduce overseas and focus on permanent investments in Brazilian companies. The BCB is stressing long-term investments by strategically modifying financial-transaction (IOF) taxes. A stream of measures has been implemented to this effect: IOF taxes on company and bank borrowing abroad for terms under 360 days were increased to 6%, while long-term borrowing over 3 years maintains a 0% rate. A similar policy saw an increase in IOF tax from 5.38% to 6% on foreign-currency loans to local institutions for all loans with 90 day maturity, significantly tighter than the 360 day term policy it replaces. Echoing this, the BCB increased taxes imposed to renew, renegotiate or transfer loans with less than a two-year maturity and tripled the tax on fixed-income purchases by foreign investors to 6%. Other tax incentives supporting the filtration of long-term foreign investment can be seen in lowering the IOF on private equity and venture-capital investments as well as withholding-tax exemption on corporate infrastructure bonds.[7]

The administration is using this series of tax increases to strategically moderate the composition of capital inflows. The BCB is seeking to reduce speculative inflows without detrimentally affecting infrastructure and industry. The BCB policy has supported tax increases to discourage short term and excessive inflows, like betting against the dollar, and has provided tax exemptions to incentivize longer-term foreign investments. The BCB has reported initial progress via a shift in the composition of inflows, with greater foreign direct investment over portfolio inflows and particular growth of tax exempt long-term FDI. This is beginning to result in more sustainable currency appreciation pressures. While central BCB figures, including bank president Alexandre Tombini, stress the importance of targeted foreign investment, restrictions will likely continue as capital concerns persist. Similarly, Finance Minister Guido Mantega has said that while capital regulations continue, strict capital controls (as mandated by the International Monetary Fund or Brazilian administration) are very doubtful.

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[6] Talley, Ian and Mathew Cowley. "Opposed to Constraints on Capital Controls." The WSJ, April 14, 2011.
[7] Bristow, Mathew and Carlos Caminada. "Brazil Broadens IOF Tax." Bloomberg Business Week. July 14, 2011.

Foreign investment in the form of portfolio inflows into the Brazilian Stock Exchange (*Bolsa de Valores de São Paulo*, Bovespa) has dropped 70% in the first half of 2011. In this same period, the Bovespa overall has fallen 13.5% due in large part to inflation, sudden tightening policies, and particularly internal problems of major Brazilian companies with influential shares. A handful of stocks drive the Brazilian stock exchange, and between management issues in Vale and significant drops in Itaú-Unibanco and state-owned Petrobras, the Bovespa valuation has suffered. With the stabilization of the market and the continued adoption of BCB policies, Bovespa figures should resume the normal ebb and flow of the stock exchange.

Amidst enduring uncertainty and persistent inflation, 2011 figures are responding to recent policy changes with revenue growth, spending restraint, and slight currency depreciation. Further growth will be supported by the mounting labor force and real wage growth, while expanding credit will continue to maintain demand. To stabilize private consumption, currently at an unsustainable 7% growth rate, the tighter monetary conditions and rising inflation will help to limit disposable income. The 2014 World Cup and 2016 Olympics are driving estimates of increased GDP growth to 4.8% in 2013 and 2014.[8] These indicators underscore sustained growth in Brazil and show a developing market driven by capable fiscal policies and stable politics. As foreign investment continues to rise, so too do the opportunities for foreign individuals and entities in Brazil.

[8] Economist Intelligence Unit, “Country: Brazil.” August 2011.

Part II:
Foreign Investment Environment and Regulations

As a foreigner or non-resident, investing in Brazil can be heavily bureaucratic. However unlike other emerging markets like China, foreigners receive the same treatment as domestic Brazilian investors stipulated by the constitution. While some specific laws and regulations place boundaries on foreign investment – like limiting foreign ventures in rural property, mass media, and air transport sectors or like barring foreign involvement in nuclear energy, health services, and postal or telegraph service industries[9] – regulations are by and large enacted to control participation as opposed to prohibit it. Moreover, liberalization of investment directives is encouraging foreign involvement, while new electronic databases are actively improving efficiency, portability, and expediency in Brazilian regulations.

Yet despite recent reform and rapid growth, doing business in Brazil is still a burdensome process with significant bureaucratic red tape. In a 2011 World Bank survey, Brazil ranked in the bottom 30% of economies surveyed (127 out of 183) in terms of overall ease of doing business.[10] The official procedures, ever-changing protocol, and plentitude of regulatory agencies, create a daunting environment for initial entry into the Brazilian market.

Major Regulatory Barriers in Brazil

Before addressing key regulatory codes for investment opportunities, like opening a business, investing in the financial sector, or trading transactions, it is useful to highlight some major barriers that pervade most foreign interaction with Brazilian policy.

- Registration
  While registration processes are becoming more digitized and electronic systems are being implemented, there is still a significant number of steps and distinct procedures for almost all types of business in Brazil. National, state, and municipal agencies require individual documentation and registry, drawing out the duration and complexity of the registration process. Prerequisite registration for one agency is often necessary before moving to the next level of authorization, yet directions or checklists are seldom specified. While specific ministries involved differ for different products and transactions, they can include the Brazilian Federal Revenue Service, Central Bank of Brazil, Ministry of Labor Employment, Ministry of Development, Industry and Foreign Trade, Ministry of Finance, Brazilian Securities and Exchange Commission, National Monetary Council, as well as State Commercial Registry Offices.

- Federal Taxpayer Identification Number (CNPJ or CPF)
  In addition to specific registration, foreign individuals and entities must obtain a federal taxpayer identification number from the Brazilian Federal Revenue Service (*Receita Federal do Brasil*). The process stipulates that resident legal representation must be appointed. This preliminary tax registry on average takes three to six months. The identification process is required for most all activities, including purchasing real estate or a vehicle, opening a bank

[9] Banco Central do Brasil. "International Capitals and Foreign Exchange Market in Brazil."
[10] The World Bank and International Finance Corporation, "Doing Business 2011: Brazil." 2011.

account, holding an interest in a Brazilian company, investing in the Brazilian financial and capital market, and carrying out a loan, lease, or import transactions. Additional necessary documentation for the proposed activity must be simultaneously certified through the Consulate and also filed with the Federal Revenue Service.

- High Taxes
  Brazil has 62 taxes with nearly 3,200 tax codes that incorporate national and state entities. An average Brazilian firm pays up to 69% of net profits to the government, as compared to 38% for U.S. firms and 30% for U.K. firms. For any given business transaction, a firm may pay up to 50% of the invoice in taxes.[11] Tax reform is a major issue for the current administration. Brazil is still in the process of simplifying its tax procedure in order to reduce interaction with all three levels of government. A new digital database system, *Sistema Público de Escrituração Digitalor*, was launched in 2010 to streamline multi-level tax entities. On average businesses are required to make ten tax payments a year and spend up to 2,600 hours on processing.[12] However as the electronic system becomes fully adopted, reduction in number of tax payments as well as time required is anticipated to decrease.

  Currently, common taxes include: income tax, with a corporate rate of 25%; CSLL (*Contribuição Social sobre o Lucro Líquido das Pessoas Jurídicas*) a tax for the Social Contribution of Net Profits for Legal Persons, with a rate of 9-15% (15% for financial institutions and capitalized companies); IPI (*Imposto sobre Produtos Industrializados*) a federal government value-added tax on imports and transations of manufactured goods; ICMS (*Imposto sobre Operações Relativas à Circulação de Mercadorias e Serviços de Transporte Interestadual e Intermunicipal e de Comunicações*) a state value-added tax on sales and services, with a rate of 7-25%; Cofins (*Contribuição Social para o Financiamento da Seguridade Social*) a tax for Social Security Financing, with a rate of 3-7.6%; PIS (*Contribuição para os Programas de Integração Social e de Formulação do Patrimônio do Servidor Público*) a tax on gross revenue of legal entities, with a rate of 1%; ISS (*Imposto sobre Serviços*) a municipal service tax paid by local service providers, with a rate of 2-5%; and CIDE (*Contribuição e Intervenção no Domínio Econômico*) a tax for Economic Domain Intervention Contribution pertaining to technology payments, transfers, and supply, with a rate of 10%.

- Double Taxation Treaty
  Double taxation is an additional tax concern for foreign investors. A current international "Treaty for the Prevention of Double Taxation" exists to allow countries involved in economic transactions to avoid paying both countries' taxes by offsetting the tax paid in one country against the tax payable in the other. Any overlap between Brazilian Income Tax code and that of the Treaty is deferred to the specifications of the Treaty provisions. While Brazil is a signatory of the treaty with 26 other countries (including Argentina, Chile, Canada, France, Portugal, South Korea, and Spain), currently neither this agreement nor any such treaty on double taxation exists between Brazil and countries like the United States, United Kingdom, and Germany.

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[11] Skamlusky, Amy. "The Cost of Doing Business in Rio." The Rio Times. November 23, 2010.
[12] The World Bank and International Finance Corporation, "Doing Business 2011: Brazil." 2011.

While no agreement is in place, in March 2011, a U.S. Senate Resolution was submitted for the initiation of a tax treaty with Brazil. U.S. executives supported the resolution and echoed the benefits of becoming a signatory of the double taxation treaty during President Obama's visit to Brazil at the sixth annual Brazil-U.S. CEO Forum in early 2011.

- Labor Laws

  Labor and employment is highly regulated in Brazil. Following the Consolidation of Labor Laws document, companies are required to register local employees with several government agencies, which maintain strict hiring and firing policies. A dismissed employee may cost its employer up to thirty months' salary. Additionally foreign and non-resident employees must receive government permission and file separate but similar registration. Incentives to grow the domestic labor force further restrict expatriate employment. The government generally mandates that a Brazilian company maintain two-thirds of its employees as Brazilian citizens, and pay out two-thirds of total compensation to Brazilian citizens. Annual reports with relevant labor data, including the number of employees, staff hours, and remuneration, must be submitted to the Ministry of Labor (*Ministério do Trabalho e Emprego*).

  In addition to regulatory factors, employers have extensive costs of employment. These financial responsibilities include hiring and employment taxes, health insurance, meal, grocery, and transport stipends, vacation pay, as well as an extra month's salary paid at the end of December known as "13th Salary." These employment expenditures can add an additional cost of 90% over base pay for any given employee. This is considerably greater than comparable estimates for U.S. employment, with added costs of 29%, and United Kingdom employment, with added costs of 18%.

These larger issues permeate much of the specific protocol and framework of foreign financial endeavors in Brazil. Below, we will target the particular regulatory requirements of five main opportunities and points of interaction between foreign companies and the Brazilian market: (1) opening a business in Brazil (including corporations, limited-liability companies, and individual enterprises), (2) establishing a branch, (3) engaging in the financial sector (including investing, operating, and establishing financial institutions), (4) acquiring real estate, and (5) trading in the Brazilian market (including import and export regulations and restrictions).

(1) Opening a Business

While no special authorization is needed for a foreign company to open a local business in Brazil, government regulation specifies a laborious registration process. On average there are 15 distinct procedures that take approximately of four months to complete.[13] However, the recent emphasis on digital synchronization between federal and state bodies has begun to streamline business start-up in Brazil.

While the ownership process is arduous, the actual limitations are minimal. Though regulations do limit foreign business in sectors like communications, news media, public utilities, and transportation, certain opportunities are becoming available as the government continues to privatize state-owned enterprises.

[13] The World Bank and International Finance Corporation, "Doing Business 2011: Brazil." 2011.

The two most common corporate entities established in Brazil are the limited liability company (Sociedade limitada, Ltda) and the corporation (Socidade anônima, SA). In general, a corporation has more extensive requirements, including significant disclosure policies, corporate meetings, financial statement specifications, as well as external auditing that result in higher expenses. A limited liability company follows a similar procedure for incorporation, but is simpler and easier to establish with fewer requirements. It is entity objectives, however, that often serve as the determining factor between the two structures: corporations are employed to issue shares, appear on the stock exchange, and be traded publicly, while limited liability companies are created to support foreign direct investment and comparable endeavors through a more streamlined process.

Corporations (Sociedade Anônima):
To establish a corporation, the main requirements are as follows:

- Capital must be subscribed by at least two original founders, foreign or Brazilian. Non-resident foreign founders must appoint a Brazilian citizen as a fully-responsible representative.
- All non-resident shareholders must register with the Brazilian Federal Revenue Service and file for a tax identification number (known as a CNPJ or CPF).
- Publicly traded corporations must deposit at least 10% of the issue price of shares subscribed for in cash into a bank authorized by the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários*, CVM).
- An application must be registered with the local Board of Trade (*Junta Comercial)*, including documentation of company bylaws and the value of capital in local currency.
- Corporation documents and certificates of incorporation must be published in the *Diario Oficial* or another comparable newspaper within 30 days of registration.
- Publicly traded companies must comply with annual external audits under Brazilian Securities and Exchange Commission regulations.
- Brazilian law requires annual payment of dividends, as established in the bylaws.
- Bylaws must enumerate total number and value of shares in local currency.

To maintain a corporation, the main governance and compliance issues are as follows:

- Corporation must be administered by a board of directors (*directoria*). The board of directors must consist of at least two directors (shareholders or non-shareholders). Directors must be Brazilian residents, but are not required to be Brazilian citizens. Directors are elected by the administrative council (or general shareholders if there is no council) for up to three years. The board of directors' duties include third-party dealings, business management, and implementation of council resolutions.
- An administrative council (*conselho de administração*) is optional for closed corporations but mandatory for publicly traded corporations. The administrative council must have at least three members who are corporate shareholders, elected at a general shareholder meeting. Members may be foreign or Brazilian. Non-resident foreigners must appoint power-of-attorney to a local Brazilian resident. The responsibilities of the administrative council include corporate strategy, hiring and firing directors, supervising management performance, calling shareholder meetings, and selecting auditors.

- A fiscal council (*conselho fiscal*) may also be established by the shareholders at a general meeting to serve as an audit committee and oversee administration carried out on behalf of the corporation.
- Annual shareholder meetings are required within four months after the end of the financial year. Meetings must review financial statements, determine dividend distributions, and elect members, directors, and councils.
- Annual financial statements must be disclosed to the Board of Trade and published in the *Diario Oficial*.

Limited Liability Companies (Sociedade Limitada):

To establish a limited liability company, the main requirements and compliance issues are as follows:

- Company must be founded by a minimum of two founding partners (quota holders), foreign or Brazilian.
- Non-resident quota holders must register with the Brazilian Federal Revenue Service, file for a tax identification number (known as a CNPJ or CPF), and appoint power-of-attorney to a local Brazilian resident.
- Company administrative offices must be located domestically in Brazil and management must be executed by local Brazilian residents.
- Company name must indicate main business activities.
- No initial capital requirements. Capital must be denominated in local currency and is said to be divided into quotas instead of shares. If the company is funded by foreign equity, investments must be registered with the Central Bank of Brazil within 30 days.
- Company capital must be subscribed upon registration; however no minimum percentage is required to be paid up front. Until total capital is paid, quota holders are liable for all capital subscribed.
- No public disclosure of financial data is required.

The specific entity differences between the Limited Liability Company and the Corporation center on capital, disclosure, and management, as well as the overall regulatory process. As such, the limited liability company is the most popular business structure in Brazil, particularly in respect to foreign entities. While the registration process is more streamlined, it still requires multi-layered government authorizations. It is therefore worthwhile to enumerate more specific registration protocol for establishing a limited liability company in Brazil.

Economic Intelligence Unit: "Investment Approval Checklist" *Direct Sourcing*[14]

1. If the company is funded by foreign capital, remit capital and register it with the Banco Central do Brasil within 30 days.
2. Register the company with the state where the company's principal office will be located. Pay registration fees and obtain an identification number.
3. Register with the Secretariat of Federal Revenue (*Receita Federal do Brasil*) for federal- and state-tax purposes. Obtain a company number (known locally as the CNPJ), confirm taxpayer enrolment, and obtain inspection of state taxes.

[14] Economic Intelligence Unit. "Country Commerce Brazil 2010: Organising an Investment: Investment-Approval Checklist." 2011.

4. Obtain permission from the respective state-level Ministry of Economy (*Secretaría da Fazenda Estadual*) to print receipts and invoices.
5. Apply for an operations permit with respective municipality.
6. Register company's employees in social integration programme (contribuição para o programa de integração social—PIS).
7. Open a bank account for the Length of Service Guarantee Fund (*Fundo de Garantia por Tempo de Serviço*—FGTS) unemployment account.
8. Request permission from the Ministry of Labour and Employment (*Ministério do Trabalho e Emprego*) for limited number of expatriate employees who need to be hired.
9. Register with the Employees Union and Patronal Union.

__Individual Limited Liability Companies (Empresa Individual de Responsabilidade Limitada)__

In addition to the two most common structures outlined above, a new entity known as the Individual Limited Liability Company (Empresa Individual de Responsabilidade Limitada, Eireli) was signed into law on July 11, 2011 as an additional article to the Brazilian Civil Code. The new structure allows an individual to establish a single person entity, without a partner. The title individual will be responsible for the entire share of capital, to be paid fully and total no less than one hundred times the highest minimum wage enforced in Brazil. The minimum wage rate is R$545 per month, as of July 2011.

The law further specifies the following:[15]

- The entity name should include the term 'EIRELI' after the firm or individual name of the company.
- The title person may only establish one individual limited liability company of this type.
- The new entity may be formed from the merging of separate corporate modalities into a single partner, regardless of the reasons for the concentration.
- The entity may be created for the provision of services of any kind arising from the remuneration on the transfer of economic rights of the author, the author's image, name, brand, or the voice of the holder of the legal entity, linked to professional activity.
- Where applicable, the law of Ltda structures will be applied to the new entity.

The implications of this new entity suggest residual benefits from the perspective of a foreigner looking to invest in Brazil. Via the new structure, a foreign investor will no longer require a local Brazilian partner to establish a business in the country. Additionally a foreign individual will be able to employ tax benefits, like income tax reductions, previously reserved to corporations, as well as have new ease in tax planning and acquiring a visa.

As the law specifies, applicable regulations will carry over from the currently popular Limited Liability Company (Ltda). This suggests parallel registration processes for the new entity as compared to those of the Ltda outlined above. Further details, regulations, and protocol obstacles remain to be worked out. Initial experiences, trial runs, evaluative reports, and legal analyses will give more insight into how registering for this entity will differ from other options and how accessible it will actually be to foreigners. The law becomes operative 180 days after its publication in the *Diario Oficial* in July 2011, and will thus not be valid until January 2012.

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[15] Casa Civil, Presidencia de Republica. "Lei Nº 12.441, de 11de Julho de 2011." July 11, 2011.

(2) Establishing a Branch

Similar to creating a corporate structure, establishing a new branch of an existing foreign company in Brazil has its own protocol. While the costs are comparable to those of setting up a corporation or limited liability company, the procedure is more intricate and the process time is longer – averaging six months. Due to this bureaucracy, particularly the first requirement listed below, few branches of foreign companies are established in Brazil. The driving benefit is that branch profits are exempt from withholding tax. Depending on the origin country of company headquarters, additional tax benefits and exemptions are available under the international Double Taxation Treaty, which Brazil has signed with 26 other countries. (See Foreign Investment Environment: Double Taxation Treaty section above for further information.)

Key regulatory requirements for establishing a branch in Brazil are as follows:

- ❖ Foreign company must receive prior authorization by presidential decree to establish a branch in Brazil. The special request is submitted to the Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior,* MDIC). This often can take significant time to acquire and can results in varying delays.
- ❖ Foreign company must provide the following documentation to the Ministry of Development, Industry and Foreign Trade to receive complete government authorization:
    - Documents and evidence of legal existence of the foreign company in the country of origin.
    - Copy of articles of incorporation, list of shareholders, up-to-date balance sheet, and a copy of the resolution to open a branch in Brazil.
- ❖ All required documents must be officially translated and certified by a Brazilian Consulate.
- ❖ Foreign company headquarters must allocate a fixed amount of capital to the branch.
- ❖ Foreign company headquarters must hire Brazilian legal representatives.
- ❖ Brazil branch must operate under same name as that used in the country of origin, and register that name with the State Commercial Registry Office.
- ❖ Brazil branch must publish annual financial statements and follow financial statement and accounting standards. Similar to the procedure for the corporation structure.
- ❖ Upon registry completion and presidential and government authorization, all necessary documents must be published in a public newspaper or in the *Diario Oficial.*

(3) Engaging in the Financial Market

Much like the processes for opening a business, engaging in the Brazilian financial market is regulated by a multitude of laws, circulars, and resolutions that continuously overlap. The Ministry of Finance (*Ministério da Fazenda*) oversees financial regulations and monitors economic activity. Major players within the ministry are the Central Bank of Brazil (*Banco Central do Brazil*, BCB), which is the highest monetary authority in Brazil, the Securities and Exchange Commission (*Comissão de Valores Mobiliários,* CVM), and the National Monetary Council (*Conselho Monetário Nacional*, CMN).

While regulations are highly bureaucratic, particularly in respect to financial institutions and to a lesser extent in trade transactions, other dimensions of Brazil's financial sector are strengthening and solidifying. In the 2011 World Bank survey, investor protection in Brazil was in the top 40% of world economies surveyed (74 out of 183), which falls just between India and China. This is Brazil's highest ranked category in the recent report on doing business abroad. Similar strengths were seen in obtaining credit. The maturity of Brazilian business and democracy is being further extended with the recent administration crackdown on corruption and bribery that has long undercut the commercial system. Confidence in the Brazilian financial sector continues to develop. A growing emphasis on disclosure and investor rights complements the regulatory reforms and digital advancements that continue to ease interacting with the Brazilian market.

Investing in the Financial Sector:

Foreign investment procedures all require registration with the Central Bank of Brazil (BCB) within the first 30 days of business, in accordance with BCB Circular 3,280. Registration was recently automated, enabling individuals to self-declare and register online through the BCB's *Sisbacen* system and Electronic Declaratory Registration (RDE). Within the system, users must register under specific modules according to classification, including foreign direct investment, portfolio investments, and credits (like loans, long-term imports financing, among others). Each module is regulated by the BCB as well as other complementary government agencies:

> Foreign direct investment regulation, stipulated by BCB Circular 2,997, requires registration be completed by the company receiving the investment and the foreign investor's appointed local resident representative. Remittances are regulated through the International Capital and Foreign Exchange Market Regulation (*Regulamento do Mercado de Câmbio e Capitais Internacionais,* RMCCI) and require specific routes and codes in order to be taken out of the country.
>
> Portfolio investment regulation, including non-resident investment in the financial and capital markets, is stipulated jointly by the National Monetary Council (*Conselho Monetário Nacional*, CMN) and the BCB, specifically through Resolution 2,689 and Circular 2,963 & 2,975 respectively. Portfolio investment policy requires that foreign investors appoint a representative to provide investment information and to complete registration with both the BCB and the Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários,* CVM). Once authorized, capital gains earned in Brazil by non-residents are subject to the same income tax rules as Brazilian residents.
>
> Foreign Credit regulation is stipulated again jointly by the National Monetary Council (CMN) and Central Bank of Brazil, particularly through CMN Resolution 2,770 and BCB Circular 3,027. Foreign credit policy requires registration via the BCB online system by the debtor or by a financial institution on behalf of the borrower.
>
> Foreign Capital policies specifically fall under Law 4,131 and are defined as "any goods, machinery and equipment that enter Brazil intended for the production of goods and services as well as any inflow of funds to be used in economic activities." Select sectors require additional attention, including foreign capital injections into financial institutions, nuclear energy, newspapers, magazines & publications, radio and television chains.

Registration with the Central Bank of Brazil and complementary agencies, whether the CMN or CVM, is mandatory and must be completed in order to repatriate capital and remit any dividends and fees. Additional processing and registration through the National Industrial Policy Institute

(*Instituto Nacional da Propiedade Industrial*) is necessary for remittances involving patents, trademarks, and foreign technology.

In addition to the authorizations required by the Central Bank of Brazil, most foreign investment activities require preliminary registration with the Brazilian Federal Revenue Service. Acquisition of a taxpayer identification number (known as a CNPJ or CPF) from the Federal Revenue Service is necessary for foreign individuals and entities to execute and operate most financial transactions and activities in the domestic market.

<u>Establishing and Operating a Financial Institution:</u>
Financial institutions are subject to some of the strictest government controls and regulations. Moreover, procedures are continually updated and altered. For Brazilian and foreign applicants, establishing and operating a financial institution (commercial, investment, and development banks; credit, financing, investment, and leasing societies; mortgage and development agencies; security, stock broker, and foreign exchange societies; and micro-entrepreneur credit societies), follows the registration process stipulated by a series of Central Bank Circulars.

Requirements are extensive and depend on the desired action of the current or future financial institution. Such actions can include establishing or canceling operation of a financial institution, transferring corporate control, formalizing institutional partnerships, or increasing foreign ownership. All required documents must be submitted to the Central Bank for authorization.

Selected required information and documents include:[16]

- ❖ Amount of foreign participation in the total capital of a local subsidiary of a financial institution (not applicable to branches).
- ❖ Importance of the entrepreneurship for the Brazilian economy, listing all benefits that could be gathered by the local financial system, such as new technologies, greater variety of products and services, incrementing competitiveness and so on.
- ❖ Detailed description of existing activities of the foreign investor in the Brazilian financial system, including any participation in local economic groups.
- ❖ Relevance of the local operations to the strategic plans of the foreign investor, including added-value analysis on any existing operations in Brazil.
- ❖ Risk rating classification of the applicant, including the entire economic group.
- ❖ Indication of any financial institutions that maintain direct or indirect relations with the financial institution domiciled abroad.
- ❖ Indication of regulatory bodies that supervise the financial institution domiciled abroad.
- ❖ Other information considered relevant for analysis by the Brazilian government.

Selected required appointments and access include:[17]

- ❖ A technically qualified contact person, with at least 5% ownership share in the institution.
- ❖ Access to complete income tax data for the three preceding years from all members of the controlling group and all qualified shareholders.
- ❖ Access to an inventory of properties, debts, and mortgages from all members of the controlling group and all qualified shareholders.

[16] Banco Central do Brasil. "Highlights on Licensing Procedures for Foreigners."Circular 3,317.
[17] Banco Central do Brasil. "Highlights on Licensing Procedures for Foreigners."Circular 3,040.

(4) Acquiring Real Estate

Regulations for acquisition of real estate place no restrictions on the foreign purchase of buildings or urban realty in Brazil. It takes an average of 42 days to register a property and there are 14 different procedure steps required. Foreigners and foreign-owned companies are prohibited from owning land within 150 kilometers of national borders, on coasts, or any area defined as 'sensitive for national security.' In terms of rural land acquisition, Brazilian regulations are very strict for foreigners. Foreign residents are limited to fifty 'modules' of rural property. Non-resident foreigners and companies are prohibited from directly owning any rural land, but rather, by law must first become Brazilian residents and Brazilian companies or branches, respectively. If a foreign company necessitates the use of agriculture, live-stock, or industrial needs for business purposes, it is required to get approval from the Ministry of Agriculture and Livestock (*Ministerio da Agricultura, Pecuária e Abastecimento*) and the National Institute of Agrarian Reform (*Instituto Nacional de Colonizacao e Reforma Agraria*). These restrictions will likely be maintained, as the government is in talks to further tighten foreign land ownership policy.

(5) Trading Transactions: Export and Import

From a regulatory and exchange perspective, Brazil has significantly simplified its import and export policies and transaction in recent years. Trade is largely regulated by the Chamber of Foreign Trade (*Secretaria de Comercio Exterior*, SECEX) within the Ministry of Development, Industry and Foreign Trade (*Ministério do Desenvolvimento, Indústria e Comércio Exterior*, MDIC). Yet, like most other financial and commercial activities, export and import transactions require several registrations and authorizations from various government agencies. The four main filings are as follows:

- Individuals must file with SECEX for Exporter and Importer Registration, known as *Registro de Importadores e Exportadores.* While users must file for registration before entering into any cross-border trade, final enrollment is granted upon the first import or export transaction.
- Initial registration with the SECEX is contingent upon prior listing with the Brazilian Federal Revenue Service through their electronic system known as RADAR. This is a preliminary tax filing and requires additional documentation to be submitted to the customs authorities. Once proper tax identification is filed, the Federal Revenue Service authorizes the next registration step for customs identification and operations.
- An intermediary step requires additional registration with the Central Bank of Brazil. Through the *Sisbacen* system (RDE-ROF), users must file for a Registration of Financial Operation (RDE- ROF). This is necessary to the extent that the trade transaction constitutes the flow of funds out of and into Brazil.
- Like the *Sisbacen* system for financial markets, the Chamber of Foreign Trade (SECEX) has instituted its own digital database for customs operations, called *Siscomex*. *Siscomex* functions as an electronic trade-management system managed within the MDIC. Registration must be completed via this online system as well. Users can connect directly and file the necessary documents digitally. The system provides users with appropriate import and export licenses and identification numbers to be used for customs clearance in subsequent trade transactions.

Import Restrictions:

Upon completion of the registration process, the *Siscomex* system provides the user with an Import Declaration (DI) that is used as clearance through customs. However, approximately 40% of all imports require prior authorization and inspection. This adds another step beyond direct self-declaration on the *Siscomex* system. This additional licensing is determined by the tariff codes and the sensitivity of the goods being imported. Products such as human blood, drugs, weapons, nuclear material, and herbicides and pesticides require such special agency authorization.[18] On average import procedures take 17 days and cost US$1,730.[19]

Export Restrictions:

Alternatively, upon completion of the registration process, the *Siscomex* system provides the user with an Export Registration (RE) that is used as clearance through customs. Upon receipt of the export registration, transactions must take place within 60 days or the filing is automatically cancelled. Like import restrictions, certain exports require special approval and additional procedures. Such exports include critical goods in scarce supply in the domestic market, nuclear or radioactive material goods, weapons, lumber and animal skins, as well as transactions involving non-convertible currency and transactions without currency coverage.[20] On average export procedures take 13 days and cost US$1,790.[21]

[18] Economic Intelligence Unit. “Country Commerce Brazil 2010: Trade Policy.” 2011.
[19] The World Bank and International Finance Corporation, “Doing Business 2011: Brazil.” 2011.
[20] Economic Intelligence Unit. “Country Commerce Brazil 2010: Trade Policy.” 2011.
[21] The World Bank and International Finance Corporation, “Doing Business 2011: Brazil.” 2011.

Part III:
Investment Targets and Areas of Opportunities

By analyzing both the current state of the Brazilian market and the regulatory intricacies of doing business in Brazil, we better understand the reality of investing in this Latin American powerhouse. Looking forward, the trifecta of economic growth, political stability, and market potential validates navigating the cumbersome processes to engage in Brazilian commerce. Another key consideration is where to begin and where to enter the market. We address investment targets in two veins: first through high opportunity industries and second through high opportunity population segments.

High Opportunity Industries in Brazil

High opportunity and high growth industries are flagship characteristics of the Brazilian economy and obvious priorities of the administration. Here we survey the oil, mining, and infrastructure industries and simultaneously target the supporting segments that depend on and contribute to them. These dominant sectors have each experienced significant and consistent growth. Through public statements and its federal Growth Acceleration Program (*Programa de Aceleração do Crescimento*, PAC), the government has expressed support and commitment to the sustained potential of each of these key industries.

PAC Program Investment Opportunities
(Ministry of Planning, Budget and Management: July 7, 2011)

Sector	Investment
Highways	US$5.2 billion
Railroads	4,498 KM (2,749 mi) Extension
High Speed Train	US$20.8 billion
Airport – Big Concession Program	
Ports	US$462.5 million
Stadiums	US$3.1 billion
Power Generation	US$42 billion
Power Transmission	US$17.3 billion
Oil and Natural Gas - New Refineries	US$57.8 billion
Oil and Natural Gas - Petrochemicals	US$212.5 million
Oil and Natural Gas – Fertilizers	US$6.8 billion
My House My Life 2	US$78.6 billion
Olympic Games	US$18.8 billion
Urban Mobility	US$7.4 billion
Hotels	US$1.3 billion

Beyond overall economic growth and fiscal policy, as introduced above in Part I of this report, the 2014 World Cup and 2016 Olympics further open Brazil to foreign and private-sector involvement. Particular emphasis has been placed on the potential of foreign investment in the infrastructure sector, as upgrades and management support are needed in ports, airports, and roads. And while Brazil tends toward a ‘statist development model’ in regards to primary products and state-owned entities, new legislation has approved private participation in oil reserves, mining, and other natural resources. The opening of the oil, iron ore, and mining sectors, is a major opportunity for further foreign investment in Brazil.

These three industries all involve the interplay between public and private entities, and as such complementary sectors play a crucial role in industry penetration. The sub-sectors provide a platform for involvement, as they are linked to the growth and overall supply chain of the core industry, but often are more accessible. Whether due to expansive projects or the dominance of major state-owned enterprises, supporting sectors provide a key avenue for investment into these high opportunity industries.

(1) Oil Industry & Supporting Sectors

Brazil is the second largest oil producer in South America. Throughout the last few decades, the oil industry in Brazil has experienced constant and exponential growth. In the 1970s Brazil produced on average 200,000 barrels of oil daily, as compared to two million barrels daily in 2009. As of 2010, 61 oil companies were operating in production and exploration in the upstream oil market. Over half are domestic companies. There are 13 refineries, 34 biodiesel producers, and approximately 5,400 kilometers of gas pipelines comprising the mid and downstream sectors. The oil and gas industry accounts for nearly 10% of Brazilian GDP.[22]

Recently, a rise in domestic oil consumption has also bolstered sector development. In 2009, oil consumption was up 3% from the previous year with 108.8 billion liters consumed. While Brazil reached oil self-sufficiency in 2006, rapid growth of domestic demand in 2010 and 2011 has forced increased importation of oil from abroad. Major industry player, Petrobras, has stated that it will import oil to supplement its own supply through 2011 and into the first half of 2012.

Oil production is divided into onshore and offshore drilling. Onshore drilling accounts for 13% of domestic production, while offshore comprises over 80%. Onshore production recorded 230,000 barrels of oil per day in 2009. However onshore drilling and exploration is growing with the construction of new oil wells and a new infusion of investment in 2010, up 30% from 2009. Future investment in onshore exploration is attractive due to lower investment in technology, lower risk, and faster return on investment. Companies like Petrosynergy, Queiroz Galvao, and Koch Petroleo do Brasil are active in onshore production. Offshore production is, however, the dominant sector in Brazil. The bulk of offshore drilling is off the coast of Rio de Janeiro. Recent discoveries of large oil field in Tupi, Carioca, Iara and Guara are further expanding offshore drilling into pre-salt fields. Significant potential growth and undiscovered crude oil centers in the offshore and pre-salt sectors. Petrobras is the key player here.

These recent discoveries of large oil fields have highlighted potential sector growth and have further fueled development. The oil sector is thus expanding upstream, investing heavily in exploration and production. Much like the mining industry, this has generated an increased demand in service, supply, and equipment sectors in order to service the expanding upstream oil industry.

Downstream development is also active with increased investments in refineries, strengthening demand for its own equipment, supply, and service sectors. Heavy investment in refineries and support sectors are reinforced by government objectives to export more processed oil over crude oil (sold a lower price), in order to generate more revenue for the state. Additionally increasing

[22] Ontario Ministry of Economic Development and Trade. “The Brazilian Oil & Gas Sector.” July 2010.

processed oil production will decrease dependence on foreign suppliers, attempting to meet domestic demand and creating jobs for local workers.

As mentioned, the largest operator in this industry is Petrobras. Petrobras operates in all major sectors of the oil industry, including exploration, production, refining, transport, distribution, and supply. As such it has very high buying power in the industry, and strong influence over companies in the supporting sectors that work closely and often with the oil giant. In addition to Petrobras and its subsidiaries, other major oil and gas operators include Brazilian & Gas Institute, BG do Brasil, BP Brasil, Chevron Brasileira de Petróleo, El Paso Óleo e Gás Brasil, Esso, Repsol Ypf Brasil, and Shell Brasil, among others.

In terms of investment, Petrobras maintains close relations with the Brazilian National Development Bank (BNDES), federal authorities, as well as its own government committee. As such Petrobras' investment plans are key triggers and indicators of larger sector growth and expansion. In 2011, Petrobras announced an aggressive development plan. It leads the industry with a proposal to invest US$224.7 billion between 2011 and 2015. Of this figure, 95% will be invested domestically in Brazil, while 45% of the total investment will be dedicated to pre-salt fields. Moreover, of the total, 57% will be invested upstream in exploration and production, while 31% will be invested downstream in refining, transportation, and marketing. By 2020, total oil production is expected to double.

With impressive expected investments and established competitors in this industry, exponential growth is likely to continue. While the dominance of large players, particularly Petrobras, limits involvement, supporting sectors and supply chain contributors linked to industry growth hold valuable opportunities.

<u>Equipment</u>: Required equipment for the oil industry varies based on upstream (exploration and production) and downstream (refining and transportation) usage, but can include motors, turbines, screw compressors, heat exchangers, lifeboats, corrosion-resistant steel, chrome steel, valves, and the like. Major players, like Petrobras, emphasize national processes and thus have created obstacles for foreign companies to supply equipment directly to Petrobras. Joint ventures are common. Domestic companies often have bottlenecks in local production, and welcome partnerships with foreign companies. Depending upon the types of equipment, this sector feeds into both upstream and downstream industry expansion. Firms of interest here include:

> *Lupatech* is a producer and supplier of equipment components. It is an expanding domestic company and a strong local firm in Brazil. Its main customer is Petrobras, and has strong, established local relationships.
>
> *Braskem* is a supplier and producer of thermo-plastic resins and material, part of the larger plastic productive chain.

<u>Refineries</u>: Part of downstream industry activities, refineries process the crude oil extracted. This segment also includes transporting both the crude oil to the refineries and the finished petroleum products to the retail terminals, most often via pipelines. Further expansion of refineries is promoted by government strategy to increase finished product exportation and domestic self-sufficiency. This sector has received increased investment in updated plans, and is an attractive growth sector. Firms of interest here include:

Ipiranga is a refining company and retail outlet provider in the petrochemical sphere. It was recently purchased by other industry players.

Marine: The marine segment includes port management, operation, floating units and storage, oil tankers, maritime firefighting, and oils spill response, namely all water aspects of petrol transportation. This is a particular growth area, due to combination of the lack of local expertise and the boom in interest and expansion in the offshore and pre-salt oil extractions. In terms of pre-salt field exploration and production, the maritime space of shipyards and offshore construction need to be further developed. Companies like Petrobras have expressed the need for maritime development in their extended supply chain systems. Firms of interest here include:

OSX is a manufacturer of offshore platforms and rigs. It has worked with major industry players, providing service for infrastructure requirements, platform units, and leasing.

Maritima Petroleo e Engenharia is a large supplier of floating oil units and also works as outsourced help for project engineering and material acquisition.

Service and Supply: This segment centers on companies that provide services, supplies, design, and engineering support for exploration, drilling, refining and other operations. The service sector is another area in need of development due to rapid industry growth, and again particularly due to the novelty of pre-salt field discoveries. There is growing demand for firms with local service, engineering expertise, and technological knowledge, specifically of drilling and offshore penetration. Firms of interest here include:

Companhia Nacional de Dutos (CONDUTO) is an engineering company providing service and expertise in pipeline construction and installation.

(2) Mining Industry & Supporting Sectors

Mining is becoming another growth industry. The mining sector grew five times between 2000 and 2008, accounting for 2% of GDP with US$23.95 billion. While 2009 saw a decrease in production due largely to the economic crisis, 2010 reported over US$35 billion with annual rising growth of 10 to 15%.[23] By 2014, estimates place the mining industry at US$46.44 billion.

The mining sector in Brazil produces 21 metals, 45 industrial minerals, and four fuels, with a total of 70 mineral products. Iron ore is the dominant product, accounting for nearly 83% of all Brazilian metal exports, followed by gold. Phosphate, potassium, and zinc are of growing importance in the industry as well. Mineral production is dominated by 15 major domestic and international companies, including Vale, CSN, Anglo American, MMX, Samarco, Mineracao, Rio Do Norte, Alcoa, CBMM, Votorantim, Anglo American Brazil, Yamana, and Kinross.

In terms of investment, the Brazilian Mining Institute (*Instituto Brasileiro de Mineração*, IBRAM) expects a total of US$54 billion to be invested in the sector between 2010 and 2014. The investment potential is matched by the immense geological potential, in that only 30% of the country has been explored. Approximately 70% of Brazil has yet to be systematically and scientifically mapped. Another driving factor of continued sector expansion, is the trade

[23] Engineering & Mining Journal and Global Business Reports. "Brazil Mining 2011." February 11, 2011.

relationship with China. China has a significant and perpetual demand for raw materials, of which mineral products play a major role. Additionally, President Rousseff was a key proponent of mining development in the 2000s, her recent election suggests further support for the industry. The government itself has a 20-year strategic plan through 2030 that seeks to streamline mineral production with domestic market potential and demand. The plan also emphasizes an industrial shift further downstream. Set-backs to sustained growth, however, are visible and include deficient infrastructure, limited qualified labor force, and scarce geological data.

The mining sector has a complex supply chain that links several related industries. These supporting segments are both integral to overall mining production and linked to the same trajectory of growth and development. These upstream and downstream activities should be considered when tracking the expansion of mineral production.

<u>Engineering, Consultancy, and Services</u>: Firms such as Camargo Correa, GeoSol, Master Drilling, SRK Consulting, AMERC, and Ausenco are some major players in this sector. The majority of engineers and consultants in the domestic arena are Brazilian. Engineering firms like Progen and Brasfond have strong domestic expertise. However joint ventures between international companies and domestic firms have become a growing trend. In terms of services, there is significant potential for growth predicating on the range of challenges and functions in the mining industry. Although many companies are adding in-house service components, service companies will continue to be important.

<u>Machinery Manufacturing and Equipment Supply</u>: The supporting equipment and machinery industries generate US$80 billion per year. This is a more mature market than that of the service segment. The majority of suppliers are located in Brazil with local manufacturing capacity. Companies include Metso, Komatsu, Cat, FLSmidth, and Cummins. Due to the progress of technology in the larger industry as well as the abundance of raw material, supply of specialist equipment, produced by domestic and international firms, is in strong demand.

<u>Capital Goods and Heavy Industry</u>: The capital goods and heavy industry is a mature market comprised of several dominant large companies, including Caterpillar, Volvo, Metso, ESCO, and Atlas Copco, most of which have manufacturing bases in Brazil. Technologically-advanced and technology-focused firms are also a growing influence in this sector, including companies like Technometal, SEMCO, CEMI, and Enfil. Due to large scale competition dominating the capital goods sector, competitive companies focus on services-provided and value-added.

<u>Geophysical Scanning Services</u>: As mentioned above, 70% of Brazilian land is uncharted and full mineral potential and location is unknown. This type of scanning and mapping service is thus a major opportunity. The government agency known as the Brazilian Geological Survey (*Companhia de Pesquisa de Recursos Mineirais*, CPRM) is currently developing the geological mapping of Brazil. However CPRM lacks the work force to properly and expediently explore a country as large as Brazil. Private science and research companies would be a desirable outsourcing or consulting option for large competitors like Vale.

<u>Drilling Services</u>: Independent drilling operators dominate this market. These drilling contractors include the market leader GeoSol, as well as many family-owned Brazilian firms. As mining industry and resource growth urges operational firms to expand their projects, budgets, and

exploration, more opportunities become available for drilling operators. A larger variety of independent firms will be contracted.

Financial Services: As of early 2011, the commercial lending rate in Brazil was 11%. Based on the mining industry's value chain and operational demands, this rate is extremely high and considered by most in the industry to be 'prohibitive.' Many companies return government licenses due to insufficient access to necessary credit. As such, international funding is very common in the mining industry. Companies willing to finance endeavors as well as companies able to connect local firms to larger investors, have a strong and growing opportunity in this arena, particularly as more natural resources continue to be harvested.

(3) Infrastructure Industry & Supporting Sectors

Investment in infrastructure has been deteriorating over the past few decades. In the 1970s infrastructure spending averaged 5.4% of GDP, in the 1980s it averaged 3.6%, in the 1990s 2.3%, and in the 2000s only 2.1%. Several studies suggest that a minimum of 2% investment is needed to simply sustain current infrastructure in Brazil. Not surprisingly, in comparison to its fellow BRIC countries, Brazil is under-investing. While Brazil's overall ratio of investment to GDP is 17%, that of China is 44%, India is 38% and Russia is 24%.[24]

With this in mind, infrastructure is becoming a high opportunity sector for Brazil. In the immediate future, Brazil has four driving factors highlighting the importance of investments in infrastructure. These factors are: the 2014 World Cup, the 2016 Olympics, the government Growth Acceleration Program (*Programa de Aceleração do Crescimento*, PAC), and the major development of pre-salt oil reserves.

The Brazilian National Development Bank (*Banco Nacional do Desenvolvimento*, BNDES), responsible for public spending and concessionary processes, has estimated infrastructure investment will total R$274 billion between 2010 and 2013. This will be distributed among on Electricity (34% of total), Railways and Sanitation (25%), Telecommunication (24%), and Ports, Highways and Airports (17%). This investment has therefore signaled future industry potential and development. The major areas within the infrastructure expansion plan each have opportunities and peripheral sectors connected to industry growth.

Electricity spending will likely center on hydroelectric plants, dictated by the PAC program and through BNDES support. This funding will constitute annualized investment growth of 6%. The telecommunications sector will receive stable financial support to maintain minimum investment regulations as well as advance technologies and progress market niches. This sector was recently privatized and is currently consolidated to several major players. Railways will be infused with significant funding, for 13% annualized growth of investment. The main driver will be to expand existing networks. Similarly, highway investment will be linked to the extension of current systems as specified in the second stage of the PAC program, representing an 8% annualized increase in investment. Lastly, ports are anticipated to have the strongest growth within the

[24] Morgan Stanley. "Brazil Infrastructure: Paving the Way." May 5, 2010.

infrastructure industry. While spending will triple, average annualized growth will be 25%. Newly privatized, growth will be contingent on the implementation of ports by the private sector.

The private sector has contributed nearly 90% of total investment in Brazil since 2000, while the public sector has contributed 10%. However in terms of infrastructure development, funding has been shared equally. In addition to public and private institutions, state-owned-enterprises (SOE) have become major investment contributors. Particularly federal SOE participation, like that of Petrobras in the oil industry, has been rising. All of these entities have heightened interplay in the infrastructure segment due to the magnitude and plentitude of projects.

A common spotlight area in Latin America, infrastructure is fiscally appealing due to domestic benefits, like job creation, residual growth potential, and lessened bottlenecks in key industries that rely on transport and large scale supply chain. Augmented by renewed urgency from the international games in 2014 and 2016 as well as domestic plans from the PAC and oil reserve expansion, the infrastructure segment is ripe for investment. However as such investment is expansive, targeting key complementary sub-sectors in the larger infrastructure industry can often be more attractive.

<u>Steel & Basic Materials:</u> Basic materials are intrinsically linked with the construction and infrastructure industry. The demand for and consumption of these materials, particularly steel, will be driven higher by infrastructure spending and progress. In addition to growth from the World Cup and Olympics, the government PAC program, particularly the Minha Vida housing projects will generate significant incremental steel consumption. These 'event-driven' investments provide an opportunity in the basic materials and steel sectors. Target firms include *Gerdau* and *Usiminas*.

<u>Transportation</u>: Highways and railways are a major component of the infrastructure sector and a primary government focus for spending. Opportunities within this sub-sector stem from BNDES-supported ventures and concession biddings for private or joint projects. Companies like America Latina Logistica (ALL) and CCR, are prime examples of firms with experience in this segment and the financial capacity for funding upcoming initiatives. Local companies have dominated bidding for projects. As such, international construction companies have been limited in opportunities in this sector without the involvement of a local partner. Within the transport sector, concession and partnership projects have helped to nearly double the volume of transported goods since 2000. Specifically, domestically transported railroad cargo increased from 21% in 2001 to 25% in 2007. Moreover, the quality and conditions of privately-constructed roads, as compared to publicly funded roads, supports future employment of concession projects.

Domestic companies vying for similar and smaller transport concessions provide investment and partnership opportunity. Firms of interest here include:

> *Embraco-Empresa Brasileira de Construção Ltda*
>
> *Companhia Brasileira de Fibras – Tarumã*
>
> *Ivai Engenharia de Obras* is involved in the execution of transporting earth, paving, and asphalting, and the construction of bridges, ports, dams, sanitation and the like.

Brazilian Middle Market & Consumer Goods Opportunities

In line with these growth industries and larger fiscal and political expansions, Brazil is experiencing a demographic phenomenon. This economic development has contributed to a shift in the composition of the Brazilian population and of the breakdown of the social classes. The traditional disparities of wealth and uneven income distribution in Brazil have been restructured, creating a new socio-economic middle class. This new population segment has emerged as a new economic target and prospect.

The Brazilian population has traditionally been categorized by five socio-economic classes, A through E, in accordance with monthly earnings. Increased consumption, greater access to credit, investment in production, and job creation have fueled the addition of over 14 million people to the labor force since 2003. A growing and influential consumer market has been assembled from the upward mobility of this previously unemployed and low-income population.

According to a 2011 Getúlio Vargas Foundation (*Fundação Getulio Vargas*, FGV) study, this demographic restructuring resulted in an impressive boom of growth for the middle class bracket. This bracket, known as Class C, is defined as having a monthly household revenue of R$1,200 to R$5,174. For the first time in the country's history, class C comprises both the largest share of the Brazilian population as well as the largest share of wealth. In 2010, nearly 102 million people were counted in the C-class, which is 53% of the total population. Since 2003, 39.5 million people have joined this new middle class.

Brazil's Population Breakdown: Growth of Class C

(Getúlio Vargas Foundation 2011 survey: "Os Emergentes dos Emergentes")

	2000	2010
Class AB	15%	22%
Class C	34%	53%
Class DE	51%	25%

	2000	
	Population	Percentage
Class AB	26.421.172	15%
Class C	62.702.248	34%
Class DE	92.936.688	51%
Total	182.060.108	100%

	2010	
	Population	Percentage
Class AB	42.195.088	22%
Class C	101.651.803	53%
Class DE	47.948.964	25%
Total	191.795.855	100%

In terms of private individual wealth, Class C comprises 46% of national income, which is greater than the 44% contributed by Class A and B combined. This is a significant development, as in 2003, Class C was responsible for only 37% of the nation's wealth.[25]

In terms of consumerism, the Brazilian consumer market expanded by more than 50 million people. Current estimates reveal 44% of all Brazilian consumers come from Class C. In 2010 Class C became the leading consumer of electronics, household appliances, and food products.

[25] Meio & Mensagem, "Brazilian Population Data." June 2011.

These emerging households in the middle market have become the main customers of products that were previously limited to higher income families. For example, Class C dominated 45% of electronics sales in 2010, up from 27% of the sales in 2003. This compares to a decrease in relative consumption from Classes A and B, reporting 37% of sales in 2010 as opposed to 55% in 2003. Similarly in the food industry, Class C purchased 41% of all long-life milk products and 39% of all condensed milk products sold in Brazil. These figures not only show the rapid growth and presence of the middle class, but also their newly dominant buying power in the market.

In the past, most companies, particularly international entities, targeted the higher income segments in Class A and Class B, with few exceptions targeting the low classes. On the whole however, the middle market of Class C has largely been ignored by the strategy of most industries and companies. With the remarkable growth of this segment, this trend is changing as companies begin to prioritize a strategic focus on the middle market. This class segment presents a wealth of opportunities for investors. While the electronics sector has already begun to report this type of impressive expansion, the food industry is on a similar trajectory. In fact, in correlation to middle class expansion, the packaged foods sector marked 44% industry growth in the past five years, generating US$105 billion in 2010.

With this in mind, the food industry is a particularly appealing area of investment and avenue into the new middle class market. Within the food industry, local and domestic Brazilian companies with the ability and impetus to zero in on this segment offer attractive partnership opportunities, on-site expertise, and brand name and reputation. Firms of interest here include:

> *Copacol* is a meat and food processor. It is a local Brazilian firm with complete national capital and backing. In 2010 the firm reported sales of R$1.1 billion.
>
> *Big Frango* is a meat company producing poultry and eggs. Based in Paraná, it is expected to earn R$1.5 billion in revenues by year end of 2011.
>
> *Grande Moinho Cearense* is a wheat milling company. Based in Fortaleza, the company generated R$205 million in operation revenue in 2009.
>
> *Itambe Laticinios* is a milk cooperative producing milk and other dairy products. On average, it generates R$2 billion in annual operating revenue.

Investment Targets: Taking Action

Depending on the capabilities, expertise, and assets of individual investors and companies, there are several angles in which to approach these industry and population segments and their respective firms of interest. This selection is a two-pronged process of industry and function – choosing *where* you want to enter the Brazilian market and then choosing functionally *how* you will enter.

First, determine to which industry you are most suited. The survey of these key segments above is a logical place to begin. Couple this with an internal survey reflecting individual or company priorities and objectives to best identify potential industries and sub-sectors. Matching international interest and local need is paramount to fiscal and organizational success in this sort of partnership arrangement.

Second, determine how you want to partner with local companies. The function-positions can include: (1) a financial backer, providing capital and international funding from assets abroad, (2) a supplier of operational support rooted in the international company's particular expertise from, (3) a provider of service consulting based on current company and personnel experience, or (4) a new Brazilian company or joint-venture to fill one of the voids or areas of opportunity mentioned above.

The next step in taking action towards launching investments in Brazil is to contact potential firms in your narrowed sphere of investment interest or specification. *Global Atlantic Partners do Brasil, Ltda* offers a strategic consulting initiative to do just this. Strategic consulting will help you explore and personalize the best industry and function for particular penetration. With an on-site office and contacts in place, we can facilitate interaction and connection with local and domestic Brazilian firms in the designated field. *Global Atlantic Partners do Brasil, Ltda* further provides its own on-site operational support for governance and compliance of the newly established venture.

Conclusion

The Brazilian market has undergone significant growth in the 21st century. In facing domestic growing pains and international externalities, Brazil is committed to stabilizing and codifying its recent expansions and developments. In line with this economic transition, the regulatory culture of Brazil has undergone its own reforms with the intention of streamlining business protocol. While progress has been and continues to be made, bureaucracy persists. By combining the knowledge of the investment environment and regulations, foreign investors can pursue the emerging opportunities in Brazil's growth industries and consumer markets, while having prepared for the unique complexities and potential complications. Taking action towards a partnership, in whatever capacity, with Brazilian firms, sub-sectors, industries, and market segments relies on the intersection of identifying local needs and prospective sectors and understanding your own abilities and objectives.

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Appendix I: Hypothetical Contact Questions

In order to extract valuable investment information, questions to ask a good resource or contact with knowledge of Brazilian industries and the middle market include:

1. Which sectors would you target to specifically penetrate the middle market?
    a. The electronics industry seems to have adapted, i.e. computer sales strategy is already focused on Class C. Similar story with packaged foods. Is basic foods relatively underdeveloped for this area? Specifically dairy? Grains? Produce? Frozen foods?
    b. Which sub-sector has the lowest barriers to entry? The least competitors?

2. If we assume the food industry is a good place to begin… Is it better (or beneficial) to target companies working with (through distribution, support, promotion) local grocery stores or the major chains? Better in terms of both degree of success as well as access to the opportunities.
    a. Would it be advantageous to directly invest in or partner with the distribution or retail companies?

3. Which types of companies are of interest or well-positioned to capture the middle market? Unaffiliated companies? Companies that are part of larger portfolios? Production-based or distribution-based?
    a. Any specific companies?

4. In targeting small and medium companies, do the local needs, and thus potential opportunities, seem to be primarily financial backing? Or operational partnership? Or services consulting?

5. Does there appear to be any advantage in introducing or pursuing a regional approach into the middle market segment?
    a. Brazil is such a large, diverse country, in which the regions differ greatly. Would it be effective to target urban versus rural segments? North versus south? Etc.

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