

From Multilatinas to Global Latinas

The New Latin American Multinationals

(Compilation Case Studies)



Vice Presidency for Sectors and Knowledge
Integration and Trade Sector
Office of Outreach and Partnerships
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This is an edited version and the views and opinions expressed in this publication are those of the authors and do not necessarily reflect the official position of the Inter-American Development Bank.

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Prologue

As economic and political power shifts worldwide, 'new champions' are emerging regionally that force us to rethink solutions to global and industry challenges.

How can old and new champions collaborate in a highly competitive global environment? Where are the natural areas of collaboration?

World Economic Forum. Davos. 26 January 2008

Introduction

A powerful new phenomenon is reshaping the dynamics of the global economy: the stunning rise of aggressive, globe-conquering multinational companies from *emerging economies*. Large-scale firms from countries in Asia and Latin America have finally come out of the shadows and are positioning themselves globally.

In 2006, Boston Consulting Group described this phenomenon as "a revolution in global business."¹ The same year *Business Week* magazine, followed by *Newsweek* in 2007, published cover stories on new corporate giants from emerging economies.² *The Economist*, for its part, made the following observation in 2007: "While globalization has opened new markets to rich-world companies, it has also given birth to a pack of fast-moving, sharp-toothed new multinationals that is emerging from the poor world."³

The emergence of regionally-based "multi-Latinas" - by definition, firms that leveraged domestic positions to expand their operations throughout Latin America -- first attracted attention in the 1990s. Today we are witnessing a new phase in which some Latin American firms are pursuing more aggressive expansions strategies on a global scale. Renewed interest in the subject is backed up by data. *América Economía* reported in 2007 that 334 of the top 500 Latin American corporations had revenues in excess of US\$1-billion.⁴ At the same time, the Economic Commission for Latin America and the Caribbean (ECLAC) observed that outward flows of foreign direct investment (FDI) from Latin America

¹ Aguiar, M.; Bhattacharya, A.; Bradtke, T.; Cotte, P.; Dertnig, S.; Meyer, M.; Michael, DC; Sirkin, H. *The New Global Challengers*. Boston Consulting Group, May 2006.

² "New Giants: Why the World's Hottest, Richest Companies are Rising out of Poor Countries", *Newsweek*, 8 October 2007.

³ "Globalisation's Offspring", *The Economist*, 4 April 2007.

⁴ Aldunate, F and Rodrigo Díaz "Bigger than Ever", *América Economía*, September 2007.

had “skyrocketed” to more than US\$40-billion in 2006 – an increase of 115% over the previous year -- offering proof that these firms are “active participants in internationalization processes, especially outside the region.”⁵

As a *New York Times* article put it in early 2007: “The new ‘multi-Latinas’ are aggressive enterprises that are a developing byproduct of the market liberalization that swept Latin American economies in the 1990s. But their broadening reach through the United States and the rest of the world – simmering below the surface for years – is beginning to turn heads.”⁶ We call these new firms “Global Latinas” defined by the following criteria⁷: *ownership; geographical reach; and annual revenues.*

First, an ownership criterion restricted our list to firms that are owned and controlled in a Latin American country. In doing so, we excluded Latin American firms acquired or controlled by non-Latin American multinationals corporations (MNCs) and 100% state-controlled firms. This immediately disqualified the biggest two oil corporations in Latin America: Petróleos Mexicanos (PEMEX) and Petróleos de Venezuela (PDVSA). Petrobras, however, was included in our sample, as an illustration of a successful privatization and the achievement of technological leadership.

Second, according to our geographical reach a Global Latina must own operations beyond Latin America on at least one other distinct geographic area (e.g. North America, Europe, Asia-Pacific or Australia), and preferably on two or more. In our view, the move into a developed country represents a certain grade of “coming of age”. We defined operations as corporate offices⁸ or assets such as manufacturing facilities, Research & Development (R&D) centers, and so on. This excluded any Latin American firm, however large, which operates only in Latin America.

Third, we established a minimum annual revenue threshold of US\$500-million. This figure – set by the World Economic Forum as a minimum threshold for Global Growth Companies – allowed us to widen our sample firms beyond traditional large-scale corporations in resource and industrial sectors. We made some exceptions, however, in our “emerging” Global Latina category by including medium-sized firms with less than US\$500-million in revenues. By doing so, we brought into the sample a few emerging companies

⁵ Economic Commission for Latin America and the Caribbean (ECLAC) *Foreign Investment in Latin America and the Caribbean*, United Nations, May 2007, p. 15.

⁶ Clifford Krauss, “Latin American Companies Make Big U.S. Gains”, *New York Times*, 2 May 2007.

⁷ Financial institutions were excluded.

⁸ Mere trade representations have been excluded.

operating in sectors (business process outsourcing, restaurants, wine) that normally do not figure in established rankings of Latin American firms. However, these corporations all illustrate certain patterns that can serve as example and advice for other small and medium sized enterprises from developing countries and represent the backbone of most economies.

In sum, a “Global Latina” is defined as a privately owned, Latin American-based multinational firm with operations on at least one other foreign continent and which generates, with the exception of “emerging” firms, a minimum of US\$500-million in annual revenues. In this report, we will seek to provide answers to the following questions about Global Latinas.

First, why have Latin American firms emerged and expanded beyond their own regional markets?

Second, what strategies did the Global Latinas adopt to expand their operations?

And third, what are Global Latinas’ unique characteristics (especially regarding their business model, strategy and operations) that differentiate them from multinationals corporations from developed economies?

This introduction is structured in four parts. First, we will set the emergence of Global Latinas within a historical context. Second, we will trace the recent emergence of these firms. Third, we will outline the main drivers for their international strategies. And fourth, we will outline the analytical approach and methodology of this report.

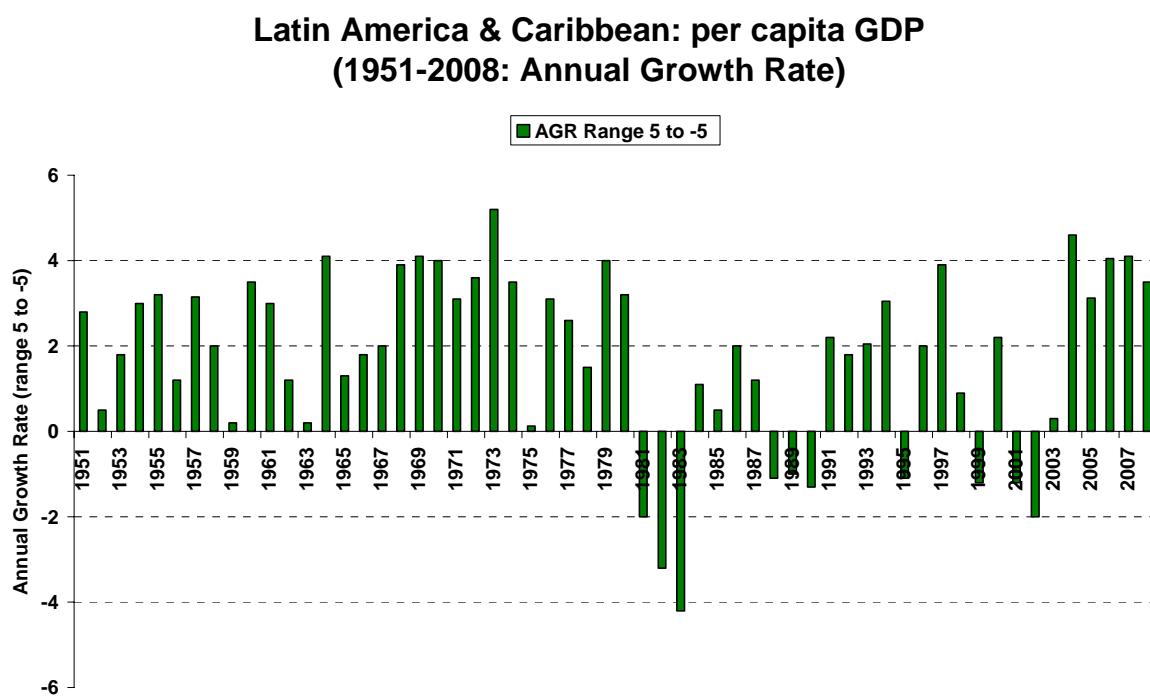
i) Historical Context

Historically, most economic analyses of business behavior in Latin America have tended to focus on the underlying causes for the paucity of globally-oriented Latin American firms: protectionist policies like import substitution and tariff barriers, captive local consumers, weak capital markets, low levels of R&D investment, complex and unpredictable political environments, and market domination by family-owned conglomerates.

The dominant position of family-owned firms is a legacy with deep historical roots. Latin American countries adopted the Napoleonic system of French civil law, which produced consequences following the emergence of capitalism because it provided less protection for minority shareholders and creditors than those found in legal frameworks in

Anglo-American countries and Germany. As a result, the growth of capital markets in Latin America was inhibited, and even today remains small in relation to the size of regional economies. Also, publicly traded companies have not always been attractive investments because of the small “floats” of traded shares. As *The Economist* noted in 1997, “this creates a vicious circle in which many entrepreneurs prefer not to issue public equity because they think the market will undervalue their firms.”⁹

Figure 1



Source: Authors based on data from ECLAC 2006 and 2007

The weight of this historical legacy favored the emergence of family-controlled companies, which tended to grow through diversification. This could be seen as a strategic response to foreign-exchange controls and import tariffs which frustrated internationalization strategies. In other words, family-owned local companies expanded in their domestic markets because of structural obstacles to international expansion. Also, diversification was a risk-reduction strategy against economic and political volatility. These factors, combined with state protections, facilitated the emergence of large-scale, family-owned conglomerates and the socio-economic consequences that it produces. Moreover, family-owned companies in Latin America tended to have highly conservative corporate cultures, particularly regarding debt, which in Anglo-American capitalism is deployed to finance expansion. Most

⁹ “Inside Story: Family Firms Still Rule”, *The Economist*, 4 December 1997.

Latin American firms have had relatively low levels of debt in relation to total assets. When not family-controlled, Latin American companies have often been state-owned and based largely in resources like oil, metals and gas – in other words, at the low end of the value chain.¹⁰

It was against this historical backdrop that Latin American firms began to emerge from their domestic markets to pursue internationalization strategies. As ECLAC observed in its 2006 study of “trans-Latins¹¹”, the internationalization of the region’s firms occurred in three successive phases. The first two phases -- in the 1970s and in the 1980s -- witnessed modest signs of internationalization. The third phase in the 1990s was characterized by more ambitious global expansion patterns.¹² We have identified a fourth phase, which began around 2002, when soaring commodity prices and high growth rates combined, along with strong demand from China, fostered a more aggressive global expansion by Latin American firms. This report focuses on the internationalization process of those firms during the third and fourth phases.

Phase 1 (1970-1982). Emerging FDI: In the 1970s a number of Latin American multinationals were part of a significant FDI wave from emerging economies. Most outward FDI flows from Latin America -- often *partnerships* driven by *market-seeking* strategies, and sometimes to bypass tariffs -- were “South-South” investments. Investment outflows were relatively modest during this period. It was during this phase that regional multi-Latinas first emerged establishing operations in neighboring countries to exploit “natural” markets elsewhere in the region.

“Natural markets”¹³, as defined by the author (Casanova 2002), are those following three criteria: geographical proximity, same linguistic sphere, and common historical links. Just as Latin America has been a natural market for Spanish companies, the Hispanic population of the United States provides a nearby natural market for Latin American firms, which can do business there with a high level of comfort and familiarity with consumer tastes and demands and Spain is often an entry point to Europe for Latin American companies. One

¹⁰ Jayant Sinha, “Global Champions from Emerging Markets”, *McKinsey Quarterly*, n°2, 2005.

¹¹ ECLAC defines “Trans-Latins” as emerging Latin American transnationals that have made direct investments outside their home countries, including those which have not gone outside Latin America. ECLAC. 2006. *Foreign Direct Investment 2005*. 2006

¹² *Foreign Investment in Latin America and the Caribbean*, ECLAC, United Nations, 2006, ch. III;

¹³ On “natural markets” see Lourdes Casanova, “Lazos de familia: Las inversiones españolas en Iberoamérica”, *Foreign Affairs* (Spanish version), vol. 2, n°2, May 2002; and Lourdes Casanova, “Telefónica, la creación de una multinacional”, *Síntesis*, 29-30, 1998.

of the findings of this report is that successful Global Latinas will be moving first into “natural markets” in their internationalization patterns.

Phase 2 (1982-1990). The Lost Decade. In August 1982, Mexico defaulted on its debt payments which produced a contagion effect of negative consequences for both *inward* and *outward* FDI flows in Latin America. Many large-scale Latin American corporations, especially in sectors protected by “import substitution” policies (car parts, textiles, steel) were either closed down or bought out by foreign MNCs. This setback had the effect of reversing the economic growth.¹⁴ Indeed, the 1980s is often referred to as the “lost decade” for Latin American business due to the debt crisis. However, in the late 1980s Latin American governments began to liberalize their economies through lower trade barriers, openness to foreign investment, and relaxed exchange controls. This process continued during the next decade. This gave Latin American firms an incentive to improve their competitive position and expand into other markets.

Phase 3 (1990-2002). The Washington Consensus years. The 1990s witnessed an upswing of both inward¹⁵ and outward FDI in the region due to a number of converging factors. Politically, the set of policies known as “Washington Consensus¹⁶” brought sweeping economic liberalization, including privatizations, in regulated industries such as telecoms, utilities, gas, and steel. As a result of these pressures, many Latin American governments abandoned their importation substitution policies and adopted more pro-market strategies encouraged by the International Monetary Fund and World Bank. Between 1991 and 2001, the number of state-controlled firms in Latin America fell from 20% to less than 9%.¹⁷ Latin American economies were also moving more swiftly towards integration into larger geographic spaces through liberalized trade treaties such as North American Free Trade Agreement (NAFTA) – between the United States, Canada and Mexico -- signed in 1994 and put into effect the following year. In this climate of economic liberalization, global MNCs were returning to Latin America.¹⁸ The combination of economic liberalization and MNC-triggered rationalization of domestic industrial and service sectors had a transforming impact on Latin American firms and, more generally, on the entire regional economy. Latin American companies had an incentive to consolidate their position domestically and

¹⁴ ECLAC. 2006. *Foreign Investment in Latin America and the Caribbean* 2005, ECLAC, United Nations, 2006, p. 66.

¹⁵ Lourdes Casanova, “East Asian, European, and North American Multinational Firm Strategies in Latin America”, *Business and Politics*: Vol. 6: No 1, Article 6. 2004.

¹⁶ The term “Washington Consensus” was coined in 1989 by John Williamson of the Institute of International Economics and advisor to the IMF. It entailed broad policy objectives such as fiscal discipline, competitive exchange rates, trade liberalization, privatization of state-owned assets, deregulation, and secure property rights.

¹⁷ “The Emergence of Latin Multinationals”, Deutsche Bank Research, 7 March 2007.

¹⁸ Martinez, Alonso; De Souza, Ivan; Liu, Francis. “Multinationals vs Multilatinas: Latin America’s Great Race”, *Strategy + Business*, 11 September 2003.

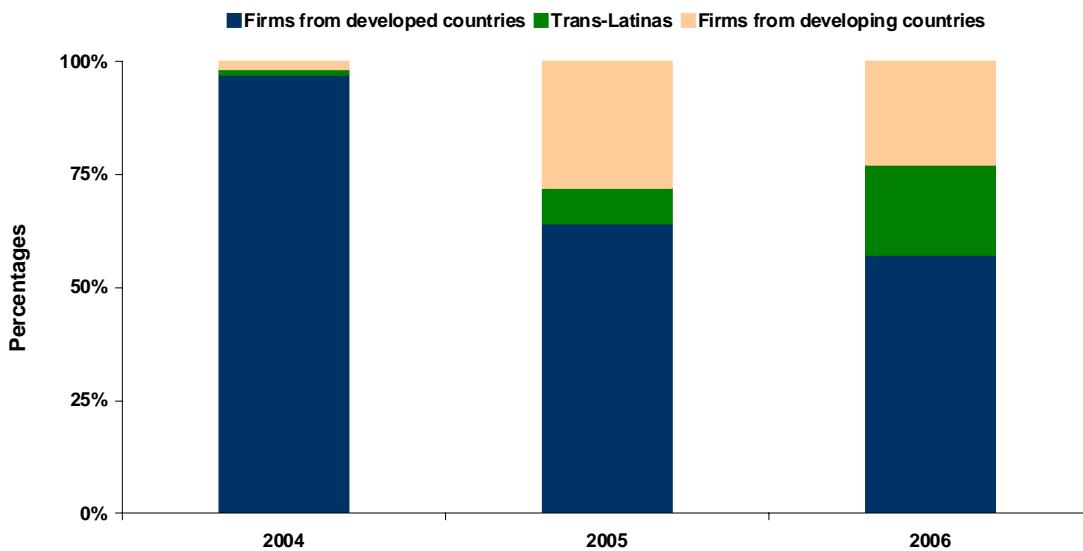
regionally by pursuing efficiencies, comparative advantages, and foreign financing – and, inevitably, to expand their operations internationally. It was during this period that Global Latinas as defined in this report emerged.

This third phase wave lost momentum, however, in the fallout of the 2000 stock market collapse triggered by the contagion effect of the Asian Crisis in 1997 and the Internet bubble meltdown in March 2000. The result was a sharp FDI downturn and economic slowdown in the region (the so-called ‘half-lost decade between 1997 and 2002¹⁹). At the same time, foreign MNCs operating in Latin America were avoiding risk and leaving the region. The anxiety of global MNCs actually opened up opportunities for large-scale Latin American firms, which were able to consolidate their position in local and regional markets by buying up assets of foreign banks, oil companies, and telecom players that were nervously withdrawing from the region.

Phase 4 (2002 onwards). Going Global. This phase began with the boom period since 2002. The ECLAC chart below highlights the growing role of Global Latinas in the region’s M&A activity.

¹⁹ Per capita output for 2002 in Latin America was almost 2% less than in 1997. José Antonio Ocampo, ECLAC’s Executive Secretary in ECLAC Notes (no 24 September 2002).

Latin America and the Caribbean: Composition of Acquisitions involving entries (2004-2006) Percentages



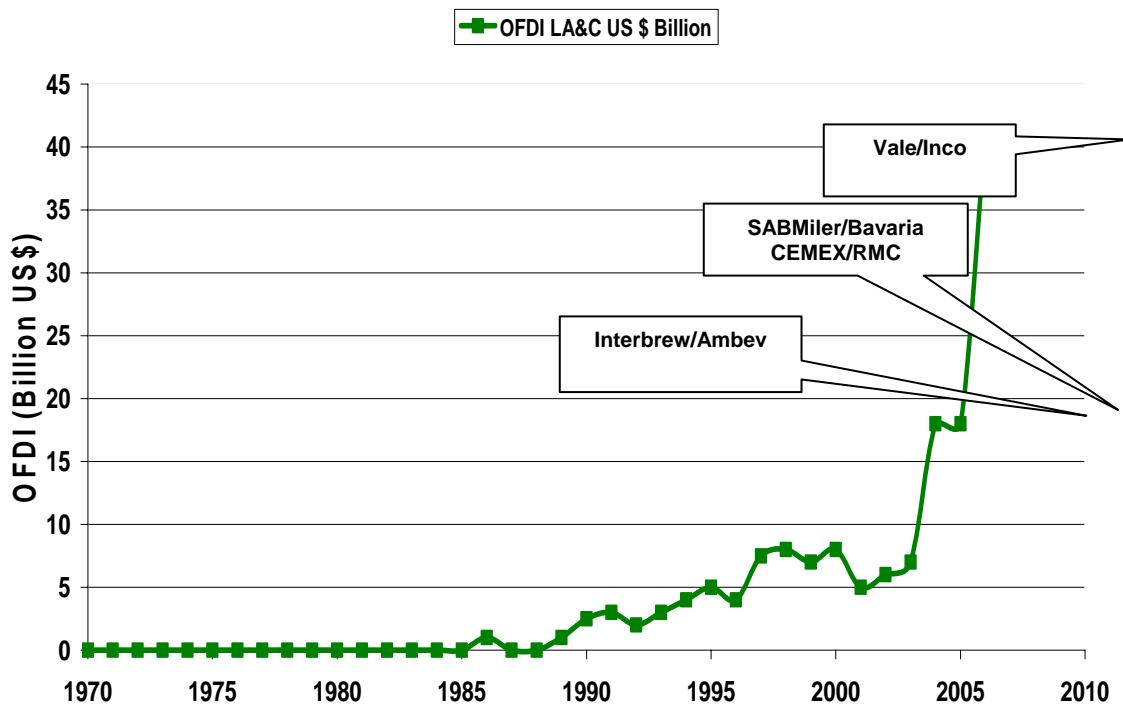
Source: Authors based on ECLAC 2007 and Bloomberg data

A sharp rise in commodity prices strengthened resource-based Latin American companies, whose strong cash position boosted regional economies – triggering the economic rebound. Levels of outward FDI from the region, especially in the form of large-scale asset acquisitions, went up.²⁰ As another ECLAC chart below indicates, outward FDI from Latin America has been soaring since 2003, largely driven by a small number of major transactions such as Mexican building materials giant CEMEX's US\$5.8-billion takeover of U.K.-based RMC Group in 2004, and the US\$17.8-billion all-cash acquisition of Canadian nickel producer Inco by Brazilian mining colossus Vale (formerly known as Companhia Vale do Rio Doce or CVRD²¹) in 2006.

²⁰ *World Investment Report 2006*, UNCTAD, 2006, p. 73.

²¹ CVRD changed the name to Vale on 28 November 2007.

Outward foreign direct investment (OFDI): Latin America and the Caribbean (1970-2006)



Source: Authors based on data from ECLAC 2006 and 2007

ECLAC²² notes, that while Latin America's FDI *outflows* have been soaring (US\$43-billion in 2006), the region's share of FDI *inflows* has actually been declining (US\$72.4-billion) as global investments shift increasingly towards Asia (notably China and India). The same report adds that, during the 1970s, Latin America represented 17% of total investment inflows. In 1997, the region's share hit a new high 16%, largely due to asset privatizations by many Latin American governments. In 2006, however, the region's share of global investments fell to 8% after averaging about 11% in previous years. The two main reasons for this decline were decreased investment by American corporations and, as noted, a shift in investment patterns towards China. The internationalization of local firms is taking off massively during this phase and our study will be mainly concentrated in this one with the emergence of Global Latinas.

²² Foreign Investment in Latin America and the Caribbean, ECLAC, United Nations, May 2007, p. 13.

Table A.1: Latin America, Internationalization Phases

<i>Phase 1</i> Emerging Foreign Direct Investment (1970–1982)		<i>Phase 2</i> 'The Lost Decade' (1982–1990)	
Selected Company milestones	Market characteristics	Selected Company milestones	Market characteristics
<ul style="list-style-type: none"> Exports to AirLittoral, France (Embraer, 1977) US subsidiary, Embraer Aircraft Corporation (Embraer, 1979) 	<ul style="list-style-type: none"> State protection facilitating the emergence of large-scale, family-owned conglomerates Family-owned local companies expanding in domestic markets Structural obstacles to international expansion Latin American companies start international expansion 	<ul style="list-style-type: none"> Consortium acquisition of California Steel Industries, US (Vale, 1984) Joint venture with Southdown, US (Cemex, 1986) Acquisition of Mrs Baird's, US (Bimbo, 1988) Acquisition of Sunbelt (JV:Southdown & Cemex, 1989) 	<ul style="list-style-type: none"> Mexico defaults on debt payments in august 1982 Beginning privatization, deregulation Internationalization slows down
<i>Phase 3</i> The Washington Consensus (1990–2002)		<i>Phase 4</i> Going Global (2002-Present)	
Selected Company milestones	Market characteristics	Selected Company milestones	Market characteristics
<ul style="list-style-type: none"> Acquisition of Valencia and Sanson, Spain (Cemex, 1992) Acquisition of Southdown, US (Cemex, 2000) 	<ul style="list-style-type: none"> Liberalization of Latin American economies, privatization of telecom, utilities, gas and steel, deregulation & the adoption of pro-market strategies Upswing of inward foreign direct investment Halving of the number of state-owned firms Purchase of foreign banks, oil companies and telecom players by MNCs (mainly Spanish) Ratified the North American Free Trade Agreement between the United States, Canada and Mexico (1994) Stock market collapsed triggered by the 1998-1999 Asian and Russian crises Multinational companies (MNC) start leaving Latin America, after 2000 Latin American firms consolidated their positions in local and regional markets at the end of the decade 	<ul style="list-style-type: none"> Acquisition of George Weston, US (Bimbo, 2002) Joint venture with Avic II (Assembly line), China (Embraer, 2002) Acquisition of Perez Company (Pecom), Argentina (Petrobras, 2002) Acquisition of Ogma, Portugal (Embraer, 2004) Acquisition of RMC Group, UK (Cemex, 2005) Acquisition of Verizon Dominicana (Dominican Republic), US (América Móvil, 2006) Acquisition of Panrico (China), Spain (Bimbo, 2006) Acquisition of Inco, Canada (Vale, 2006) Acquisition of Rinker, Australia (Cemex, 2007) 	<ul style="list-style-type: none"> Growing role of Global Latinas in region's merger and acquisition (M&A) activities Commodity boom strengthens resource companies Shift in investment patterns towards China Rising levels of Outward FDI Higher growth rates Bold takeovers, conquering of markets in the US & Europe Diversification of export basket, away from commodities

Source: Lourdes Casanova, Henning Hoeber and Samantha Rullán based on ECLAC (Economic Commission for Latin America and the Caribbean)'s ECLAC 2007 Statistical Yearbook for Latin America and the Caribbean and own research.

ii) Emergence of Global Latinas

The emergence of Global Latinas, it cannot be doubted, has been facilitated by a general context in Latin America of surging economic growth driven by high commodity prices.²³ From 2003 to 2007, while the growth rate for the entire region was roughly 5%, many Latin American countries were enjoying much higher GDP growth rates -- more than 10% in Venezuela and 9% in Argentina. Although these rates did not match those recorded in Asia, they were still impressive for the region, which was finally emerging from decades of political and economic crisis and instability.²⁴ At the end of 2007, Latin American countries boasted current-account surpluses, sound fiscal positions, growing foreign currency reserves, more flexible exchange-rate policies, low inflation, and expanding credit. There is now talk of a burgeoning "new middle-class" throughout the region. *The Economist* summed it up succinctly in mid-2007: "Adiós to poverty, hola to consumption".²⁵

Against this backdrop of economic boom, Global Latinas are making headlines as they expand their operations through bold takeovers as those just mentioned by CEMEX and Vale. In the fallout of these mega-deals, Global Latinas and the executives who run them are becoming internationally famous. In June 2005, a formerly obscure Guatemalan business executive, Juan José Gutiérrez, made the cover of *Newsweek* for a special feature called "Super CEOs". The magazine cited Gutiérrez, chief executive of the Guatemala-based restaurant group Pollo Campero, as a business leader who is "sparking a revolution in corporate strategy". In July 2007, news outlets worldwide feverishly reported that the richest person in the world was a relatively unknown Mexican business titan, Carlos Slim, founder of mobile telecom giant América Móvil. Slim's personal fortune, pegged at US\$67.8-billion, was apparently big enough to dislodge Microsoft billionaire Bill Gates from his long reign atop of the *Forbes* billionaire index.²⁶

Cold numbers provide quantifiable evidence of macro-economic factors driving the emergence of Global Latinas. Worldwide investment flows were soaring in 2006, reaching US\$1.3-trillion -- a 38% increase over the previous year. These flows continued to be dominated by MNCs from industrialized economies – US\$857-billion in investments among

²³ Pablo Gerchunoff, "Latin America's Era of Milk and Honey", *Latin Business Chronicle*, August 2007. For a detailed economic study of economic growth in Latin America, see "Economic Growth in Latin America and the Caribbean: Multiple Growth Transitions in the Absence of Steady States", in *Economic Survey of Latin America and the Caribbean 2006-2007*, ECLAC, United Nation, July 2007.

²⁴ *Foreign Direct Investment in Latin America and the Caribbean*, ECLAC, United Nations, May 2007. ECLAC reported that the average growth in emerging countries was 6.5%.

²⁵ "Latin America's middle class: Adiós to poverty, hola to consumption", *The Economist*, 16 August 2007.

²⁶ "Carlos Slim's Fat Fortune", *Business Week*, 4 July 2007; "Mexico's Carlos Slim Now World's Richest Person", *International Herald Tribune*, 3 July 2007; "Carlos Slim, the Richest Man in the World", *Fortune*, 20 August 2007; and "The World's Billionaires", *Forbes*, 3 August 2007.

developed countries, and a record high of US\$379-billion invested by developed countries in emerging markets. More significantly, FDI outflows from emerging countries reached US\$193-billion -- remarkable growth over a timeline of a few decades. As the ECLAC chart below clearly indicates, whereas in 1970 outward foreign direct investment from emerging markets was virtually non-existent, by 2005 it had grown to nearly 16% of the total flows. The most rapid growth has occurred since 2003.

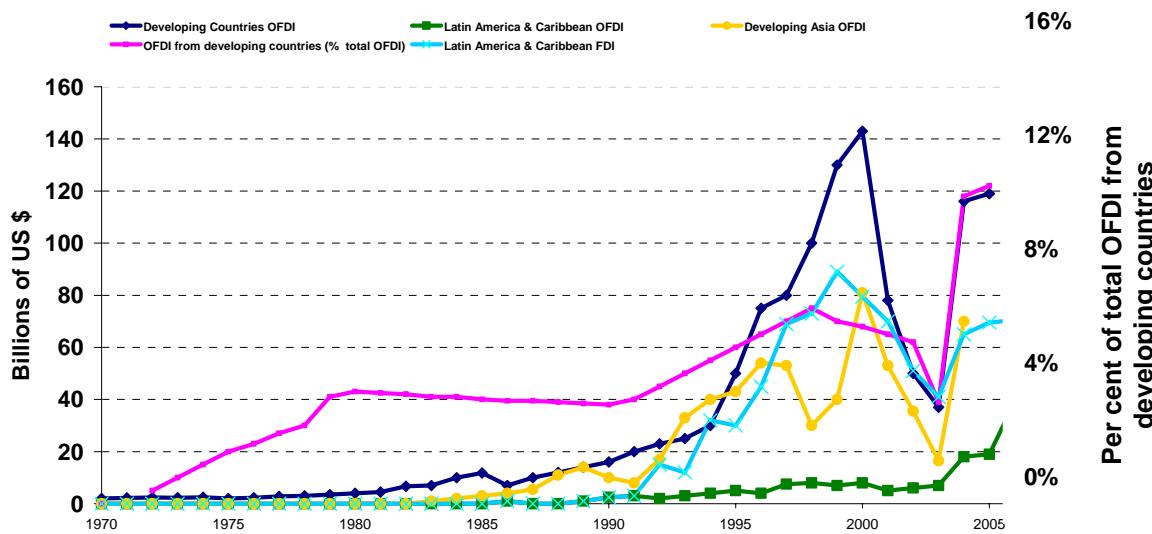
Brazil led the regional surge of FDI outflows with US\$28.2-billion in investment outflows totaling as already stated US\$40-billion. The sectoral drivers for this phenomenal outward FDI growth were primarily the mining sector, resource-based manufacturing, and telecommunications.

This trend marks a new phase of globalization characterized by outward investment flows in *two* directions simultaneously. First, MNCs from developing countries are increasingly investing in other *emerging* markets – or “South-South” investment flows.²⁷ Second, MNCs from these same emerging economies are conquering markets in the United States, Europe, and elsewhere in the industrialized world (“South-North” investments). There is a direct link between increases in FDI outflows and overall economic conditions. As the ECLAC chart below shows, FDI outflows from Latin America and Caribbean (the bottom curve) increased during the economic boom in the mid-1990s, decreased during the downturn from 1997 to 2002, and then rebounded with the updraft that has created the most recent boom in the region.²⁸ As the graph indicates, while Latin America’s international investments clearly increased after 2002-2003, they were no match for the outward investment patterns of developing Asia corporations.

²⁷ For more on “South-South” flows, see *World Investment Report*, UNCTAD, 2007; and Aykut, Dilek: Goldstein, Andrea. “Developing Country Multinationals: South-South Investment Comes of Age”, OECD Working Paper No. 257, OECD Development Centre, December 2006.

²⁸ For an idea of the economic impact of this crisis, according the World Bank the region’s average GDP per capita in 2002 was 2% lower than in 1997.

Outward and inward foreign direct investment from and to developing countries (1970-2006: Billions of US\$)



Source: Authors, based on data from the Economic Commission for Latin America and the Caribbean (ECLAC) 2006 & 2007

Note: Estimations were made, by the author, for the % of OFDI from developing countries from 1970-1999, FDI from Latin America & the Caribbean from 1970-1991 and developing countries OFDI from 1970 to 2000.

In this overall context, Latin America's largest companies enjoy dominant positions in their home markets. Others have emerged as state-backed "national champions" -- defined as state-sponsored firms protected from domestic competition and benefiting from government support for exports -- designated vehicles for national industrial policies such as employment, economic growth, and international prestige. Alongside these Latin American champions, however, a new breed of Global Latinas was emerging in a diverse range of sectors -- to name only a few, Mexico's Bimbo in baked goods, América Móvil in wireless telecommunications, Guatemala's Pollo Campero in fast food, Brazil's Politec in Information Technology (IT) services, Chile's Concha y Toro in wine; and Brazil's Natura in cosmetics. Indeed, Latin America's export basket has significantly diversified away from commodities, which declined from 50% to less than 30% of total exports in the two decades since the mid-1980s.²⁹

Evidence of this growing diversity was provided in 2007 by *Latin Trade's* "Top 500", which included a sector-by-sector ranking measured in terms of total trade. Although the largest sector was oil & gas representing 30% of total sales, service and manufacturing sectors were also significant: retail (10%), telecom (8%), food & beverage (6%), electricity (7%), steel (5%), chemical (3%), and automotive (6%). *Latin Trade's* 2007 ranking of top firms forecasting

²⁹ "Assessing Latin American Competitiveness: Challenges and Opportunities", in *The Latin American Competitiveness Review 2006*, World Economic Forum, Davos, 2006.

future growth included Vale (mining), Embraer (aircraft), América Móvil (telecom), CEMEX (building materials), Bimbo (food), and Natura (cosmetics).³⁰

The trend towards increased outward FDI from emerging economies is also reflected in the number of multinationals from emerging economies listed in the *Fortune's "Global 500"*, the ranking of the world's largest corporations by revenues – a total of 68 (or 13% of the total 500). However, only 10 Latin American companies -- five from Mexico and five from Brazil -- made the list:

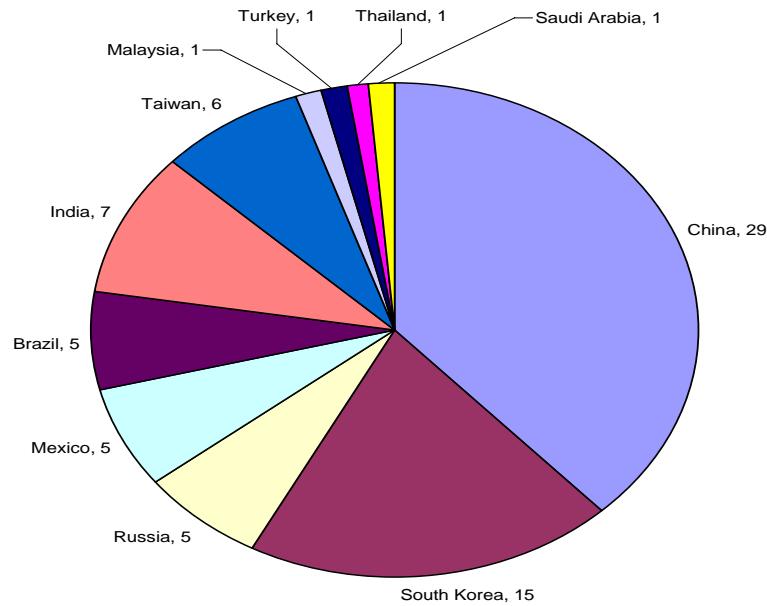
³⁰ "Top 500 Companies in Latin America", *Latin Trade*, July 2007.

Latin American companies in the <i>Fortune Global 500</i>					
1987			2008		
Rank	Company	Country	Rank	Company	Country
26	Petrobras	Brazil			
40	Pemex	Mexico	42	Pemex	Mexico
49	Petróleos de Venezuela	Venezuela			
			63	Petrobras	Brazil
138	Yacimientos Petrolíferos	Argentina			
			204	Bradesco	Brazil
			235	Vale (formerly CVRD)	Brazil
			273	Itaúsa-Investimentos	Brazil
			282	Banco do Brasil	Brazil
			283	América Móvil	Mexico
335	CVRD (now Vale)	Brazil			
340	Codelco	Chile			
362	Empresa Colombiana de Petróleo	Colombia			
			389	Cemex	Mexico
405	Sidor	Venezuela			
408	Ford Brasil	Brazil	408	Comisión Federal de Electricidad	Mexico
409	Industrias Votorantim	Brazil			
436	General Motors do Brasil	Brazil			
456	Grupo Alfa	Mexico			
			464	Carso Global Telecom	Mexico
485	Chrysler de Mexico	Mexico			
500	Siderúrgica Nacional	Brazil			

Source: Lourdes Casanova, Henning Hoeber and Samantha Rullan based on data from *Fortune Global 500* of 1987 and 2008.

This number does not compare favorably with the 153 corporations from the United States, 39 from France, 34 from Britain, 14 from Canada, and 11 from Spain. The score for the entire Latin American region was not only low compared with these industrialized countries,

but also with other emerging countries (see table below), where 29 firms were from China and 7 from India.



Source: Lourdes Casanova and Henning Hoeber based on data from Fortune Global 500 (2008).

Whereas the revenues of the 10 listed Latin American multinationals were US\$406.44-billion, the 29 Chinese firms in the same “Global 500” ranking produced total revenues of nearly US\$1.14-trillion. Furthermore, the number of Latin American firms in the ranking – i.e. 10 – has declined in the past twenty years. If we look at the Latin American firms in the July 1987 Fortune Global 500 edition, we find 14 companies from a variety of countries beyond Brazil and Mexico (the only ones represented in 2008): Chile, Colombia, and Venezuela (see chart below). If we exclude the three automotive companies from the United States (Chrysler, Ford, and General Motors), the total number is 11.

It must be noted, therefore, that the rise of Global Latinas is still in its early phase and limited to a relatively small number of firms.

iii) Drivers for Internationalization

A number of studies have attempted to explain why Latin American firms have pursued international strategies. As noted above, there is no shortage of analysis focusing on the factors that have constrained Latin American firms from expanding internationally. As

Jayant Sinha (2005)³¹ observed, protected domestic firms, high tariffs, underdeveloped capital markets, inadequate levels of R&D, family-owned conglomerates with risk-averse corporate cultures, and turbulent political and economic climate frustrated the emergence of globally-oriented Latin American firms.

Yet as Pablo Haberer from McKinsey (2007)³² has noted, some of the same factors that had long held back Latin American firms suddenly became competitive advantages that could be strategically exploited: catering to low-income and price-sensitive consumers, familiarity with challenging distribution systems, pragmatic knowledge of complex political and regulatory environments, and lessons learned from domestic competition with foreign MNCs. In a word, many Latin American firms, making a virtue of necessity, were forced to adopt *innovative* strategies as a matter of survival.

Latin American multinationals also faced commercial pressures in their domestic markets after liberalization reforms. When governments liberalized their economies in the late 1980s and in the 1990s, domestic firms could no longer count on the state protections which, in many countries, had been institutionalized through import substitution policies. Liberalization policies also brought increased competition from foreign MNCs acquiring local industrial assets, often purchased from Latin American governments selling off state-owned companies to shore up their debt-heavy treasuries. As Khanna and Palepu (2006)³³ have noted, competing with global MNCs in their own backyard was challenging for domestic firms because foreign corporate giants had ready access to international capital markets, top-flight executive talent, powerful brands to leverage, and leading-edge technology. But as Dawar and Frost (1999)³⁴ have said, Latin American entrepreneurs had “contender” attitudes that drove them to upgrade and expand their operations in order to compete and survive. In do-or-die situation, they had to restructure, upgrade, acquire know-how, and expand internationally. Indeed, as Andrea Goldstein has argued (2007)³⁵, those Latin American firms that succeeded were the ones that responded structurally to liberalization in order to develop competitive advantages.

³¹ Jayant Sinha, “Global Champions from Emerging Markets”, *McKinsey Quarterly*, n°2, 2005.

³² Interview with authors, August 2007; and Pablo Haberer and Adrian F. Kohan, “Building Global Champions in Latin America”, *McKinsey Quarterly*, 2007, in special edition: *Shaping a New Agenda for Latin America*.

³³ Khanna, Tarun and Palepu, Krishna. “Emerging Giants: Building World-Class Companies from Emerging Countries”, Harvard Business Review Article, 17 October 2006.

³⁴ Kiraj Dawar and Tony Frost, “Competing with Giants: Survival Strategies for Local Companies in Emerging Markets”, *Harvard Business Review*, March-April 1999.

³⁵ Andrea Goldstein, *Multinational Companies from Emerging Economies*, Palgrave, 2007, ch. 5.

Other macro factors served as a catalyst for Latin American firms to expand internationally. Starting in 1994, a thrust towards “open regionalism” through trade treaties -- notably NAFTA -- opened up the United States, Canada and other foreign markets to Mexican goods and services as well as foreign imports. In South America, Brazil, Argentina, Paraguay and Uruguay founded the Regional Trade Agreement, Mercosul/Mercosur (Mercado Común del Sur) in 1991 with the Treaty of Asunción. Its purpose was to promote the fluid movement of goods, people and currency. The World Economic Forum’s *Latin American Competitiveness Review*³⁶ measured the impact of these strategies: from the early 1990s to 2006, Latin America’s “openness ratio” increased from roughly 12% to 21% of GDP. At the same time, merchandise exports from Latin America grew at an annual rate of 8.1% -- about 3% faster than the world average.

These Latin American firms have also been opportunistic buyers of industrial assets when foreign MNCs have withdrawn from the region due to unstable political and economic conditions. This shift in asset ownership has been dramatic. According to ECLAC (2006) in 2000, foreign MNCs accounted for 41% of revenues generated by the biggest 500 corporations in Latin America; but that figure had plunged to 25% five years later. Latin American firms moreover have proved more skilful at navigating domestic market and political environments thanks to their intimate knowledge of local consumer tastes and familiarity with institutional realities. In the final analysis, their home-turf experience competing head-to-head with foreign MNCs has proved to be a blessing in disguise. It has forced them to be innovative and strengthen their operational capacities, M&A skills, and brand management.

Besides macro-economic drivers, *firm-specific* factors are crucial indicators to understand the global expansion of Latin American firms. Firms tend to expand their activities in order to enhance (or protect) their profitability and capital value. Multinational corporations pursue global growth to drive revenue, increase margins and enhance shareholder value through market access or asset acquisitions. Other multinationals expand globally to secure long-term access to raw materials. Taking Dunning’s (1993)³⁷ conceptual framework, these dynamics can be expressed in terms of four broad motivations that determine investment behavior: market-seeking; efficiency-seeking; resource-seeking; and asset-seeking.

³⁶ *The Latin American Competitiveness Review 2006*, World Economic Forum, Davos, 2006, p. 21.

³⁷ John H. Dunning, *Multinational Enterprises and the Global Economy*, Addison-Wesley, 1993.

Market-seeking strategies are the most common, though motivations for seeking market opportunities vary. They can be based on leveraging a successful brand, exploiting competitive advantages in market niches, or rolling out a business model. We have found that many Latin American multinationals are primarily market-seekers. Since natural resources and labor are relatively plentiful and cheap at home, large-scale Latin American firms can devote their energies to seek markets. Often the prime market-seeking motivation is in their ‘natural markets’. Mexican firms that expand into the United States are following this territorial logic.³⁸

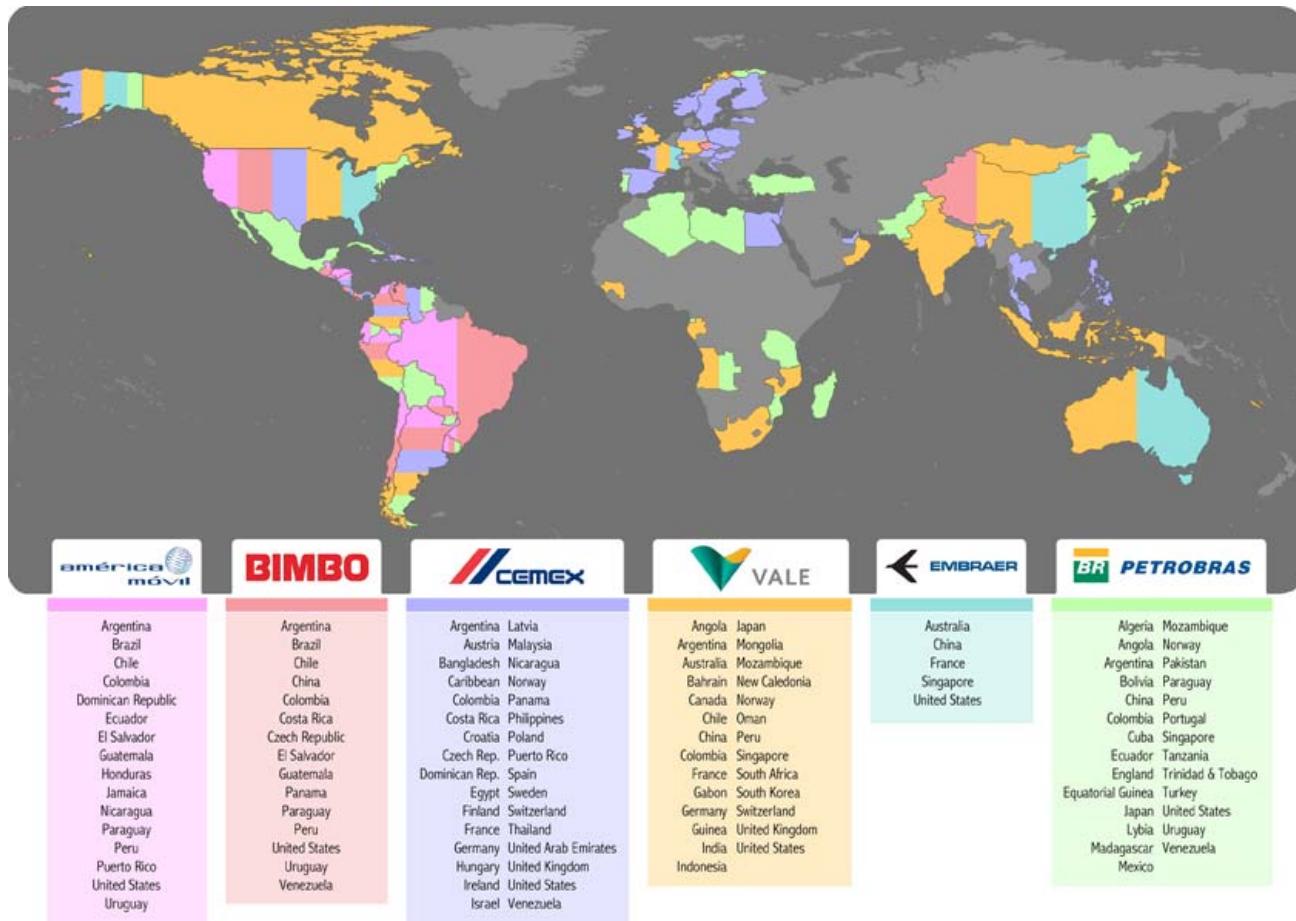
Efficiency-seeking is often characterized in terms of taking advantage of lower-cost labor in foreign countries. This strategy goes beyond low-cost input factors, however, and also includes motives related to the efficiencies of vertical integration of production and service lines of business, particularly in *producer-driven* sectors such as electronics and automobiles. The regional manufacturing sector is been dominated by so-called *maquila* branch-plants – often assembly lines of American and Japanese industrial giants in sectors like automobiles – who achieve efficiencies in countries like Mexico through access to relatively cheap labor.³⁹ Similarly, from Manaus in Brazil to Costa Rica, we can find the so called Free Trade Zones (FTZ) all over the continent where MNCs from Asia, EU and US have set up assembly plants to take advantage of cheap labor cost.

Resource-seeking global strategies are generally pursued by firms from countries – notably China – looking for access to natural resources such as oil and gas in order to fuel the engine of domestic industrial activity. Since Global Latinas come from countries with plentiful supplies of natural resources, they tend *not* to be motivated primarily by resource-seeking strategies. In some cases, though – such as Petróleo Brasileiro S.A., (Petrobras) and Vale -- Latin American companies have expanded to acquire reserves in foreign markets.

Asset-seeking, is generally associated with research and development activities.

³⁸ Foreign Investment in Latin America and the Caribbean, ECLAC, United Nations, 2005, ch. IV.

³⁹ On *maquilas*, see Lourdes Casanova, “Latin America: Economic and Business Context”, *International Journal of Human Resource Management*, Vol. 16., n°12, December 2005.



In 2006, Boston Consulting Group⁴⁰ expanded on these four conceptual models by outlining six strategic motivations: taking brands global; leveraging low-cost R&D talent; establishing category leadership in a particular niche; leveraging natural resources; rolling out business models; acquiring resources. From these categories, we have identified five broad motivations that can be applied to the firms studied in this report.

These theoretical models produce rich insights into the firms studied in this report. We have also identified other motivations for international expansion. One is *competitive advantage-seeking*: many Latin American firms expand internationally to gain access to know-how and expertise. Another is *access to cheaper capital*. For Latin American firms, a primary motivation driving this strategy lies in the reduction of their cost of debt due to lower country risk premia that financing in foreign industrial countries brings along, for example, a debt issuance in the United States or Spain. The higher cost of debt capital in their domestic markets stems from more unfavorable credit ratings (as of October 2007, only Mexico and

⁴⁰ Ibid.

Chile are investment grade⁴¹ in Latin America). This strategy has been facilitated by a global context of high liquidity levels and low interest rates⁴². As the OECD observed in a study published in April 2007: “A global appetite was stimulated among the enterprises by industrial and financial interests, i.e. the quest to expand their markets and improve their risk profiles. Their hunger for new markets was combined with the financial need to reduce the cost of access to capital.”⁴³ We will return to this theme in our case study analysis of different companies and in the conclusions to this report.

Beyond these motivations, it is important to underscore that firms also possess specific characteristics – leadership, innovation, technology deployment, organizational know-how, operational strengths and brand management – that are deployed as competitive advantages when pursuing internationalization strategies. These are important measures throughout this report.

iv) Methodological Approach: Case Studies⁴⁴

Our goal in this report is to provide a comparative analysis of the motivating drivers and strategies behind the internationalization strategies of Global Latinas operating in a diverse range of sectors. As noted above, we seek to answer three main questions – *first*, about what lies behind the emergence of Global Latinas?; *second*, about which internationalization strategies?; and *third*, about which are the unique characteristics that differentiate these firms from multinational corporations from developed economies?.

The existing body of analysis on Latin American multinationals -- notably from ECLAC and UNCTAD -- is rich in data and insights. ECLAC (2006) examined the emergence of “trans-Latins” -- as defined as those Latin American firms investing outside their home country -- in its report, *Foreign Investment in Latin America and the Caribbean 2005*, which provided country-by-country analysis and some firm-specific profiles.⁴⁵ In many respects, this report builds on ECLAC’s work by using in-depth case studies and choosing medium-sized firms that have not already been examined in most available literature. We move from “trans-Latins” or Multilatinas -- defined as those Latin American firms investing outside their home country -- to Global Latinas, those which have ‘graduated’ by investing in the so-called

⁴¹ Investment grade is given by rating agencies such as Moody’s or Standard and Poor’s to countries that are likely enough to meet payment obligations.

⁴² As the report is going to press in January 2008 this context of high liquidity is declining.

⁴³ *The Emergence of Latin Multinationals*, Deutsche Bank Research, March 2007, p14; and Alvaro Vargas Llosa, “Latin America’s Global Players”, Independent Institute, 15 August 2007.

⁴⁴ Data collection in this report concluded in November 2007. Statistic data for companies, unless otherwise stated, is for year-end 2006.

⁴⁵ *Foreign Investment in Latin America and the Caribbean 2005*, ECLAC, United Nations, 2006.

developed world. It should also be noted that much of the existing analysis is largely *quantitative* in nature, measuring the global reach and size of firms according to a number of benchmark variables. UNCTAD's "Transnationality Index", for example, measures multinational firms in terms of three ratios: foreign assets/total assets; foreign sales/total sales; and foreign employment/total employment.⁴⁶ This index gives a precise profile of a firm's reach beyond its domestic market according to three highly useful criteria: asset valuation, revenues, and employee numbers. Yet the definition of "foreign" as non-domestic evacuates the notion of a *regional* Latin American firm, and thus constrains any analysis seeking insights into why some multi-Latinas break out of their region to become Global Latinas. Other measures focus on geographical reach as determined by the *location* of assets in foreign territories. This measure is useful because the horizontal reach of corporate operations over many countries on different continents affects the "transnationality" of a firm. Still other measures combine top-line revenue figures and asset valuations with geographical research.

In this report, we have taken a different approach, which examines the behavior of Latin American firms, is more *qualitative, a case study approach based on bottom-up analyses and interviews with executives at selected firms*. It has not been our ambition to elaborate a general theory about the international investment patterns of Latin American firms. Nor have we analyzed the quantifiable economic impacts of these firms on their domestic economies and the foreign countries in which they have invested⁴⁷. Our main focus has been on the underlying factors that have contributed to the success of these firms in becoming global players. It was a deliberate choice to focus primarily on firms that, at this point in time, have internationalized successfully to highlight best practices. Given the size of the sample of selected firms, which we acknowledge is not sufficiently representative for us to generalize about firm behavior, we consider the findings to be of a preliminary nature. We hope that our analysis may help to inform further research in the field.

We have opted for an *inclusive* approach when selecting firms. If size alone – whether measured by revenues or assets – were our sole criterion, the selection process would have been simple. Most available rankings -- *América Economía, Fortune 500, Latin Trade* – publish lists that include the biggest corporations in Latin America.⁴⁸ Not surprisingly, virtually all these rankings list among the top ten Latin American firms a handful of resource-based giants

⁴⁶ *World Investment Report 2006*, UNCTAD, 2006, p 32.

⁴⁷ It should also be noted that comparing Latin American firms with other multinationals from emerging economies, is beyond the scope of this report.

⁴⁸ For rankings, see "500 Las mayores empresas de América Latina", *América Economía*, July 2007; *Fortune's "2007 Global 500"*, and *Latin Finance's "Top 100 Companies"*.

(Pemex, PDVSA, Petrobras) and utilities (CFE, Telmex). Consequently, if we restricted our study to only the *biggest* corporations, the insights contained in our findings would be constrained. We therefore opted for a methodology that would diversify the sectors represented in our case studies.

We believe that this flexible approach is appropriate for this study of motivations and strategies, since they are markedly different according to the *sector* in which specific firms operate. Resource-based companies, for example, do not generally deploy the same foreign investment strategies as consumer-goods firms, service sector firms, technology firms and intermediate manufacturers. Firms adopt investment strategies in response to the competitive realities of their own sector.⁴⁹

We selected a total of *eleven* companies -- seven for individual case studies and four firms grouped together in a separate chapter on "emerging" Global Latinas. The six leading firms selected are from Mexico: (1) **América Móvil**, the Mexican mobile telecom titan, (2) **Bimbo**, the Mexican food giant; (3) **CEMEX**, the Mexican building materials; and from Brazil: (4) **Embraer**, the Brazilian aircraft manufacturer; (5) **Natura** the Brazilian cosmetics firm; (6) **Petrobras**, the Brazilian oil and gas company; and (7) **Vale**, the Brazilian mining company. The four "emerging" Global Latinas selected are: Chilean winemaker **Concha y Toro**; Brazilian-based IT outsourcing firm **Politec**; and two restaurant groups, Guatemalan country chicken chain **Pollo Campero** and Peru's **Astrid & Gastón**. We include a short description of the companies and the reasons why we choose them below.

Global Latinas from Mexico:

1. **América Móvil:** As of 2007, the largest privately-held company in Latin America by market capitalization. América Móvil has annual revenues exceeding US\$20-billion and a market presence in 17 countries throughout Latin America and the United States. Forced to innovate due to its large low-income customer base throughout Latin America, the company pioneered the "pre-paid" mobile phone usage model that later spread through the industry. In the United States, the company operates under the Tracfone brand, and uses different brands in Latin American countries. Its main competitor in Latin America is Spanish-based telecom giant, Teléfonica. We chose this highly innovative and acquisition-driven company because it seems to be one of the cases that best illustrate the management of customers with low income.

2. **Bimbo**: Mexican bakery giant Bimbo has total revenues of nearly US\$5-billion and operations in North America, Europe and Asia. With its origins in the bread business, Bimbo began internationalizing in the 1980s, starting with exports and operations in the United States, mainly to market its bread and snacks products to Hispanic immigrants. The company thus began expanding to seek new markets. Bimbo is also an asset seeker. Acquisitions have been strategically critical for its expansion into the United States and Europe. The company has recently expanded into China. We chose Bimbo because it's an innovative consumer goods firm with excellence in branding, logistics and packaging, all of them key skills in the sector.
3. **CEMEX**: Mexico's global building materials giant, CEMEX has operations in more than 30 countries. It is the third largest building materials company in the world, with annual revenues in excess of US\$18-billion. Its first international expansion strategy was focused on the southwestern United States along the Mexican border. The key to CEMEX's success has been asset acquisition and vertical integration – particularly buyouts of its own suppliers. The company is both a market and efficiency seeker. Apart from major acquisitions in Spain in the early 1990s, CEMEX initially focused its global strategy on emerging economies -- especially in Indonesia, Thailand, Philippines, and Egypt. After 2000 it began moving into developed markets with large-scale acquisitions in the United States, Britain, and Australia. The company is famous for its company-wide established operating system called the "CEMEX Way". The firm was an obvious choice for this study as it succeeded in a price driven and highly competitive commodity market and changed the rules of the game.

Global Latinas from Brazil:

4. **Embraer**: A privatized Brazilian-based aircraft manufacturer, Embraer has total revenues of roughly US\$4-billion – 93% of which are generated outside of its domestic market. Specializing in small regional jets, Embraer capitalized on Brazil's war-based aerospace engineering strengths after Second World War and invested heavily in R&D. Once a fierce rival of Canadian-based niche player, Bombardier, Embraer now competes with markets served by Boeing and Airbus. We chose this company because it provides a fascinating case study of the transformation from protected "national champion" to global industrial player in a very advanced technological manufacturing sector.

⁴⁹ *Foreign Investment in Latin America and the Caribbean*, ECLAC, 2006, ch. I.

5. **Natura Cosmeticos:** Natura sells premium cosmetics and related products that have an eco-friendly appeal because they are made from extracts of local Brazilian plants. Natura sells its products – fragrances, makeup, skin treatment, sun creams, hair care, deodorants, soaps, and shaving creams -- mainly through door-to-door direct sales. This market model has proved highly successful in Brazil, where the company has a network of more than 560,000 independent sales representatives with about 5,000 employees. It earned US\$215-million in profits on 2006 revenues of US\$1.3-billion. More than 95% of total sales come from the Brazilian market. We chose this firm because of its unique market positioning as an eco-friendly company leveraging the biodiversity of Brazil's natural resources.
6. **Petrobras:** Brazilian-based Petrobras is a government-controlled, but privately owned, oil giant with roughly US\$60-billion in annual revenues. It is the 65th largest corporation in the world according to *Fortune* "Global 500" 2007 ranking. Petrobras controls oil and power industry assets on several continents: South America, North America, Europe, Africa, and Asia. It has unparalleled technological know-how in offshore deep-sea oil drilling. Petrobras was an obvious choice for this report due to its global reach in the oil sector, a key resource in the region, and also because of its forward-looking strategy to become a world leader in biofuels.
7. **Vale (formerly known as CVRD):** Brazil's Vale is the second-largest mining company in the world with operations on five continents. Founded in 1942, it is a global leader in the mining of iron ore and steel-related minerals. Besides mining, Vale operates large-scale railroads in Brazil. During 2006, the company purchased Canadian nickel-producing giant, Inco, in a US\$17.6-billion all-cash deal – the largest foreign takeover ever by a Latin American company. We chose Vale because it has emerged in recent years as one of the biggest players in the global mining sector, a key sector for the region.

Emerging Global Latinas:

Small and medium size companies are key to the development of any country. They create employment and foster entrepreneurship and innovation and are a key ingredient of the fabric of the economic development.

From Chile:

8. **Viña Concha y Toro:** Chile's main wine exporter and one of the most recognized wine brands worldwide. Exporting to more than 115 countries, the company's consolidated

revenues in 2006 exceeded US\$400-million. While Europe and the United States are its main export markets, it has been targeting Asia to boost growth. Exports represent about 75% of the company's revenues. Its main wine brands are Concha y Toro, Don Melchor, Terrunyo, Marques de Casa Concha, Casillero del Diablo, Trio, Sunrise and Frontera. Through its subsidiaries, it also markets brands such as Cono Sur, Isla Negra, Vina Maipo and Trivento. Its premium red wines are primarily made from Cabernet Sauvignon, Merlot, Carmenere, Syrah, Pinot Noir and Malbec grapes. We chose this company because it's a successful global brand from a region that is not known for brand leveraging. Chilean wine is an exception. Indeed, Chilean wines have successfully taken on the biggest selling French brands worldwide and changed the industry.

From Brazil:

9. **Politec**: The company is the leading Brazilian IT service provider with roughly 6,500 employees and 2006 revenues of more than US\$230-million. In 2006, *Business Week* ranked Politec second on Gartner's list of the world's top 15 "Emerging Outsourcing Players". In 2007, *Global Services* ranked Politec among the world's "100 Most Innovative Service Providers", and the World Economic Forum has included Politec on its list of new "global growth" champions. We chose this medium-size company because we wanted to include a firm in a high-value-added new IT sector and the governments want to move away from the dependency on commodities to high added sectors like Business Process Outsourcing.

From Guatemala and Peru:

We chose these two restaurant chains because of their unique challenge leveraging brands in a global sector dominated by strong brands, and their strategy based on country-branding and economic growth.

10. **Astrid & Gastón (A&G)**: Peru's Astrid & Gastón is a restaurant company that unites several brands of specialized Peruvian restaurant concepts. Today the company owns restaurants in Peru, Ecuador, Chile, Colombia, Venezuela, Panama, Spain and Mexico. Its estimated 2007 revenues were US\$30-million. In 2007 the World Economic Forum named Astrid & Gastón as a "Global Growth" company. A&G is also an example of a social responsible entrepreneur that uses his home country's biodiversity of ingredients and its variety in tastes as a natural resource to leverage.

11. **Pollo Campero:** Guatemala's "country-style chicken" restaurant chain has emerged as the most inspiring international restaurant chain from South America. It counts more than 7,000 employees working in more than 271 restaurants worldwide, including the United States, Spain, China, and Indonesia. Pollo Campero ended fiscal 2006 with estimated revenues of nearly US\$400-million. Its goal is to open 500 units in the United States by 2012, including in Wal-Mart stores. Its parent company is family-controlled conglomerate, Corporación Multi Inversiones, which controls 300 companies and has more than 30,000 employees in 14 countries within six divisions. Besides representing a Central American country, Pollo Campero was chosen because it uses a strategy of accessing minority "bridgeheads" in natural markets with country-rooted branding and flavoring.

These companies -- mid-cap and large-cap -- represent a relatively wide variety of sectors and figure consistently in rankings of Latin America's top corporations. For example, *Latin Trade*'s Top 500 ranking for 2007 (including both Latin American firms and subsidiaries of foreign MNCs) lists six of our selected companies in its top hundred firms: Petrobras (3rd), América Móvil (5th), Vale (6th), CEMEX (9th), Bimbo (54th), and Embraer (85th).⁵⁰

⁵⁰ "Top 500 Companies in Latin America", *Latin Trade*, July 2007.

Global Latinas: Presence in regions (number of countries/region) / Financial data																	
Region	Latin America	Europe	Asia	North America (US & Canada)	Africa	Australia	América Móvil	Astrid & Gastón	Bimbo	Cemex	Concha y Toro	Vale	Embraer	Natura	Petrobras	Politec	Pollo Campero
Latin America	14	6	14	9	12	4	-	-	-	-	-	-	-	11	-	7	
Europe	-	1	1	14	5	5	1	1	1	1	1	1	1	2	4	1	
Asia	-	-	1	6	4	9	2	-	-	-	-	-	5	3	2		
North America (US & Canada)	1	-	1	1	2	2	1	-	-	-	-	1	1	1	1		
Africa	-	-	-	1	3	5	-	-	-	-	-	6	-	-	-		
Australia	-	-	-	1	-	2	1	-	-	-	-	-	-	-	-		
Revenues (US\$ mm)	28,544.2	30	6,622.9	21,681.5	400	36,562.7	5,636.2	1,732.1	96,300	270	450						
Net profit (US\$ mm)	5,367	N/A	349.2	2,391.8	400	11,294.3	370.9	260.7	12,144.6	na	Na						
Total employees	45,646	N/A	81,000	67,000	2,035	60,405	20,180	5,900	68,931	6,500	7 000						
Employees outside home country	N/A	N/A	42,800	29,200	N/A	12,000	3,100	500	6,800	N/A	N/A						
Countries active in	15	7	17	32	26	27	5	5	27	8	11						
International sales/exports as % of total	50%	65%	32%	82%	95%	84%	96.4%	4%	21%	5%	-						
Listed stock exchanges	AMX NYSE (2000) Nasdaq Latibex	Not listed	AMX (1980)	AMX (1976) NYSE (1999)	NYSE (1994)	Bovespa (1943) NYSE (2000) Latibex (2000)	Bovespa NYSE (2000)	Bovespa NYSE (2004)	Bovespa NYSE BCBA Latibex Dow Jones Sustainability Indexes	Not listed	Not listed						

Source: Lourdes Casanova, Henning Hoeber and Samantha Rullan based on 2008 América Economía data, company reports and personal interviews with companies.

Our selected firms, moreover, have consistently figured in both qualitative (“most admired companies”) and quantitative (“market leaders”) measures of Latin America firms. In 2002, *Latin Trade* published a ranking of “Latin America’s 20 Most Admired Companies”, which included Bimbo, CEMEX, and Embraer.¹ In 2006, *América Economía* ranked market leaders in their sectors: Bimbo, CEMEX, Vale, and, América Móvil placed *first* in their respective sectors, and Petrobras placed third (after Pemex and PDVSA) in the oil and gas sector. What’s more, one of our emerging Global Latinas, Natura, placed second (after Procter & Gamble but ahead of Avon Cosmetics) in the hygiene sector. Not only are they market leaders in the region, but also place high in *América Economía*’s rankings as top exporters: Petrobras (5th), Vale (7th), Embraer (10th), Bimbo (22nd). Finally, when state-owned firms are excluded from *América Economía*’s revenue rankings, five of the selected firms figure in the top 50: América Móvil (1st), CEMEX (3rd), Vale (4th), Bimbo (26th), and Embraer (37th). Given these performance rankings from a purely statistical point of view, we are confident the selected firms for our case studies achieve our combined objective of comparative diversity and methodological rigor.

In the following chapters, while analyzing the companies, we provide a statistical overview of each one including profits, employees and revenues followed by a short snapshot profile of the firm’s historical development and the evolution of the share value compared to different indexes. This is followed by the internationalization drivers and strategies including identifying common phases of regional and global expansion. We have a concluding section containing some forward-looking analysis of the success factors and challenges facing each company. Our analysis is based on empirical research and interviews with senior executives at all the companies studied in this report (See Annex for a list of points discussed with company executives).

In sum, the aim of this report is to provide bottom-up, reality-based insights into the motives and consequences of the emergence of Global Latinas as corporate players in the international economy. We have also endeavored to measure, where possible, the role of international financial agencies in the emergence of large-scale Latin American corporations. This assessment is not only relevant for these agencies – such as the Inter-American Development Bank and World Bank – as they evaluate their own activities aimed so far at working with governments mainly; it also is a timely analysis in the current context of dramatically increased availability of private capital and, as a result, a potential need for

¹ “Latin America’s 20 Most Admired Companies”, *Latin Trade*, May 2002.

discussion and debate as international funding agencies reassess their relevance, purpose, and mandates.

Vale¹

Brazil's Iron Fist

Vale² has successfully evolved from a state-owned natural resources conglomerate that benefited from protection and state support to a modern global mining corporation. High commodity prices, soaring Chinese demand for commodities, a strong position in its home market and strong leadership have been important factors of the company's success in its internationalization strategy. Facing a consolidation trend in its own industry and its clients' sectors, Vale's latest acquisitions have facilitated its transformation to a global diversified mining player in order to reduce its dependence from iron-ore based revenues and to achieve its goal of becoming a one-stop-shop for the steel industry. For further growth, Vale is well suited.

Introduction

"We pray every day that China will keep growing and investing so that we can keep surfing this wave that China is sending around the world."

– Roger Agnelli, chief executive, Vale, 2007.³

Vale is one of the world's largest mining companies with a global leadership position in iron ore and worldwide operations in nickel, copper, bauxite, manganese, potassium, and other non-ferrous metals. Following its US\$17.8-billion all-cash acquisition of Canadian nickel producer Inco in 2006, Vale is one of the world's biggest nickel producers. It also controls 39% of the global seaborne iron ore market⁴ and is also one of the largest freight logistics players in Brazil.

¹ The authors are grateful to Companhia Vale do Rio Doce (CVRD) executives for their cooperation in the preparation of this chapter.

² Formerly known as Companhia Vale do Rio Doce (CVRD), since November 2007 its name has been changed to Vale.

³ Wheatley, J. (2007). CVRD leads Brazil's move further afield. *Financial Times*, 11 January 2007. Retrieved October 2007 from Factiva database.

⁴ Le Page, S. (2007). Secteur minier: le combat des titans. *Les Echos*, 10 October 2007.

In 2008, *Fortune* ranked Vale as the world's 235th biggest corporation⁵ and the world's 3rd largest company in extractive industries as measured by revenues. According to *América Economía*, it is the 5th largest corporation in Latin America⁶. With US\$15.7-billion in EBITDA on 2007 revenues of over US\$32-billion Vale is headquartered in Rio de Janeiro, and counts about 55,000 employees working in four divisions in 27 countries worldwide. (See Exhibit 1 in Annex for expansion timelines).

Metals and Mining Industry

The global metals and mining industry⁷ generates total revenues of roughly US\$1.5-trillion.⁸ The steel segment represents 67% of the industry's total value.

There are some 4,100 metal mining firms operating worldwide, though only 149 multinationals are considered as "majors". These global giants account for roughly 60% of the industry's total value.⁹ The global industry is undergoing massive consolidation with conflicting tendencies rising between the strategies of new players from emerging economies and established mining giants. Today nearly half of the world top 25 metal mining giants are headquartered in developing countries including Russia.

As of 31 October 2007, the top 10 global diversified mining companies, as measured by market capitalization were in ranked order: BHP Billiton Ltd (Australia, ASX) at US\$242-billion; BHP Billiton plc (United Kingdom, LSE) at US\$216-billion, Vale (Brazil, NYSE) at US\$182-billion; Rio Tinto Ltd (Australia, ASX) at US\$130-billion; Rio Tinto plc (United Kingdom, LSE)¹⁰ US\$119-billion; Anglo-American plc (UK/South Africa, LSE) at US\$93-billion; Xstrata (Switzerland, SWX) at US\$69-billion; Norlisk Nickel Mining and Metallurgical Company (Russia, RTS) at US\$56-billion; Freeport-McMoRan Copper & Gold Inc. (USA, NYSE) at US\$45-billion; Southern Copper Corp. (USA, NYSE) at US\$41-billion; Grupo

⁵ Fortune global 500. (25 August 2008). *Fortune*.

⁶ Las 500 mayores empresas de América Latina. (21 July 2008). *América Economía*.

⁷ The global metals & mining industry refers to primary aluminum, iron & steel, gold, silver, platinum, palladium, rhodium, industrial and gem-quality diamonds, primary coal and the base metals lead, zinc, copper, nickel and tin.

⁸ Datamonitor. (2007). *Global Metals & Mining*. Industry Report No. 0199-2106.

⁹ United Nations Conference on Trade and Development (UNCTAD). (2007). *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. New York and Geneva: United Nations.

¹⁰ Both BHP Billiton and Rio Tinto were created in dual listed company (DLC) mergers. In a DLC structure two companies contractually agree to operate their businesses as a single enterprise, while they retain both their separate legal identities and stock exchange listings. The DLC involves a common board of directors to coordinate operations and pays equal dividends to the respective shareholders.

Mexico SA de CV (Mexico, BMV) at US\$23-billion and Teck Cominco Ltd. (Canada, TSX) at US\$22-billion.¹¹ (See Exhibit 2 in Annex for Vale's main competitors).

The global metal mining industry is dominated by privately owned companies. In the 1960s and 1970s, however, the industry was targeted by widespread nationalizations as states – especially in emerging economies – wanted to capture rents from the sector to pursue socio-economic goals. As in the oil and gas sector, states began taking control of the metal mining sector when prices were at all-time highs in the decades following the Second World War. There were 32 expropriations of foreign mining companies in the 1960s, and 48 during the 1970s. Chile and Peru nationalized copper mining in the 1960s, and during the following decade Brazil, Chile, Venezuela and India partially nationalized their iron ore industries, while Bolivia took over tin production. Today, state ownership has been scaled back considerably, with notable exceptions in Chile, Russia and Poland.¹²

Mining is a backbone in Latin American economies. In Brazil, mining accounted for 5.5% of GDP in 2006, while the industry provided employment for about 650,000 people, or 4% of the domestic labor force. Brazil holds approximately 18.5% of the world's iron ore reserves. Chile is the world's largest copper producer, accounting for 37.5% of global production and 30% of the worldwide copper reserves. Copper exports represent nearly 23% of Chile's GDP. Peru is the world's largest producer of silver, the third largest producer of copper and zinc, the fourth largest producer of lead and the fifth largest producer of gold. Mexico is number two in silver, accounting for 17% of global production, and is the world's fifth largest producer of lead, sixth largest in zinc, and tenth largest in copper. About 2% of Mexico's GDP is related to mining.¹³

Vale: Past & Present¹⁴

The history of Vale can be traced to the end of the 19th century when a group of British investors founded Itabira Iron Ore Company. During the Second World War, the Brazilian government nationalized the firm and – under pressure from the U.S. government to supply ore to the American war industry – merged its assets into a newly created entity bearing the company's legal name, Companhia Vale do Rio Doce. After nationalization,

¹¹ Capital IQ. Accessed October 2007. The three letter code refers to the stock exchange the companies are listed at.

¹² United Nations Conference on Trade and Development (UNCTAD). (2007). *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. New York and Geneva: United Nations.

¹³ Mergent. (2007). *Mining - Latin America*. Industry Report No. 618. Retrieved October 2007 from Factiva database.

¹⁴ www.cvrd.com.br. Accessed September 2007.

Vale, financed through the Office of Lend Lease Administration,¹⁵ consolidated its position in Brazil to achieve critical mass before expanding internationally. Although state-owned, it was listed on the Rio de Janeiro Stock Exchange in 1943.

By the end of the 1940s, Vale was producing 80% of Brazil's iron ore exports.¹⁶ The post-war boom throughout the 1950s provided robust demand for products – like steel – needed for the reconstruction of the war-torn countries, especially Japan which depended entirely on imports. Although Australian producers were geographically closer to Japan, Vale gained a competitive edge by building large-scale bulk carriers, feeder systems, and ore ports to lower export costs and thus under-price Australian shipments.

In 1960, Vale began diversifying its business activities with a steel subsidiary, Companhia Siderúrgica Vatu, which manufactured sponge iron. Two years later, the company created a shipping arm, Docenave, to facilitate seaborne exports. In 1965, the Inter-American Development Bank (IDB) provided the company with loans to finance capital upgrades, construction of a new port in Tubarão,¹⁷ and expansion of the company's Southern System railroad in the Brazilian state of Minas Gerais. In 1967, Vale created a forestry division – a move that marked its diversification into an industrial conglomerate. Other diversification moves – especially in pelletizing,¹⁸ railroads and shipping – allowed the company to capture additional profits by transporting minerals extracted by other firms. In 1972, it entered bauxite mining through a joint venture, Mineração Rio do Norte, with Canadian-based Alcan. Two years later, it entered aluminum refining via Alumínio Brasileiro (Albrás), a joint venture with Japanese-based Nippon Amazon Aluminum. In 1984, Vale entered the gold mining sector.

Throughout this period, the company could count on the Brazilian government's support when dealing with foreign companies. In 1970, when U.S. Steel discovered the world's largest known iron ore deposit in Brazil's northern rainforest, the Carajás reserve, the government forced the American steel giant into a joint venture with Vale. In 1977, U.S. Steel sold its stake to its Brazilian partner and walked away.

¹⁵ An agency set up by the U.S. government to support its allies in recovering from the effects of the Second World War.

¹⁶ Chaddad, F. R. (2003). *CVRD Mining by 2010: Redrawing Firm Boundaries for 3x Market Cap*. Case Study No. 303-003-1. Sao Paulo, Brazil: Accenture.

¹⁷ As of 2007, the Tubarão port was the largest port for iron ore worldwide.

¹⁸ Pelletizing refers to an agglomeration process, where small and fine particles of iron ore are aggregated into larger and consistent iron ore fragments.

A major milestone for Vale was its privatization in the late 1990s. The Brazilian government, like other states in the region during the economic slowdown, was privatizing state-owned assets under pressure from international institutions such as the International Monetary Fund. The government put the company on its privatization list despite strong nationalistic resistance. However, in the early 1990s, Vale itself participated in the privatization of the Brazilian steel industry with equity investments in mills to integrate forward and to consolidate its position as the dominant supplier of iron ore to the sector, resulting in a 57%¹⁹ market share. Furthermore, Vale was able to participate in the turnaround potential of the steel manufacturers it took over. "We want these steel makers to grow so that we can grow with them,"²⁰ as Roger Agnelli, after his appointment in 2000, commented on Vale's steel ventures in retrospective. At the same time, the company was further strengthening its domestic position through joint ventures. In 1995, for example, it joined forces with Korean-based POSCO to establish a new pelletizing plant in Brazil.²¹ It could also count on financial help from the government. In 1997, the Brazilian development bank, BNDES, accorded Vale a "mineral risk contract" to help finance investments in mineral exploration.

Vale's privatization, which began in 1995, was accomplished in three steps over seven years. First, in 1997 roughly 42% of the company's shares were sold in an auction. Non-Brazilian mining giants like Rio Tinto, BHP, and several large-scale Japanese steelmakers were excluded from bidding due to state concerns about controlling iron ore supply. The remaining bidders were two Brazilian-led consortia: the first was made up of Brazilian conglomerate Votorantim and Anglo-American; the second, called Valepar, included Brazilian steel producer Companhia Siderúrgica Nacional (CSN) with backing from Brazilian investment firms and international banks. The Valepar group won the auction with its US\$3.1-billion bid for voting control. (See Exhibit 3 for the company's ownership structure).

¹⁹ CS First Boston. (1995). *Companhia Vale do Rio Doce – Riding on Strength of Brazil's Natural Resources*. Analyst Report. 09 October.

²⁰ Kepp, M. (01 April 2002). Refining Mining. [Electronic version]. *Latin Trade Magazine*, 10(4). Retrieved October 2007 from Factiva database.

²¹ Pohang Iron and Steel Company was one of Korea's top steel companies at that time.

Second, in 2000 – the same year Petrobras was partially privatized – Vale was listed on the Latibex in Madrid²² and the New York Stock Exchange to give the company access to international financial markets. (See Exhibit 4 for the company's stock performance). “Our decision to create a listed ADR reflects our strategy to raise our visibility globally and especially in the U.S.,” said Jorio Dauster, the company’s CEO at the time.²³

Third, the privatization process was completed in 2002 with the sale of the government’s remaining stake through a global equity offering.

Vale’s new controlling shareholders appointed a young and charismatic leader, 41-year-old Roger Agnelli as CEO in 2001. Agnelli had worked as head of capital markets at Brazilian investment bank Bradesco, which had been lead adviser to the winning bidder Valepar during the auction process. His first challenge as CEO was to transform the company’s culture from a conservative engineering outfit to a modern business group. His arrival also marked a new era for Vale’s internationalization strategy.

Following privatization, the company’s main priority was – like many Latin American multinationals – to consolidate its domestic market position. Between 2000 and 2001, Vale acquired three Brazilian mining companies – Socoimex, Samitri and Ferteco – to improve its resource position and replace exhausted mines. Domestic mining assets were relatively cheap to purchase from retreating foreign multinationals at the time given the economic crisis in Latin America and the world’s focus on internet and high-tech stocks. In late 2001, Vale and Japanese conglomerate Mitsui jointly acquired Caemi Mineração e Metalurgia, a Brazilian firm with operations in iron ore, pellets, kaolin, bauxite and railroads.²⁴ Caemi, which accounted for 3% of world iron ore production, extended Vale’s market position significantly. After the deal, the company had a worldwide market share of 18% in iron ore mining. Its 28% share in the global iron ore export market was higher than the market shares of both Rio Tinto (22%) and BHP Billiton (15%).²⁵ Vale’s strategic rationale behind the acquisitions was both defensive and offensive: they were designed to consolidate its market share and to keep BHP out of the iron ore market in Brazil.

²² The Latibex is an electronic market created by the Madrid Stock Exchange in 1999 in order to enable the trading of Latin American equity securities in euro denomination. CVRD’s ticker symbol is RIO.PR. Prior to the listing, Vale was only traded over the counter (OTC) since 1994, when a first ADR program was set up.

²³ Business Wire. (2000). *J.P. Morgan announces CVRD ADR Program Launch*. Retrieved October 2007 from Factiva database.

²⁴ In March 2003, CVRD acquired Mitsui’s remaining stake in the company and merged it into its assets in 2006.

In 2002, Anglo American approached Vale to discuss a merger. While the strategic outlook of a merger was attractive, in the final analysis the offer was rejected by Vale in order to pursue its own growth strategy. The same year, the company consolidated its interests in the Brazilian aluminum industry via several acquisitions,²⁶ and in 2003 obtained a US\$310-million syndicated loan to expand its Alunorte²⁷ project with Norsk Hydro.

Even after having consolidated its position in Brazil, Vale continued to develop the market for iron ore. It has been actively seeking joint investments with foreign companies in Brazil. In 2006, it teamed up with German steel giant ThyssenKrupp to create Companhia Siderúrgica do Atlântico²⁸ as an export base to meet increased global demand for steel. A similar venture is Ceara Steel Company with South Korean steel producer Dongkuk Steel and Italian plant maker Danieli. BNDESPar, the investment arm of BNDES, was involved in this project along with Petrobras. The steel produced is mainly exported to Asia, Europe and the U.S. In 2007, Vale set up another Brazilian steel mill with Chinese Baosteel.

Vale was able to successful negotiate very favorable prices for its iron ore in the last years. In 2005, it was able to rise prices for ore 71,5%, after negotiating with Asian heavy-weights Nippon Steel, JFE Holdings and Posco. The price negotiations in 2007 between Baosteel (which represented other Chinese steel mills) and Vale led to a 9.5% price increase.

²⁵ Chaddad, F. R. (2003). *CVRD Mining by 2010: Redrawing Firm Boundaries for 3x Market Cap*. Case Study No. 303-003-1. Sao Paulo, Brazil: Accenture.

²⁶ Plunkert, P. A. (2002). Bauxite and Alumina. In United States Geological Survey (Ed.), *U.S. Geological Survey Minerals Yearbook – 2002*. Retrieved October 2007 from <http://minerals.usgs.gov/minerals/pubs/commodity/bauxite/index.html#pubs>.

²⁷ In mid-2007, Alunorte was the largest aluminum refinery in the world.

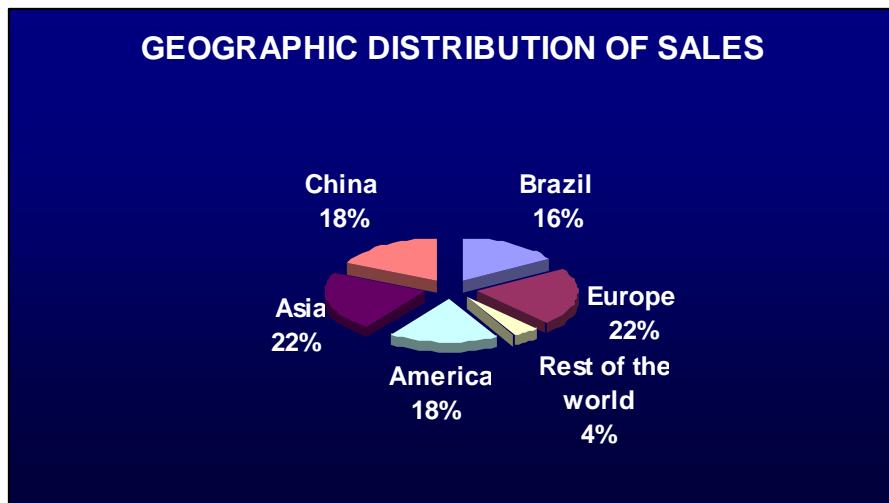
²⁸ The iron ore project is valued at US\$3.6-billion. The project was financed BNDES, which committed a credit corresponding to 18% of the project's total investment.

These negotiations set the pattern for other steelmakers.²⁹ The first agreement between large iron ore suppliers and steel majors usually represent a global benchmark for the contract year.

With large, undeveloped high-quality bauxite deposits and opportunities for low-cost expansions in its aluminum refining business, CEO Agnelli has made it clear that aluminum is one of the company's next targeted growth areas.

Vale teamed up with Shell and Petrobras, in order to meet its rising energy consumption needs. The company owns several hydroelectric power plants all over the world to directly supply its mining operations with energy. Beside its maritime operations, Vale is also a major player in the Brazilian land cargo sector and holds concessions for three Brazilian railways. Once built for iron ore logistics, some of its railroads now involve passenger traffic, too. With Petrobras, Vale aims at taking advantage of the ethanol boom in Brazil, as it provides transportation for the raw materials with its railroad infrastructure.

Going Global



After developing solid operations in its home country, Vale went out of Brazil to amplify its resource base and enhance its participation in the worldwide minerals industry – becoming a powerful integrated global player in the diversified mining sector. (See Exhibit 5 for the geographic spread of the company's revenues).

²⁹ Platts (2007). 2008 iron ore contract-price talks not yet under way. *Platts Commodity News*, 04 October 2007. Retrieved October 2007 from Factiva database.

After the giant discovery of the Carajás³⁰ deposit it seemed there was no need for Vale to acquire more resources. However, the company realized that it was important not only to secure resources but also markets for its mineral exports to stabilize demand. The internationalization strategy of Vale can be summarized in three phases.

i) Establishing Bridgeheads abroad (1984-2000)

In 1984, Vale teamed up with Japanese Kawasaki Steel to acquire major U.S. sheet steel producer California Steel Industries (CSI). However, it was until 1992 that Vale made a first foray into Europe, when it acquired a 35% stake in SEAS, the Société Européene D'Alliage pour la Siderurgie. The participation was stepped up to 100% during the same year and the name of the French company was changed to Rio Doce Manganése Europe.

ii) New Markets and New Resources (2000 - 2006)

Vale didn't emerge as a Global Latina until the company was privatized and put under the leadership of CEO Roger Agnelli. In the post-privatization period from 2000 to 2006, Vale invested billions in exploration operations, started up over 20 Greenfield and Brownfield³¹ projects and pursued several acquisitions. The company sold off all non-core and non-strategic assets – pulp, paper and forest products, fertilizers, certain steel mills, and unattractive port and railroad facilities to focus on its core competencies, mining and logistics. Much of the US\$3.6-billion in proceeds was re-invested in the new core business areas.³²

In 2000, Vale moved into the Middle East via a 50% stake in Bahrain-based Gulf Industrial Investment Company (GIIC), which owned one of the largest independent iron ore pelletizing plants in the world, shipping facilities and other assets related to the iron pellets business. The other 50% stake was held by the regional investment bank, Gulf Investment Corporation. Thanks to this deal, GIIC began importing raw materials from Vale's Brazilian operations and processing them locally for sale to steel mills in the Middle East.

In Europe, the company bought the Norwegian ferrochromium company Elkem Rana in 2003. This acquisition, renamed Rio Doce Manganese Norway, provided a market for Vale's manganese products mined in Brazil (exports to the United States had been restricted

³⁰ Located in Pará, Brazil.

³¹ The term Greenfield refers to new mining start-ups, whereas Brownfield describes the extension of existing mines.

by trade sanctions). The Scandinavian acquisition catapulted Vale into European ferroalloy market leadership with a 40% market share.³³

Nevertheless, geographically, about 90% of Vale's assets were still located in Brazil and two thirds of its value chain was linked to iron ore. While the company proved it was able to compete successfully with the global mining companies on its home turf, it realized that on a worldwide level, its ability to compete with the giants needed to be improved,³⁴ especially regarding the dependence from iron ore, its business cycles, the Brazilian market and the country risks. Vale needed to diversify its product and geographic reach, especially since iron ore was now offering less growth opportunities. Such a diversification strategy would protect the company from an inevitable future downturn in iron ore prices and the addition of other minerals to its product portfolio would help its rising ambitions of becoming a one-stop-shop for the steel industry.³⁵

The company therefore began looking for other minerals, putting greater strategic emphasis on non-ferrous metals. Vale formed a joint venture to explore new copper opportunities in Chile and Peru with the Chilean state-owned company Codelco in November 2001. In the following year, it agreed to establish a joint venture with Chilean Antofagasta on copper exploration in Southern Peru. Further exploration projects for copper and gold in Peru and Chile began in 2002. Brazil as a net importer of copper, gave Vale a readymade market to cash in on.

In Asia, the company has a special interest in China, the world's largest importer of iron ore due to soaring demand for cars, capital goods, buildings, infrastructure and railroads. Therefore, in 2001, the company signed a deal to supply China's largest steelmaker, Shanghai Baosteel Group Corporation, with six million tons of iron ore annually over a 20-year period.

³² Companhia Vale do Rio Doce (2006). *Pursuing Long-term value growth*. Company presentation held at Goldman Sachs, New York, 15 May 2007. Retrieved October 2007 from www.cvrd.com.br

³³ Economic Commission for Latin America and the Caribbean (ECLAC). (2006). *Foreign Investment in Latin America and the Caribbean 2005*. United Nations publication No. E.06.II.G.44. Santiago, Chile: United Nations.

³⁴ Without changes in its corporate activities and geographical reach, Vale may have become a valuable takeover target for another mining giant expanding in iron ore or a backward-integrated steel company as a low-cost supply source.

³⁵ Wheatley, J. (2007). CVRD leads Brazil's move further afield. *Financial Times*, 11 January 2007. Retrieved on October 2007 from Factiva database.

Furthermore, the Brazilians expanded into Africa, which Agnelli saw as one of the last remaining frontiers for global mining companies and as a source of global competitiveness.³⁶ With its activities in Africa, Vale is one of the few multinational players able to compete with the Chinese companies on the continent.³⁷ Vale subsidiaries on the African continent now include La Compagnie Minière des Trois Rivières in Gabon (established 2003), Rio Doce Mozambique (2004), Gevale in Angola (2005) and Rio Doce South Africa (2006).³⁸ In 2006, Vale and Petrobras, signed a deal to explore opportunities in Mozambique's gas fields and electrical power generation. Agnelli referred to the agreement as a "very important strategic partnership"³⁹ with long-term potential.

iii) Becoming a One-Stop-Shop for Global Steel (2006 onwards)

In the following phase, Vale continued to broaden its product mix and lessened its dependence from iron ore revenues. The high commodity prices were an important factor for the next wave of expansion. As steel firms began backward integration, Vale aimed at transforming itself into a one-stop-shop for the global steel industry. To achieve this objective, Vale added nickel to its business lines, used mainly to produce stainless steel. First, in 2006 it completed the purchase of Canadian Canico Resources, which added the Onça Puma nickel project in Northern Brazil to its portfolio alongside its own Vermelho nickel project. However, Vale's milestone deal was the US\$19-billion⁴⁰ takeover of Canadian-based Inco, the world's second-largest nickel producer (after Russia's Norilsk Nickel) and owner of the world's largest nickel reserve base.⁴¹

The Inco deal enhanced Vale's product and geographic distribution and improved its bargaining power. It also added to its global operations large-scale Greenfield and Brownfield projects in Indonesia and New Caledonia. The transaction was moreover in line with a general industry trend, which has seen global mining corporations investing massive

³⁶ Campbell, K. (2007). Brazilian group to build coal mine in Mozambique. *Mining Weekly*, 22 June 2007. Retrieved on October 2007 from http://www.miningweekly.co.za/article.php?a_id=111498.

³⁷ Busch, A. (2007). Die Aufkäufer aus Brasilien. *Handelsblatt*, 15 February 2007.

³⁸ In Gabon, Vale froze CMTR's projects at the end 2006, due to the weak performance of manganese prices and the loss of an iron-ore mine concession to a Chinese mining group.

³⁹ Campbell, K. (2007). Brazilian group to build coal mine in Mozambique. *Mining Weekly*, 22 June 2007. Retrieved on October 2007 from http://www.miningweekly.co.za/article.php?a_id=111498.

⁴⁰ According to the company, the US\$19.0-billion acquisition value of Inco comprehends the price of US\$17.8-billion plus a net debt assumption of US\$1.2-billion.

⁴¹ Kinch, D. (2007). With eyes on No. 1, CVRD plans \$15.3B bid for Inco. *American Metal Market*, 11 August 2006; and: CVRD Announces Proposed All-Cash Offer to Acquire Inco. (11 August 2006). *Canada NewsWire*. Both retrieved October 2007 from Factiva database.

profits from the commodity boom to ensure a greater spread of earnings and pricing power.⁴² As CEO Agnelli said in a statement: "The operations of the two companies are complementary and the combination will enhance our capabilities to benefit from the fast-changing global landscape in the metals and mining industry."⁴³

Besides nickel and manganese, another important natural resource for the steel industry is coal. To become an overall supplier to the steel industry, further expansion into the coal business was essential. In 2007, the company added significant coal-mining capacity to its operations with the acquisition of Australian-based AMCI Holdings, a privately held entity which operates coal assets through joint ventures.⁴⁴ Besides contributing to Vale's diversification plans, the AMCI acquisition strengthened the company's plans to develop a growth platform in the coal business. Prior to the AMCI buyout, the company had purchased 25% minority stakes in two Chinese coal companies: Shandong Yankuang International Coking Company (2004) and Henan Longyu Energy Resources (2005).⁴⁵ In 2007, Vale signed a contract to develop a large coal deposit in Mozambique, and acquired a 51% stake of the Belvedere coal mining joint venture in Queensland, Australia.⁴⁶ The Mozambique deal was also a milestone for Vale's coal strategy, and the BNDES bank formally expressed an interest in supporting the project.

The company also has not lost sight of its goal of securing markets for its iron ore despite the company's focus on product and geographic diversification. During 2005, Vale concluded a first iron ore shipment to the Ukraine, the world's 7th largest steel producer, which marked a new frontier in seaborne ore trading,⁴⁷ and in August 2007, it was part of a consortium, called E2 Acquisition⁴⁸, that bid for the U.S.-based Sparrows Point steel mill from world leader Arcelor Mittal.⁴⁹

⁴² Trounson, A. (2006). CVRD bid to become nickel giant. *The Australian*, 14 August 2006. Retrieved October on 2007 from Factiva database.

⁴³ Kinch, D. (2007). With eyes on No. 1, CVRD plans \$15.3B bid for Inco. *American Metal Market*, 11 August 2006. Retrieved on October 2007 from Factiva database.

⁴⁴ CVRD wraps up acquisition of Australian coal miner. (23 April 2007). *Business News Americas*. Retrieved October 2007 from Factiva database.

⁴⁵ Kinch, D. CVRD acquires Australian coal producer AMCI Holdings. *Metal Bulletin News Alert Service*, 23 April 2007. Retrieved October 2007 from Factiva database.

⁴⁶ Brazil's CVRD buys Australia coal project. (23 July 2007) *Reuters News*. Retrieved October 2007 from Factiva database.

⁴⁷ Chadwick, J. (2005). CVRD's iron fist. *International Mining*, December 2005.

⁴⁸ Apart from CVRD, the joint venture partners include Ukrainian steelmaker IUD-Donbass, U.S. steel companies Esmark and Wheeling-Pittsburgh, as well as institutional investors from the United States.

⁴⁹ Sparrows Point sale approved for \$1.35bn. (6 September 2007). *Steel Business Briefing*. Retrieved October 2007 from Factiva database. CVRD withdrew from the consortium later, when union oppositions against the takeover arose.

Nevertheless, Vale has huge undeveloped bauxite deposits and seeks to strengthen its position in this business area. Therefore, it was speculated that it was a potential buyer of the Canadian aluminum giant Alcan, but in the end it was bought by Rio Tinto. On the other hand, Vale never confirmed that it made an offer for Alcan.⁵⁰

Vale is committed to keep lowering the exposure to the iron ore market and its targeted goal is to reduce iron ore to 50% of revenues.⁵¹

The Essence of Vale's Success

For many years, Vale profited from its state-owned industrial champion status enjoying quasi-monopoly privileges in its domestic market before expanding internationally. Like other Latin American firms, Vale was privatized in a context of economic crisis and low commodity prices, with pressures on Latin American governments to liberalize their economies. In the 1970's, the discovery of the Carajás reserve gave the company 400 years supply of the finest grade iron ore.⁵² High commodity prices have been key to Vale's success and if this trend continues, it promises an outstanding performance for the next years to come.

At the firm-level of analysis, Vale's success has been strongly linked to the personal leadership of CEO Roger Agnelli, who has driven the company's internationalization strategy since privatization. In particular, he transformed the company from a diversified conglomerate holding to focus on its core mining business. With an excellent reputation for M&A management and negotiation, Vale's acquisition and joint-venture strategy has succeeded in consolidating its leadership position in iron ore while providing diversification in other minerals to reduce the risk exposure from a single product.

According to experts, record prices for iron ore have in large part been due to Agnelli's formidable negotiations with Chinese customers. Higher prices for its main product have given Vale the cash flow needed to invest in other mining activities. Furthermore, Agnelli's ability to convince foreign steel companies to invest in jointly-owned mills in Brazil,

⁵⁰ Fick, J. (2007). CVRD Gains On Iron Ore's Rise. *Wall Street Journal*, 3 October 2007. Retrieved on October 2007 from Factiva database.

⁵¹ Busch, A. (2007). Die Aufkäufer aus Brasilien. *Handelsblatt*, 15 February 2007.

⁵² Chaddad, F. R. (2003). *CVRD Mining by 2010: Redrawing Firm Boundaries for 3x Market Cap*. Case Study No. 303-003-1. Sao Paulo, Brazil: Accenture.

in order to secure a stable client base for iron ores and pellets, could be considered as an important part of the company's success and dominant market position in Brazil.

With its latest acquisitions in a diversified range of metals, Vale is getting closer achieving its goal to become a one-stop-shop for the steel industry. This business model transformation is important, as the trend of major steel corporations like ArcelorMittal is to seek backward integration. The ability to offer packaged deals to steel mills lowers transaction cost for its customers and can exploit economies of scale and scope, which results in competitive advantages and further enhances Vale's low cost production structure.

Thanks to this combination of high commodity pricing and well-thought strategy, Vale's stock price has been soaring. With a strong demand from China, a strong presence in the nickel market after the Inco acquisition, and probable price increases from the next rounds in iron ore price negotiations, Vale's performance and earnings should significantly increase through the next years.

ANNEX

Exhibit 1: Expansion Timeline

Year	Country	Mode of Entry	Target Company/ Partner/Subsidiary/Client	Transaction Value (in mm USD)
1984	USA	Consortium acquisition	California Steel Industries	<i>undisclosed</i>
1992	France	Acquisition	SEAS	<i>undisclosed</i>
1992	Argentina	Consortium acquisition	Somisa (nka Siderar)	<i>undisclosed</i>
2000	Bahrain	Stake Investment: 50%	Gulf Industrial Investment Co.	183
2001	Chile and Peru	Joint Venture	Codelco	<i>n.a.</i>
2001	China	Exports	Shanghai Baosteel Group	
2002	Peru	Joint Venture	Antofagasta	<i>n.a.</i>
2002	Peru	Greenfield	<i>n.a.</i>	<i>n.a.</i>
2002	Chile	Greenfield	<i>n.a.</i>	<i>n.a.</i>
2003	Norway	Acquisition	Elkem Rana	17.6
2003	Gabon	Greenfield	CMTR	<i>n.a.</i>
2004	Mozambique	Greenfield	Rio Doce Mozambique	<i>n.a.</i>
2004	Mozambique	Concession Stake: 95%	Moatize Field	123
2004	Mongolia	Joint Venture	Itochu Corporation	<i>n.a.</i>
2004	China	Stake Investment: 25%	Shandong Yankuang	<i>n.a.</i>
2005	Angola	Greenfield	Gevale	<i>n.a.</i>
2005	Canada	Acquisition	Canico	760
2005	China	Stake Investment: 25%	Henan Longyu	86
2005	Ukraine	Exports		
2006	South Africa	Greenfield	Rio Doce South Africa	<i>n.a.</i>
2006	Canada	Acquisition	Inco	17,800
2006	Mozambique	Partnership	Petrobras	
2007	Mozambique	Greenfield	Moatize Field	<i>n.a.</i>
		Call Option on Stake:		
2007	Australia	51%	Belvedere	90
2007	Australia	Acquisition	AMCI Holdings	787

Source: Authors. Transaction Values are based on Capital IQ. Accessed on December 2007.

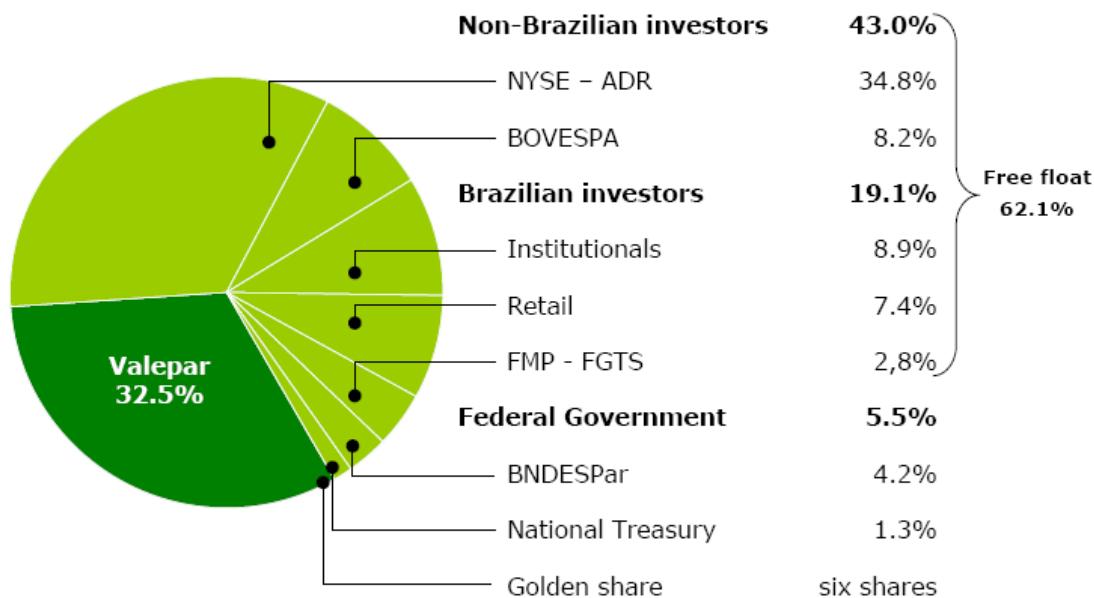


Exhibit 2: Main competitors and revenues, September 2007

#	Mining Company	Revenue (M)	Revenue Growth	Rev. Gr., 3 Yrs
1.	BHP Billiton Limited (ADR)	\$39,498.0	22.8%	18.9%
2.	Anglo American plc (ADR)	\$33,843.0	12.4%	21.1%
3.	Alcoa Inc.	\$31,445.0	18.8%	13.3%
4.	Companhia Vale do Rio Doce (ADR)	\$28,346.0	53.6%	54.3%
5.	Alcan Inc. (USA)	\$25,013.0	16.3%	19.5%
6.	Rio Tinto plc (ADR)	\$23,899.0	18.0%	34.5%
7.	Freeport-McMoRan Copper & Gold Inc.	\$11,388.1	38.6%	37.8%
Industry Average Metal Mining		\$25,400.8	31.6%	30.7%

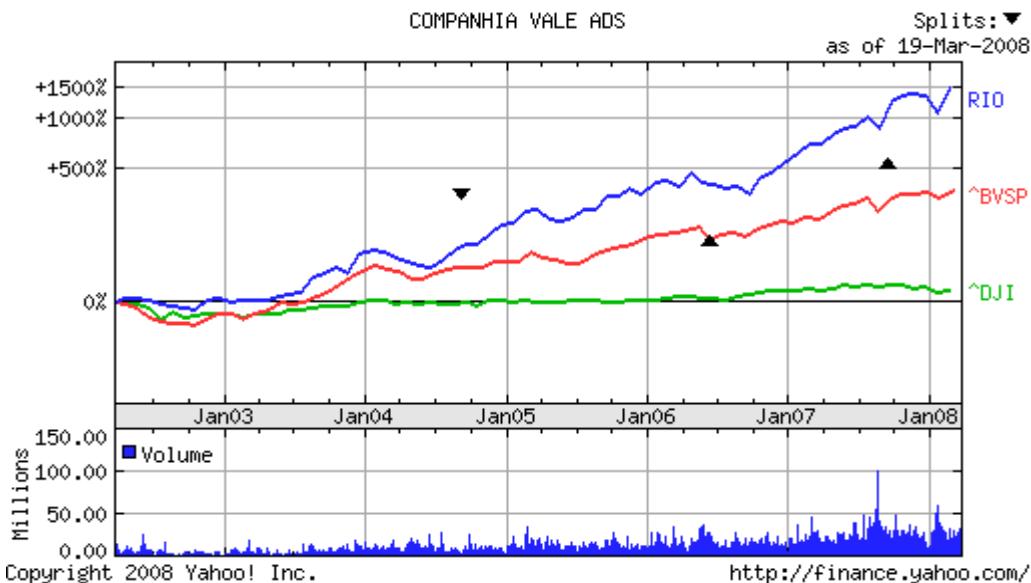
Source: Reuters. Accessed October 2007. The data does not include the effects of Rio Tinto's takeover of Alcan in October 2007.

Exhibit 3: Ownership Structure (as of August 2007)



Source: www.vale.com, as of October 2007

Exhibit 4: Stock Performance vis-à-vis the Dow Jones and the São Paulo stock exchange indexes



RIO = Companhia do Vale do Rio Doce trading at the New York Stock Exchange

BVSP = Bolsa de Valores de São Paulo Index

DJI = Dow Jones Index

Exhibit 5: Revenues by Geography, Division, Product 2007

Revenue Analysis by Geography	Amount	Percentage
Brazil	\$4.218	20,7%
China	\$3.706	18,2%
Japan	\$2.188	10,7%
Europe	\$5.183	25,5%
The Americas	\$1.620	8,0%
Asia (other than China, South Korea and Japan)	\$1.570	7,7%
Middle East/Africa/Oceania	\$1.010	5,0%
United States	\$868	4,2%

Revenue Analysis by Division	Amount	Percentage
Ferrous Minerals	\$12.166	61,9%
Non-ferrous Minerals	\$3.905	19,9%
Holdings	\$2.433	12,4%
Logistics	\$1.147	5,8%

Revenue Analysis by Product	Amount	Percentage
Iron Ore and Pellets	\$7.900	40,2%
Nickel	\$7.055	35,9%
Aluminium	\$1.592	8,1%
Copper	\$1.120	5,7%
Manganese & Ferro Alloys	\$334	1,7%
Logistics	\$924	4,7%
Other	\$727	3,7%

Source: Authors based on "Companhia Rio do Vale Doce", Datamonitor Company Profile, August 2007.

Petrobras

A Borderless Barrel¹

Petrobras has become a swift player in the oil & gas industry. With technological expertise and soaring profits from high commodity price levels the company has been able to extend its global reach. Its status as a semi-public company comes in handy, especially when negotiating with foreign governments for exploration rights and ethanol exports. In addition, taking advantage of economic crisis and market challenges to make strategic acquisitions and expand its asset portfolio has been an excellent internationalization strategy for the company. A global player, who is aware of the fact that crude oil is not eternal, is betting on an important product line for the future, ethanol.

Introduction

"We will become one of the five largest (energy) integrated companies in the world and the preferred choice among stakeholders."

– José Sérgio Gabrielli, chairman Petrobras, Vision 2020.

Brazilian oil and gas giant Petrobras is one of the largest corporations in the world. A fully integrated company, it owns more than 100 production platforms, 15 refineries, 23,000 kilometers of ducts and more than 6,000 gas stations in Brazil and abroad. Headquartered in Rio de Janeiro, Petrobras operates mainly in Latin America and the United States (Gulf of Mexico), but also in Africa, the Middle East, and Europe (Portugal). (See Exhibit 1 for the company's expansion timeline).

Petrobras earned over US\$21-billion in 2007 operating income, with net revenues of approximately US\$87.7-billion, and counted nearly 69,000 employees worldwide. Petrobras enjoys international recognition for its technical know-how in ultra-deep-water drilling. In 2008, the company was ranked 63th in the 2008 *Fortune Global 500*.² It is the 13th largest

¹ The authors gratefully acknowledge the cooperation of Petrobras executives in the preparation of this chapter.

² Fortune global 500. (25 August 2008). *Fortune*.

company from a developing country as measured by foreign assets;³ and, according to *América Economía*, ranks 2nd in Latin America as measured by revenues, just after Mexico's state-run oil and gas company PEMEX.⁴

The company was founded in 1953 as a state-owned monopoly. Although partially privatized, Petrobras – which has been called one of the “New Seven Sisters” from emerging economies – remains a state-controlled national champion.⁵ The company is a major contributor to Brazil’s economic development. In late 2007, the *Financial Times* named chief executive José Sérgio Gabrielli as one of the Top 10 most important figures in the global energy industry.⁶

Oil & Gas Industry

The global integrated oil and gas sector, the engine of the world economy, has total revenues of roughly US\$3.6-trillion.⁷ Sales are highly sensitive to price fluctuations, which can be triggered by geopolitical factors and natural disasters. A combination of increased demand and limited excess capacity has also driven prices to record highs. Oil prices over the past ten years have fluctuated dramatically from a low of just over US\$9/barril in 1998 to a high of nearly US\$100/barril as of November 2007 – a tenfold increase less than a decade.⁸ Oil prices went up by 2% per year between 1990 and 2002 and since have increased about 22% per year.

The industry is risky and capital-intensive, which imposes high barriers to market entry. Most major industry players have reduced risk by vertically integrating their upstream exploration and production operations with downstream activities in transportation, refining, distribution and retail sales of oil products.⁹ Also, partnerships in exploration and extraction

³ United Nations Conference on Trade and Development (UNCTAD). (2007). *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. New York and Geneva: United Nations.

⁴ Las 500 mayores empresas de América Latina. (21 July 2008). *América Economía*.

⁵ Hoyos, C. (2007). The New Seven Sisters: Oil and Gas Giants that Dwarf the West’s Top Producers. *Financial Times*, 19 June 2007. Retrieved on October 2007 from Factiva database. The FT identified the “New Seven Sisters” as: Saudi Aramco, Russia’s Gazprom, CNPC of China, Iran’s NIOC, Venezuela’s PDVSA, Petronas of Malaysia, and Brazil’s Petrobras.

⁶ Crooks, E. (2007). Ten top powers to be reckoned with. *Financial Times*, 09 November 2007.

⁷ Datamonitor. (2007). *Global Integrated Oil and Gas*. Industry Report No. 0199-2089.

⁸ In 1999, Venezuelan President Hugo Chávez whose country is a member of OPEC went to visit all major oil producing countries (oil prices had been at record lows in the previous year) and organized a meeting between the OPEC and non-OPEC countries (Mexico, Norway, Oman and the Russian Federation) where all countries agreed on the quotas. Oil prices started to go up after the meeting.

⁹ Business Insights Limited. (2006). *The Top Ten Oil & Gas Companies - Growth Strategies, Consolidation and Convergence in the Leading Players*. Industry Report. Business Insights Limited; and: Roberts, J., & Podolny, J. (1998). *The Global Oil Industry*. Technical Note No. S-IB-15. Stanford, USA: Stanford University.

are key to the oil industry's dynamics. The main contractual forms for these partnerships are concessions, joint ventures, production sharing agreements (PSAs) and service contracts. PSAs account for more than half of all exploration and extraction by multinational companies in developing countries.¹⁰

While many global oil and gas giants are privately owned, pressures towards state ownership have characterized the industry over the past century. States have entered the energy sector not only because of the strategic importance of natural resources for economic and military reasons, but also due to elevated rents- especially when prices are high. In some cases, states have nationalized privately-owned oil and gas companies operating on their territories. In Latin America, for example, Bolivia and Mexico nationalized their industries in the 1930s, Venezuela nationalized the sector during the Second World War, and Argentina and Peru nationalized the industry in the 1960s. The oil sector in Latin America today is dominated by national champions such as PDVSA, PEMEX and Petrobras.

While much of the planet's hydrocarbons can be found in emerging regions, the global industry has been traditionally dominated by a small number of giants – once known as the “Seven Sisters” – from Western industrialized countries: Exxon, Shell, BP, Gulf, Texaco, Mobil and Chevron. In recent years, however, companies from emerging markets have surfaced as major global players. In October 2007, the world’s top 10 integrated oil and gas companies, as measured by market capitalization, were: Exxon (U.S.) at US\$511-billion; PetroChina (China) at US\$449-billion; China Petroleum and Chemical Corp (China) at US\$301-billion; Royal Dutch Shell (UK/Netherlands) at US\$270-billion; Gazprom (Russia) at US\$263-billion; BP (UK) at US\$239-billion; Chevron (U.S.) at US\$192-billion; Petrobras (Brazil) at US\$188-billion; Total (France) at US\$174-billion; and ConocoPhillips (U.S.) at US\$133-billion.¹¹

Surging economic growth, particularly in Asia, is expected to generate increased demand for energy over the coming decades. Roughly 80% of the growth in consumption will come from emerging countries.¹² This is good news for Latin America, which has the largest proven oil reserves in the world after the Middle East. About 14% of daily global oil

¹⁰ United Nations Conference on Trade and Development (UNCTAD). (2007). *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. New York and Geneva: United Nations.

¹¹ Capital IQ. Accessed October 2007.

¹² Business Insights Limited. (2006). *The Top Ten Oil & Gas Companies - Growth Strategies, Consolidation and Convergence in the Leading Players*. Industry Report. Business Insights Limited.

output comes from Latin America. Mexico and Venezuela, whose oil industries are state-controlled, are major oil exporters to the United States.

Petrobras: Past & Present

Petrobras emerged from a historical experience immediately following the Second World War. In 1946, Brazil's new constitution stipulated that hydrocarbons discovered on national territory could be exploited commercially by both Brazilian and foreign companies – thus opening the door to multinationals such as Standard Oil and Shell. In the early 1950s, however, former Brazilian dictator Getúlio Vargas returned to power as an elected president and, once in office, adopted nationalistic measures to control the country's rich oil reserves. Vargas created Petrobras in 1953 as part of a nationalization policy aimed at achieving energy self-sufficiency with no reliance on foreign multinationals.¹³

During the 1960s, the exploration activity was concentrated mainly on three Brazilian states: Bahia, Sergipe, and Maranhao. The following years, new discoveries were just replacing production, which also promoted expansion to conserve national, Brazil-based reserves and constantly add new discoveries in outside territories.

The 1974 discovery of oil deposits in the Campos Basin was the foundation for Petrobras' most important exploration area, with additional discoveries of huge fields in that basin during the next years. In 1988, the Rio Urucu site started production in the Amazonian region.

In 1995, the Brazil's oil industry was deregulated and opened the market for international competition. However, the discovery of the largest Brazilian natural gas reserve in 1999, at the Santos Basin gave Petrobras a comfortable resource position. Due to the economic crisis from 1997 until 2002 – known as the “lost half decade” – domestic expansion slowed down. However, after 2004, Petrobras' expansion in Brazil regained momentum. In August 2004, its downstream subsidiary Petrobras Distribuidora acquired Agip do Brasil from Italian-based Eni. Another subsidiary, Gaspetro, purchased stakes of Enron's former Brazilian assets, Gasmig and CEG-RIO. Petrobras also acquired several power plants and a Brazilian liquefied petroleum gas, fuel and lubricant company, Liquigas Distribuidora.

As a state-owned monopoly, Petrobras faced no competition during its early years when consolidating its domestic market position. In the 1960s, it began to expand into non-monopolistic activities and with it; new subsidiaries were required to manage Petrobras'

diversifying operations. In 1967, a petrochemical subsidiary called Petroquisa was created and four years later a distribution unit called BR.

Petrobras' monopoly was reaffirmed by Brazil's 1988 constitution, which ended the military dictatorship after nearly twenty-five years. The following decade witnessed major transformations in the national oil industry in a macro context of political and economic changes, including hyperinflation that was finally controlled with the 1994 "Real Plan¹⁴".

In 2000, Brazilian president Fernando Henrique Cardoso took liberalization a step further by selling a 28.5% stake in Petrobras to private markets, including an ADR listing on the New York Stock Exchange. (See Exhibit 2 in Annex for the company's stock performance). Bringing private capital into Petrobras' shareholder base, even though the state kept voting control, had the effect of transforming the company into a more autonomous, market-driven corporation.¹⁵ Two years later, however, the election of Luiz Inácio Lula da Silva as Brazil's president created some uncertainty about Petrobras' business plans. Many interpreted the election as another sign of a "shift-to-the-left" political climate throughout Latin America. In particular, there was concern about a possible return to price-control regimes and state regulation of fuel production. However, the anxiety was largely unfounded, because the Brazilian government maintained a pragmatic approach concerning the energy sector. What's more, after 2002 Petrobras' prices were no longer subject to government directives, though the government could still impose limits on the company's long-term debt, and its budget was still subject to approval by the country's Congress. Overall, however, it seemed Petrobras was putting business interests before political agendas.¹⁶ When José Sérgio Gabrielli was appointed CEO in 2005, he brought higher efficiency and provided strategic direction in new opportunity areas such as ethanol.

Petrobras' flexible pragmatism has proved highly successful. Its revenue and profit performance have consistently shown signs of robustness – facilitated, of course, by soaring

¹³ Brandão, F. (1998). *The Petrobras Monopoly and the Regulation of Oil Prices in Brazil*. Oxford Institute for Energy Studies, Oxford.

¹⁴. The Real Plan resulted in significant structural changes in the economy and with the introduction of the new currency, the real, Brazil successfully managed to curb inflation, stabilise the economy and attract foreign direct investment.

¹⁵ The company's Class B shares were listed on the Buenos Aires Stock Exchange, and its American Depository Shares were listed on the New York Stock Exchange. The investment arm of Brazil's economic development bank, BNDESPar, owns 7.9% of the company's equity and 2% of its voting shares. Minority shareholders (non-government) hold four seats on Petrobras' nine-member board of directors. The other seats, a majority, are controlled by the government -- and the CEO, moreover, is state-appointed.

oil prices after 2004. The company operates according to standard oil industry practices: bidding for drilling rights and buying participations in existing projects, often involving large-scale partnerships to share risks and benefit from different types of expertise. Roughly 50% of Petrobras' exploration projects involve partners, compared with only 10% on production and refining. Among its partners you can find global players like Total-Fina-Elf, Exxon-Mobil, Chevron Texaco, Devon, Eni, as well as governments or other national oil companies.

In 2007, Petrobras announced US\$112-billion in capital spending over the next five years on oil and gas exploration, production, refining and gas infrastructure as well as on new downstream activities in petrochemicals and biofuels. Almost all these investments – totaling US\$104-billion – are being generated internally from cash flow.¹⁷ While Petrobras could finance 100% of its expansion activity internally, the company turns to private sources for roughly 10% of its requirements in order to maintain good relations with financial markets.¹⁸

Given that oil and gas companies must go to where the natural resources are located, and cannot create a market where no hydrocarbon deposits exist, technological expertise and experience (and sometimes political considerations) are crucial for success in the international oil and gas industry. Petrobras' expertise and technology platforms in deep-water oil exploration and production are a key factor in the company's competitive position – indeed, probably the main driver in the company's internationalization. In 1986, Petrobras created the Technological Innovation and Advanced Development in Deep and Ultra-Deep Water Program (PROCAP) to study exploration and production in deep waters to a depth of 2,000 to 3,000 meters.¹⁹

Going Global

"Petrobras is a great domestic success story that is beginning to move onto the world stage."
– Financial Times, 20 August 2007.²⁰

Like other Global Latinas, Petrobras has established a strong presence in its "natural" market in Latin America, including retail gas stations, while expanding its exploration and

¹⁶ Kerr, J. (2003). *Petrobras and the PT Government in Brazil*. Industry Report. Global Insight. Retrieved on October 2007 from Global Insight database.

¹⁷ Crooks, E. & Mahtani D. (2007). Petrobras forges new supply chain link. *Financial Times*, 20 August 2007

¹⁸ Interview with authors, 12 July 2007.

¹⁹ Global Markets Direct. (2007). *Petroleo Brasileiro S.A. Company Profile*. Analyst Report No. GMDGE0880P. Global Markets Direct.

²⁰ Crooks, E. & Mahtani D. (2007). Petrobras forges new supply chain link. *Financial Times*, 20 August 2007

extraction operations internationally. The company's internationalization strategy can be broken down into *three* general phases. The first phase began in 1972 with the creation of the company's internationalization subsidiary, Braspetro, and its foray into the Middle East and throughout Latin America. The second phase began in 2000 with the company's partial privatization and subsequent creation of the International Business Area. The third phase, starting in 2006, began with increasing participation in new growth markets and the emerging biofuel opportunities.

i) **Braspetro: 1972 - 2000**

A milestone year for Petrobras' internationalization strategy came in 1972, when the company set up a subsidiary, Braspetro, to manage its overseas exploration activities. The Brazilian government's goal of energy self-sufficiency was a strategic factor in Braspetro's creation. By exploring for hydrocarbons in other countries, Brazil could hold on to its own resources in reserve. Soaring oil prices in the early 1970's also played an important role.

Braspetro immediately turned to oil-rich Middle East, including Iraq and Iran, largely through technical assistance service contracts. In Iraq, for example, Braspetro was behind the major discovery of the giant Majnoon field in 1975. The company was forced to leave Iraq, however, after President Saddam Hussein nationalized the oil industry, though the Iraqi government compensated Petrobras in kind with oil. A decade later, the company was forced to leave both countries after the Iran-Iraq war broke out.

These setbacks forced Petrobras to reassess its internationalization strategy. Henceforth, the company pursued its expansion in "natural" markets in Latin America. It had begun operations in Colombia in 1972 and returned to the country fourteen years later when it acquired the domestic assets of British-based Lasmo and American oil giant Exxon. Further expansion plans were put off, however, because of Brazil's debt crisis in the 1980s. It wasn't until the 1990s, when Brazil's economy began to recover, that Petrobras stepped up foreign investments in the region – notably Bolivia, Argentina, and Ecuador. In Bolivia, for example, Petrobras moved into the country opportunistically when the country's gas industry was privatized. Petrobras was a partner in the joint Bolivia-Brazil gas pipeline built between 1997 and 2000. The pipeline project received significant financial support by international institutions like the Inter-American Development Bank, World Bank, Andean Development Corporation, European Investment Bank, Banco Nacional de Desenvolvimento Econômico e Social and the Export-Import Bank of Japan. Petrobras soon became Bolivia's biggest

corporation accounting for roughly 20% of the country's GDP and about 25% of its tax collection.

In late 1990s, two important events affected Petrobras' international expansion plans. First, in 1998 the contagion from the Asian economic crisis led to a major devaluation of the Brazilian real and consequently the entire region was hit by an economic slowdown. Second, oil prices plummeted to record lows. Against this backdrop, Petrobras' expansion in Latin America lost momentum. Indeed, as previously mentioned, these same factors pushed the Brazilian government to liberalize the sector and sell off a minority stake in Petrobras to private investors.

ii) International Business Area (2000 onwards)

In 2000, Petrobras set up a corporate entity, International Business Area (IBA), to manage assets and operations outside Brazil and drive global growth.²¹ IBA was given responsibility not only for oil and gas exploration and production, but for all international operations including refining, pipeline transportation, and retail distribution. Through IBA and its subsidiaries²², the company now operates in 27 countries on three continents and in 2006 invested US\$2.6-billion abroad. (See Exhibit 3 for the company's oil and gas production in the world).

Latin America

The timing of these two moves – privatization and creation of IBA – was, in theory, unfortunate against the backdrop of Latin America's economic downturn. To make matters worse, Petrobras had to manage a catastrophic setback when, in March 2001, one of its offshore oilrigs in the Atlantic Ocean exploded and caused a massive spill as it sank. Because of the accident Brazil had to put its energy self-sufficiency goal on hold. Petrobras was in addition facing competition from foreign multinationals after 2002, when Brazil's energy market was fully liberalized.

Like other Global Latinas, Petrobras took advantage of economic crisis and market challenges to make strategic acquisitions and expand its asset portfolio. Argentina – which was going through a severe economic crisis at the time – became Petrobras' targeted "pilot

²¹ Following the creation of IBA, in 2002, the company's international unit Braspetro was folded into the company operations.

country".²³ In 2001, Petrobras conducted an asset-swap deal with Spanish oil company, Repsol-YPF, receiving Argentine-based Eg3 (including a network of more than 700 service stations and refining assets).²⁴ The big play came in 2002 when Petrobras paid approximately US\$3.5-billion for a controlling 58.6% stake in Argentina's second-largest oil giant, Pecom Energia, which was part of the family-owned Pérez Companc conglomerate.²⁵ Petrobras also paid US\$90-million for Petrolera Sante Fe, an Argentine oil and gas company owned by U.S.-based Devon Energy Corporation. This latter deal had all the hallmarks of a familiar pattern: a Latin American firm buying up the assets of foreign multinationals retreating from the region in times of crises.

The Pecom deal significantly increased Petrobras' oil reserves and foreign assets. As Francisco Gros, the company's president at that time, noted: "As of today, we will no longer be solely the major Brazilian company in the oil business, but also Brazil's major multinational corporation."²⁶ When the deal was completed, Petrobras controlled upstream assets in three Latin American countries – Ecuador, Peru and Venezuela – where previously it had not been present. Joao Figueira, Petrobras' head of exploration and production, said that the company's ambition was to "become a more international oil company because producing and exploring for oil in a variety of different places around the world diversifies risk."²⁷

Mexico was another strategic market for Petrobras, largely due the company's interest in the Gulf of Mexico where it was partnering with American firms. Petrobras entered Mexico in 2003 in onshore natural gas exploration and production in partnership with the Japanese-based Teikoku Oil and Mexican-based Diavaz.

In 2004, Petrobras joined Exxon and Colombian state-owned Ecopetrol in a major off-shore exploration initiative in the Caribbean Sea. This joint venture consolidated Petrobras' international position in deep-water exploration. Petrobras meanwhile partnered with Ecopetrol and Canadian-based Nexen to exploit Colombia's Guando field southwest of Bogotá. In Uruguay, Petrobras has been operating in natural gas distribution since 2004,

²² Main subsidiaries include Petrobras International Finance Co., Braspetro Oil Company, Petrobras International Braspetro BV, Brasoil and Petrobras Netherlands.

²³ Interview with Petrobras executives, 12 July 2007.

²⁴ Petrobras SEC Filings, Form 20-F, 2001. Petrobras offered Repsol-YPF a 10% stake in the Albacora Leste field, 30% of its REFAP refinery, and exclusive distribution rights for 250 gas stations.

²⁵ Desai, M., & Reisen de Pinho, R. (2003). *Drilling South: Petrobras Evaluates Pecom*. Case Study No. 9-204-043. Boston, USA: Harvard Business School Publishing.

²⁶ Petrobras Teleconference, 17 October 2002, on the "Signing of the definitive Stock Purchase Agreement to acquire controlling interest in Perez Companc S.A.". Retrieved on October, 2007, from www.petrobras.com.br

partnering with national oil company Administración Nacional de Combustibles Alcohol y Portland (Ancap).

Argentina paid off big time for Petrobras. Since the Pecom deal, the company has consolidated its position in Argentina through a series of takeovers. As of 2007, Petrobras operates an extensive network of Argentine retail service stations that have a 13.8% share of the national gasoline and diesel market and 11% of the lubricants market. Moreover, Petrobras owns a 50% stake in the parent company of Transportadora de Gas Del Sur (TGS), which operates Argentina's biggest network of gas pipelines. In electricity, Petrobras owns the Genelba natural-gas based thermoelectric plant and the Pichi Picún Leufú hydroelectric plant. Also, in 2004 the company bought two Argentine petrochemical plants. In 2006, Petrobras was selling nearly 1.5 million tons of ethane, propane, butane and natural gasoline in Argentina.

Petrobras meanwhile continued shopping for assets to strengthen its downstream position in Latin America. Once again, a foreign multinational was retreating from the region. In 2006, Petrobras paid US\$140-million²⁸ for Shell's operations in Paraguay and Uruguay, plus gas stations in Colombia. Shell was exiting Latin America due to growing anxiety about the potential nationalization of oil assets following events in Venezuela and Bolivia. In total, Petrobras acquired 261 gas stations (52 with convenience stores), a lubrication plant, a basic products terminal, and LPG and aviation fuel product commercialization points at airports in Asunción, Ciudad del Este, and Carrasco. In June 2006, Petrobras purchased 51% in Gaseba Uruguay, a natural gas distribution utility in Montevideo.

Petrobras remains the largest natural gas company in Bolivia despite Bolivian President Evo Morales's nationalization of the industry in 2006 following a "people's trade agreement" with Hugo Chavez and Fidel Castro. Bolivia's nationalization decrees gave companies like Petrobras 180 days to accept new contracts stipulating an increase of the Bolivian government's share from 50% to 82% in all gas projects.²⁹ Petrobras also had operated two market-leading Bolivian refineries through Petrobras Bolivia Refinación, which supplied 100% of the country's demand for gasoline, 100% of its jet-fuel requirements, and

²⁷ Petrobras explores abroad. (April 2003). *Latin Finance*.

²⁸ CapitalIQ. Accessed October 2007.

²⁹ Now it's the people's gas. (6 June 2006). *The Economist*.

70% of its demand for diesel.³⁰ On June 26, 2007 Petrobras sold the two refineries to YPFB³¹. In Venezuela, where Petrobras gained market entry thanks to the Pecom takeover, the company has focused – due to political sensitivities – on service operations in fields belonging to state-controlled PDVSA.

Europe, United States and Japan

Like other Global Latinas such as CEMEX, Petrobras has made an historic return to its former colonial mother country. In 2007, the company started operating in Portugal following an agreement with Galp Energia and Partex to explore and produce oil off the Portuguese coast. With a 50% stake, Petrobras is the project's operator. Elsewhere in Europe, Petrobras signed an agreement in 2007 with the Norwegian oil corporation, Statoil, in joint biofuel production projects and was evaluating equity investments in Japan, the Netherlands, Spain and the United Kingdom. The company has also facilitated the Latin American market entry of Russian gas giant Gazprom, the largest global gas company. In 2006, the two companies signed an agreement to study the building of a gas pipeline from Venezuela to Argentina, Chile and Brazil. The deal marked Gazprom's first foray into South America.

Petrobras has been operating in the United States since 1987, when it acquired shares of Texaco's operations in the Gulf of Mexico. It is also a player in the American petroleum and oil by-products trading market. Over the past two decades, subsidiary Petrobras America has been intensifying its operations through "farm-ins"³² and by acquiring exploration blocks in U.S. government auctions. In 2006, it acquired a 50% stake in the Pasadena Refinery in Texas from Astra Oil Company, affiliated with the Belgian private equity group Compagnie Nationale à Portefeuille. The refinery is strategically positioned next to the Houston Ship Channel and is connected to main pipelines that transport oil products throughout the country. With the Pasadena deal, Petrobras achieved significant growth in the downstream segment of the U.S. market. Petrobras America plans to invest over US\$4-billion in the United States operations, including the new discoveries in the Gulf of Mexico which will begin production in 2010.

Through these U.S. deals, Petrobras has been increasing its American asset portfolio and thus boosting its recognition worldwide for its high-tech expertise in ultra-deep water

³⁰ <http://www.petroleumworld.com/story06050312.htm>. Accessed October 2007.

³¹ Yacimientos Petrolíferos Fiscales Bolivianos

³² The term farm-in refers to the acquisition of a license interest in an oil or gas exploration project.

operations. In 2007, Exxon sold Petrobras a refinery in Japan, allowing the Brazilian company to tap in to the Asian market.

Africa and Middle East

Africa is among Petrobras' investment priorities in the company's Strategic Plan for 2020. With a solid portfolio of exploration and production activities in Africa already – Angola, Nigeria, Equatorial Guinea, Tanzania, Mozambique and Libya – Petrobras considers parts of Africa as a "natural" market. This is particularly the case of Angola, a former Portuguese colony with which Brazil has long and solid trade relations.

Petrobras has been operating in Angola since 1979, four year's after the country's independence, where its activities are mainly partnerships with other oil giants, including Chevron, Total, and Angolan state-owned Sonangol. Elsewhere in Africa, the company began deep-water operations off the shores of Nigeria in 1988, and has since consolidated its presence in Nigerian oil exploration and production. Petrobras also plans to invest a total of US\$1.9 billion in two Nigerian joint ventures with Chevron-Texaco and Total, while it also established projects with Shell, Phillips, Exxon-Mobil, and Norwegian Statoil. Petrobras' activities in Nigeria are not limited to crude: it is also negotiating to supply ethanol to that country.

In Tanzania, Petrobras won the first round of bids opened by the government in 2001, and in 2004 signed an agreement with national oil company, Tanzania Petroleum Development Corporation, for exploration in a deep water basin. The same year, Petrobras purchased a 40% participation in an off-shore oil exploration project in Senegal from the Italian company Edison Spa, which held 95% of the block's interests. The remaining 5% belonged to Senegalese national oil company, Petrosen.

Petrobras also operates off the Libyan coast via a partnership with Libya's state-owned National Oil Company (which holds a controlling 51% stake). In 2006, Petrobras and Mozambique's national oil company, Empresa Nacional de Hidrocarbonetos (ENH), signed an agreement for onshore and offshore oil and natural gas exploration. Petrobras also bought a 17% stake in the Zambezi Delta exploration block off the coast of Mozambique, where plans include biofuel research to produce biodiesel from the jatropha plant and sugar cane-based ethanol production.

iii) New Markets and Renewable Energy

Petrobras also actively seeks for participation in the new oil hot spots around the world. In 2004, the company acquired upstream assets in Iran, which it also chose as the location for its unit, Petrobras Middle East, set up to facilitate access to oil exploration and production throughout the region. An early result of those efforts was the contract signed with the National Iranian Oil Company for oil exploration in the Persian Gulf.

While Petrobras – like other Latin American firms – is cautious about the Chinese market, it is examining potential opportunities in that country before making significant capital commitments. So far, Petrobras has signed two agreements with Chinese national oil companies. The first, in 2004, was with Sinopec for oil exploration, production, refining and petrochemicals. The following year, Petrobras signed an agreement with the powerful Chinese National Petroleum Corporation to undertake joint projects – in both Brazil and China – in integrated activities from exploration and extraction to refining and pipelines.

Pakistan meanwhile was looking to its oil and natural gas reserves as strategic resources. In 2005, President Pervez Musharraf chose Petrobras as a 50/50 partner with the national oil company, Oil and Gas Development Company Limited. India, for its part, became a Petrobras partner in June 2007 when it signed an agreement with India's biggest oil and gas company, ONGC, which was interested in the Brazilian oil giant's proven expertise in ultra-deep water exploration and production.

Petrobras began operations in Turkey in 2006 when national oil company, TPAO, granted the company two concessions for deep-water exploration and production in the Black Sea. The Turkish part of the Black Sea, largely unexplored, presents high risks but also has high upside potential since Turkey has a large network of oil and gas pipelines that supply Europe.

As crude oil is not everlasting, Brazil is betting on ethanol as a global biofuel substitute for hydrocarbons. Ethanol – produced from the fermentation of certain crops such as corn, sugar beet, and sugar cane – is used as an additive blended with petrol, but it can also be a substitute for gasoline in automobiles and has potential use in electricity generation and petrochemicals.³³ Ethanol's appeal has been growing as governments look for ways to reduce

³³ Kerr, J. (2005). *Lessons from Brazil's Proalcool Ethanol Programme*. Industry Report. Global Insight. Retrieved on October, 2007, from Global Insight database.

their cost of oil imports and to reduce carbon-dioxide emissions in order to meet their Kyoto Protocol commitments.

Brazil is the world's largest consumer and producer of ethanol – accounting for roughly 36% of total production – thanks mainly to the government self-sufficiency policy aimed at reducing the country's dependence on oil imports and creating a market for its surplus sugar cane production. The production of ethanol took off in Brazil as a result of the government's 1975 "Pro-Alcohol Fuel Program" in response to global oil price shock at that time. The program ended following a slump in world oil prices at the end of the 1980s, but has been revived in recent years through legislation and tax incentives for automobile makers.

Today, ethanol is widely used as a fuel in Brazil. By law, all gasoline sold in Brazil must contain an anhydrous ethanol content of 25%. The 2003 launch of the new flex-fuel car – which can run on ethanol – drove soaring demand for the biofuel.³⁴ By law, all cars manufactured in Brazil must run on ethanol, gasoline, or a combination of both. The production of ethanol in Brazil is profitable when the price of oil exceeds US\$30 per barrel.³⁵ (See Exhibit 4 in Annex for the history of oil prices). In 2007, investors were planning to spend some US\$12.2-billion on 77 new ethanol plants over the following five years and US\$2.4-billion on existing plants which by 2012 would be producing 9.5 billion gallons of ethanol.³⁶ Petrobras meanwhile partnered, in 2005, with Nippon Alcohol Banhai to form the Brazil-Japan Ethanol Company to supply the Japanese market with Brazilian-made ethanol.

Petrobras, which thus far has been involved mainly in the transport and distribution of ethanol, may enter production for fuel applications in response to rising demand – especially in the United States.³⁷ The company owns 33% of ethanol distribution in Brazil. Petrobras CEO José Sérgio Gabrielli has said that his vision for the company is to become "the Saudi Arabia of bio-combustibles" (ethanol and biodiesel) with a goal to export 4.75 billion liters annually by 2012.³⁸

In October 2007, Brazilian-produced ethanol received a major boost when the International Monetary Fund released its World Economic Outlook, which identified the

³⁴ Ethanol in Brazil is produced mainly from sugar cane, while in the United States it is produced mainly from corn.

³⁵ Interview with Brazilian government officials by authors in April 2007. As of October 2007, these price structures were controversial due to inflationary pressures of basic agricultural products used to make ethanol.

³⁶ Fuel for friendship. (1 March 2007). *The Economist*,

³⁷ Interview with the authors, 12 July 2007.

country's sugar-cane-based ethanol as the only ethanol that is cheaper to produce than gasoline.³⁹

The Essence of Petrobras' Success

Petrobras learned "to think on its feet like an international oil company but still retained the strengths and advantages of a national company."
– Richard Taylor, president of BP's Brazilian operations, 2007.⁴⁰

Petrobras' emergence as a global oil and gas giant was facilitated by historical and macro-economic factors common to other Global Latinas.

Most obviously, Petrobras is a classic Latin American “national champion” which, thanks to its privileged status as a state-owned energy giant, was able to leverage monopoly rents in its domestic market to expand its operations. The company’s status as a vehicle to achieve Brazil’s energy self-sufficiency also influenced its corporate strategy, for its expansion into Latin America was motivated by government policy to secure a stable energy supply. In like manner, it was government policy that led Petrobras to play a pioneering role in the development of ethanol as a substitute for gasoline. In short, domestic market factors have played a major role in Petrobras’ international expansion strategy.

Petrobras has of course been – like all global oil giants – the happy beneficiary of soaring oil prices. Surging demand for hydrocarbons has given oil and gas giants huge cash resources to deploy for global expansion. In this context, it is not surprising that many of the world’s largest corporations – as all the global rankings attest – are in the energy sector. Petrobras moved into the Middle East at a time of highly inflated oil prices – though suddenly retreated from the region due to political turbulence. It was after its withdrawal from the Middle East that Petrobras began expanding throughout Latin America. The company’s return to the Middle East after 2004 was timed, as it had been in the early 1970s, with another round of record high oil prices.

It should be noted, however, that Petrobras – despite its involvement in many exploration projects around the world – has largely remained focused on Latin America. This

³⁸ Jogo Bonito. (October 2007). *Expansion*.

³⁹ Brazil's fuel-powerhouse plans get a boost. (18 October 2007). *Wall Street Journal*; and: Big debate over benefits and costs of biofuels. (9 November 2007). *Financial Times*. On the issue of the environmental impact of corn-based ethanol in the United States, see: Green Dreams. (October 2007). *National Geographic*.

⁴⁰ How a Sleepy Oil Giant Became a World Player. (2007). *The Wall Street Journal*. 30 August

is particularly evident in its purchases of retail assets from foreign multinationals retreating from the region.

On a *firm* level of analysis, Petrobras has developed significant competitive advantages thanks to its proven expertise in deep-water offshore exploration. Decades of experience in the challenging business of extracting oil from deep-water offshore sites along the coastline of Brazil gave Petrobras know-how and technological capabilities that proved advantageous as the company expanded globally via partnerships. It is no surprise, therefore, that Petrobras has been particularly successful in leading operations in countries – Angola, Nigeria and United States (Gulf of Mexico) – with hydrocarbon deposits located in deep waters off their coastlines.

While partially privatized, Petrobras benefits from its state ownership, especially when negotiating with foreign governments for exploration rights. Another advantage of state control is leadership continuity: with a single controlling shareholder that is a government, Petrobras can pursue a long-term strategy that can achieve success over the long term. This however can also lead to certain conservatism in the company's expansion strategy. Petrobras deploys internal funds to finance growth, and tends to take a relatively low-risk approach to expansion, opposed to going to private markets to finance its moves globally. Another potential downside to state control is the ever-present risk of political turbulence – always a sensitive issue for a Latin American multinational.

Petrobras' strong market position in the burgeoning ethanol market – thanks to Brazil's longstanding government policy of self-sufficiency – is undoubtedly the wild card in the company's global fortunes. There can be no doubt that the company is well-positioned to establish itself as the world leader in ethanol as demand for biofuel grows.

Latest Developments

Petrobras announced at the end of 2007 the discovery of the giant Tupi oilfield in the Santos Oil Basin, which may contain as much as 8 billion barrels of oil and natural gas, an amount that would boost the country's reserves by 62 percent. According to an oil analyst, this discovery changes everything for Petrobras, as the Tupi deposit is not only large, but its light oil offers enormous cost advantages in refining. It is a deep water reserve and according

to CEO Gabrielli, Petrobras will be able to start producing from the field in five to six years.⁴¹ The consequences of the discovery therefore have to be awaited – but just as in similar countries, the expected profits opened a public debate about re-nationalization.⁴² Brazil's President Lula da Silva said the discovery could lead Brazil to join OPEC, though added that it would not join the oil cartel for another five years. Tupi might give Brazil enough clout to rival Venezuela's in setting energy policy in Latin America.

⁴¹ Source: <http://www.bloomberg.com/apps/news?pid=20601086&refer=news&sid=arYFojM6udEI>. Accessed February 2008.

⁴² Busch, A. (2007). Petrobras: Tupi or not Tupi". *Handelsblatt*, 15 November 2007. Retrieved on February 2008, from http://www.handelsblatt.com/News/Vorsorge-Anlage/Bulle-Baer/_pv/_p/203978/_t/ft/_b/1352297/default.aspx/petrobras-tupi-or-not-tupi.html.

Annex

Exhibit 1: Petrobras International Expansion Expansion Timeline

Year	Country	Mode of Entry	Target Company/ Partner/Subsidiary/Client	Transaction Value (in mm USD)
1972	Iraq*	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1972	Colombia	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1979	Angola	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1986	Colombia	Acquisition	Lasmo and Exxon assets Texaco Gulf exploration shares	<i>undisclosed</i>
1987	USA	Acquisition		<i>undisclosed</i>
1988	Nigeria	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1993	Argentina	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1995	Bolivia	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1996	Ecuador	Greenfield	<i>n.a.</i>	<i>n.a.</i>
1997	Bolivia	Pipeline Joint Venture	Gas Transboliviano	370
2001	Bolivia	Acquisition	Downstream assets	<i>undisclosed</i>
2001	Argentina	Asset Swap	Eg3 (from YPF-Repsol)	<i>undisclosed</i>
2001	Tanzania	Concession Acquisition	<i>n.a.</i>	<i>undisclosed</i>
2002	Argentina**	Acquisition	Perez Companc (Pecom)	3,539
2002	Argentina	Acquisition	Petrolera Entre Lomas	49.80
2003	Argentina	Acquisition	Petrolera Santa Fe	90
2003	Mexico	Exploration Joint Venture	Teikoku Oil and Diavaz	<i>n.a.</i>
2004	Colombia	Joint Venture	Exxon, Ecopetrol and Nexen Distribuidora Uruguayana	<i>n.a.</i>
2004	Uruguay	Stake Investment: 55%	Conecta	3.2
2004	Chile	Greenfield	Superpavi Brand	<i>n.a.</i>
2004	Argentina	Acquisition	Petrochemical assets Tanzania Petro.. Dev.	<i>undisclosed</i>
2004	Tanzania	Exploration Joint Venture	Company	<i>n.a.</i>
2004	Senegal	Agreement	Edison Spa	<i>n.a.</i>
			National Iranian Oil	
2004	Iran	Partnership agreement	Company	<i>n.a.</i>
2004	Iran	Acquisition	Upstream assets	<i>undisclosed</i>
2004	China	Partnership agreement	Sinopec	<i>n.a.</i>
2005	Lybia	Concession Acquisition	<i>n.a.</i>	<i>undisclosed</i>
2005	Lybia	Production Share Agreement	National Oil Company	<i>n.a.</i>
2005	China	Partnership agreement	CNPC	<i>n.a.</i>
2005	Pakistan	Partnership agreement	Pakistani Government	<i>n.a.</i>
2005	Japan	Distribution Joint Venture	Nippon Alcohol Hanbai	<i>n.a.</i>
2006	Uruguay	Stake Investment: 51%	Gaseba Uruguay	12.8
2006	USA	Stake Investment: 50%	Pasadena Refining System	370

2006	Mexico	Pipeline Joint Venture	Sinopec	<i>n.a.</i>
2006	Russia	Collaboration Agreement	Gazprom	<i>n.a.</i>
	Equatorial			
2006	Guinea	Exploration Joint Venture	Chevron, Sasol, others	<i>n.a.</i>
2006	Mozambique	Partnership agreement	ENH	<i>n.a.</i>
2006	Turkey	Greenfield	<i>n.a.</i>	<i>n.a.</i>
2006	Venezuela***	Pipeline Joint Venture	Gazprom	<i>n.a.</i>
2006	Paraguay	Acquisition	Downstream assets of Shell	
2006	Uruguay	Acquisition	Downstream assets of Shell	
2007	Colombia	Acquisition	Downstream assets of Shell	
2007	Japan	Stake Investment: 87.5%	Refinery assets	50

* The company exited Iraq in the 1980s due to political instability.

** The Pecom acquisition gave Petrobras access to the following markets: Bolivia, Peru and Ecuador

*** The pipeline will transport gas from Venezuela to Brazil, Argentina and Chile.

Source: Authors based on Capital IQ, company annual reports and interviews.

Geographical Presence Chart

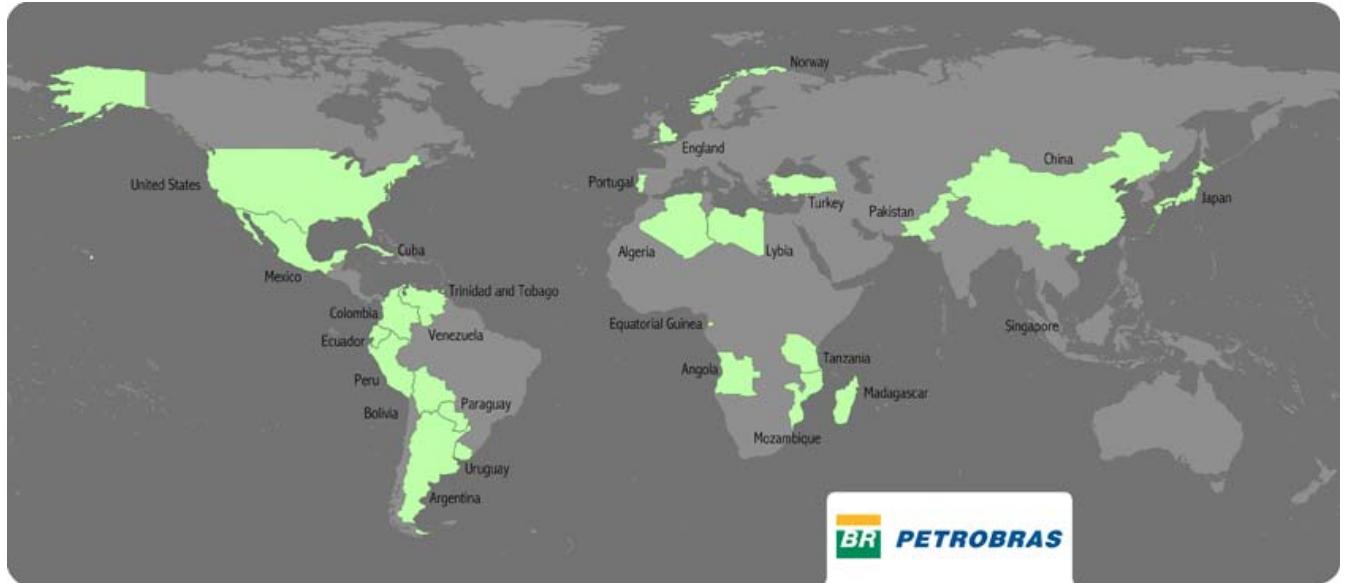
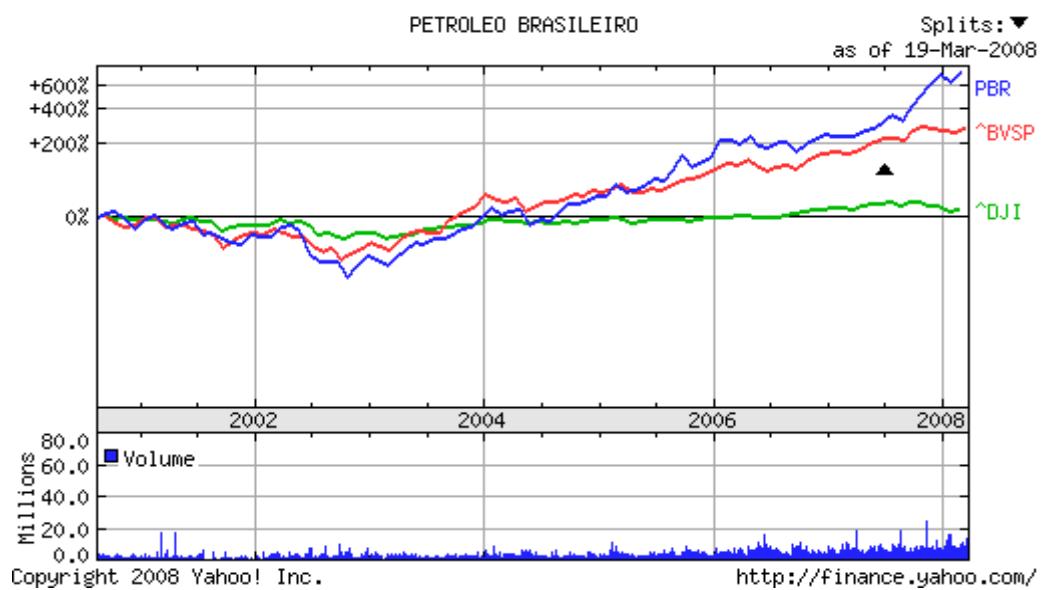


Exhibit 2: Stock Performance compared with the Dow Jones and the São Paulo stock exchange indexes



PBR = Petroleo Brasileiro = Petrobras trading at the New York Stock Exchange

BVSP = Bolsa de Valores de São Paulo Index

DJI = Dow Jones Index

Source: Yahoo!Finance, accessed April 2008.

Exhibit 3: Petrobras' oil and gas production

	2007			2006			2005		
	Oil (mbbl/d)	Nat. Gas (mmcf/d)	Total (mboe/d)	Oil (mbbl/d)	Nat. Gas (mmcf/d)	Total (mboe/d)	Oil (mbbl/d)	Nat. Gas (mmcf/d)	Total (mboe/d)
Brazil:									
Offshore:									
Campos Basin	1,475.3	750.0	1,600.3	1,468.3	759.1	1,594.9	1,404.7	752.4	1,530.2
Other	87.8	281.8	134.8	77.4	256.5	120.1	35.9	171.9	64.5
Total Offshore.....	1,563.1	1,031.8	1,735.1	1,545.7	1,015.6	1,715.0	1,440.6	924.3	1,594.7
Onshore	229.0	605.0	329.8	232.0	644.0	339.3	243.5	718.5	363.2
Total Brazil(1).....	1,792.1	1,636.8	2,064.9	1,777.7	1,659.6	2,054.3	1,684.1	1,642.8	1,957.9
International:									
Argentina	54.4	287.3	102.3	62.1	274.9	107.9	61.9	253.1	104.1
Bolivia	9.3	308.8	60.8	8.9	288.9	57.0	8.5	273.8	54.1
Colombia.....	16.6	0.1	16.6	16.8	0.2	16.9	16.5	0.4	16.6
Ecuador.....	10.4	0.0	10.4	11.9	0.0	11.9	9.1	0.0	9.1
Peru	13.3	11.0	15.1	12.7	10.9	14.6	12.6	10.7	14.3
Venezuela	0.0	0.0	0.0	10.5	4.3	11.2	44.2	20.2	47.6
United States.....	4.7	40.8	11.5	1.4	15.9	4.0	1.7	17.2	4.6
Angola.....	3.6	0.0	3.6	5.3	0.0	5.3	8.3	0.0	8.3
Total International.....	112.3	648.0	220.3	129.6	595.1	228.8	162.8	575.4	258.7
Total consolidated production.....	1,904.4	2,284.8	2,285.2	1,907.3	2,254.7	2,283.1	1,846.9	2,218.2	2,216.6
Equity and non-consolidated affiliates: (2)									
Venezuela	13.9	11.5	15.9	12.6	11.5	14.4	-	-	-
Worldwide production	1,918.3	2,296.3	2,301.1	1,919.9	2,266.2	2,297.5	1,846.9	2,218.2	2,216.6

Source: Petrobras, Form 20-F, 2007

Embraer

Flying High in the Global Market

A “national champion” who largely benefited from state subsidies, until it was privatized, has transformed itself, in part due to an outstanding leadership and to its ability to identify a niche with growth potential, into a profitable and successful business. Through risk-sharing partnerships, joint ventures and important acquisitions Embraer has been able to offset developing costs and reduce significant risks, an approach that has proven to serve their goals for international expansion.

Introduction

“Our actions and attitudes are always guided by our belief that success in our business stands on five pillars – technology, people, global presence, cash, and flexibility.”
– Mauricio Botelho, CEO Embraer, 2005.

Brazilian aircraft maker Empresa Brasileira de Aeronáutica (Embraer) is one the world’s top aircraft manufacturers. The company has long vied with Canadian-based Bombardier for third place -- after Airbus and Boeing -- in global rankings of aircraft manufacturers.

According to *América Economía*, the company is the 84th largest corporation in Latin America. With revenues of US\$4.9-billion (the best results in the company’s 37-year history)¹ Embraer has a total workforce of more than 23,000² including regional plants and offices in North America, Europe, China, and Singapore. Exports make up 95% of Embraer’s total sales.

The Embraer success story – which has been described as “a saga from agony to glory” -- owes much to the company’s ability to identify the growth potential of regional jets and leverage know-how and technology in that niche. Going forward, Embraer’s strategic ambition is to be a global leader in the executive jet market by 2015.

¹ “Las 500 mayores empresas de América Latina”, *América Economía*, July 2007; and “A Embraer na encruzilhada”, *Exame*, 23 May 2007.

² As of December 2007.

Aircraft Manufacturing Sector

The aircraft industry is divided into four main categories. First, *commercial* aircraft (more than 100 seats) are used for medium to long-haul flights that connect major cities. This segment is dominated by Europe's Airbus and U.S.-based Boeing. Second, *regional* aircraft (20 to 90 seats) are generally used for short and medium-haul flights that connect smaller cities with larger hubs. This segment is dominated by Bombardier and Embraer (both producing jets) and Franco-Italian ATR (manufacturing turbo-props). Third, *light* aircraft (fewer than 20 seats) include both business jets (such as the Gulfstream, Raytheon's Hawker, Bombardier's Learjet, Dassault's Falcon, and Embraer's Legacy, Lineage and Phenom) and aircraft used for medical evacuations, border patrolling, forest fire fighting and other uses. Finally, the *military* aircraft industry is dominated in the United States by major players such as Boeing and Lockheed Martin, which compete globally against European-based EADS, BAE Systems, Dassault, and Saab Aerospace.

From an industrial perspective, the aircraft industry is capital-intensive and therefore characterized by high barriers to entry. Research and development (R&D) and product launch costs are extremely high, though cost reductions over time from learning are unusually significant. Economies of scale are critical for competitiveness. Global players achieve scale advantages through market share and by bringing out a mix of products that share costs in part-fabrication, engineering, R&D, sales and marketing. In a word, the aircraft industry is oligopolistic.

Risk-sharing through manufacturing partnerships is increasingly becoming the industry practice. Large-scale subcontractors develop aircraft parts in exchange for long-term supply contracts. The aircraft sector is also heavily regulated by governments and obtaining product certification can be a complex process. Governments moreover are potential customers and, in the United States and Europe, fund R&D initiatives for military aircraft. Governments also provide export assistance to their domestic aircraft makers. In fact, this market is subject to a separate World Trade Organization regime: the OECD Arrangement on Officially Supported Export Credits Sector Understanding on Export Credits for Civil Aircraft.

Against this backdrop, it is not surprising that countries with world-class aircraft manufacturing sectors have a century-long history of investing in aviation stretching back to the First World War.

Embraer Past & Present

Embraer emerged as a classic state-owned “national champion”. The Brazilian government – in particular, the military – was the company’s launch customer, protector against market forces, and source of subsidies.

By the Second World War, influential Brazilian military thinkers like General Carlos de Meira Mattos developed theories about enhancing the country’s international stature through modernization. In the past, Brazil’s economic development had been dominated by agriculture and mining. The Brazilian military wanted to bolster the country’s prestige based on technological and industrial autonomy.³ Regarding the aeronautical sector specifically, concrete strategies involved a policy of market reserve, state financing and technological support to private firms through the *Centro Tecnológico Aeroespacial* (CTA). The CTA, an umbrella organization for aeronautical research modeled on the Massachusetts Institute of Technology, was set up in 1945 in São José dos Campos due to the local availability of electrical power and the area’s pleasant climate and topography.⁴ The creation of CTA led to the establishment of sister institutions devoted to engineering education and aerospace research.

In the early 1960s, the Brazilian economy lost steam and the ensuing political instability led to a *coup d'état* in 1964, ushering in more than two decades of military rule. The Brazilian military, while accepting private ownership, directed greater efforts towards a planned economy and consequently increased resources were allocated to science and technology. For reasons of national security, it was argued, Brazil should not depend on imported aircraft and spare parts, nor could the country allow the domestic aeronautical sector to be controlled by foreign corporations.

³ K. Sikkink, *Ideas and Institutions: Developmentalism in Brazil and Argentina*, Cornell University Press, Ithaca, 1991.

⁴ C. Campolina Diniz, and M. Razavi, “São José dos Campos and Campinas”, in A. Markusen, Y.-S. Lee and S. DiGiovanna (eds.), *Second Ties Cities*, Minneapolis, University of Minnesota Press, 1999.

In 1969, the military government created Embraer as an industrial national champion protected by its import-substitution-based industrial policy.⁵ Not only did the government manipulate the domestic market to Embraer's advantage, it also concentrated in the company's hands most financial, fiscal, marketing, regulatory, and international responsibilities.⁶ Embraer provided customers with alternate financing through Brazil's state-owned development bank, BNDES. The company also benefited from FINEX (*Fundo de Financiamento à Exportação*), an export support scheme administered by Banco do Brasil, and was granted generous fiscal incentives.⁷ In addition, in 1973 the Ministry of Foreign Affairs set up PNEMEM (*Política Nacional de Exportação de Material de Emprego Militar*) to promote arms exports.

When production started in the 1970s with foreign partners, the company negotiated co-production and licensing arrangements designed to achieve rapid market penetration without excessive technological dependence. For the most part, Embraer shied away from manufacturing high-value, high-technology components and concentrated instead on designing aircraft, producing fuselages, and assembling the final product. Embraer's practice was to negotiate long-term purchase agreements with its major suppliers. Its best-selling planes – the two-seat Tucano turbo-prop military trainer and the 19-seat non-pressurized, twin-engine Bandeirante turbo-prop – were designed in Brazil, though more than half of the latter aircraft's value consisted of imported parts. Fruitful collaborations with Italian partners led to the production of the Xavante jet trainer and ground-attack plane (under license from Aermacchi) and the AMX (in joint venture with Aeritalia and Aermacchi), a subsonic surface attack aircraft. Embraer was also collaborating with Brazilian private firms which supplied an increasing share of final components. Half of the company's directors, moreover, were private-sector executives.⁸ Although equity links were relatively tenuous, aeronautics was a good example of the “triple alliance” -- between foreign corporations, local private

⁵ Other important defense companies in São José dos Campos which also spun off from CTA are Avibrás (established in 1961) for missiles and Engesa (in 1975) for tanks and armoured vehicles. In the 1980s, Avibrás sold an estimated 66 Astros II, a multiple rocket launcher, to Iraq and an unspecified number to Saudi Arabia, Bahrain, and Qatar. Total sales of the Astros II between 1982 and 1987 reached US\$1-billion. While Avibrás has been highly dependent on imported components, Engesa developed its own design and technology capabilities and was more integrated with the local industrial base, in particular auto parts manufacturers. See *Brazil Special Weapons Guide* at <http://www.fas.org/nuke/guide/brazil/index.html>.

⁶ The government and the Brazilian Armed Force bought roughly a third of Bandeirantes produced before 1980. They usually paid up-front and directly contributed to development expenditures.

⁷ All weapon-producing companies were exempted from duties on the import of inputs. Moreover, Embraer did not pay trade (ICM) and production (IPI) taxes. Furthermore, all Brazilian companies buying non-voting shares in Embraer could obtain a 1% rebate on corporate-income tax. Federal agencies were also required to buy Brazilian aircraft provided their price was no more than 15% more expensive than competing imported goods. Finally, aircraft imports were subject to a 50% duty if a competing Brazilian product was available.

⁸ O. Silva, *A decolagem de um sonho. A história da criação da Embraer*, São Paulo, Lemos, 1998.

entrepreneurs, and state-owned enterprises -- that underlined Brazil's rapid accumulation of capital until the early 1980s.⁹

Embraer used the threat of a steep increase in import duties to arm-twist foreign aircraft manufacturers into accepting to provide kits to assemble final products in Brazil – thus acquiring organizational know-how in serial production.¹⁰ Indeed, Embraer's strong focus on the *export* market was an early priority that proved crucial in offsetting development costs. It permitted longer production runs, stimulated customers to bring new ideas that facilitated technical change, and demanded exacting performance standards. The company saw a niche for low-cost, technologically innovative aircraft that could operate in the difficult environments often found in developing countries.¹¹ The same logic underlined the production of military aircraft with less sophisticated features than planes exported by advanced industrial countries. The Tucano, for example, was produced in Egypt under license and sold to the British and French air forces.

Brazil's economic turmoil and political instability in the 1980s almost caused Embraer's collapse. The country's debt crisis – which coincided with a transition from military rule to democratically elected government – suddenly ended the low financing costs that had been supporting the domestic aerospace industry. When the dictatorship ended, military contracts declined and the country's civilian government was preoccupied with skyrocketing inflation that hit a staggering of 6,800% by the end of the decade. At the same time, Embraer was hit hard by the world recession in the late 1980s and, closer to home; the decision by Brazil's elected government to discontinue FINEX. Further bad news came when the company's attempt to develop the CBA-123 aircraft with Argentina's Fábrica Militar de Aviones (FAMA) was a flop. In that deal, political motivations to strengthen bilateral co-operation and build mutual trust with Argentina had prevailed over business considerations. In sum, Embraer had been able to enhance its competitiveness and secure a significant presence in overseas markets, but its deeply embedded corporate culture of putting engineering before marketing considerations was an unfortunate symptom of the company's long-term reliance on public procurement. In the end, this legacy proved disastrous.

⁹ P. Evans, *Dependent Development*, Princeton, Princeton University Press, 1979

¹⁰ Since the 1980s Embraer has been the sole subcontractor to design and produce outboard flaps for the McDonnell Douglas MD-11 and to produce dorsal fin and wing tips for the Boeing 777. It also manufactures precision-machined parts for the 747 and 767.

The time of reckoning for Embraer arrived in the early 1990s. As the economic crisis took its toll on Brazilian corporations – drastically reducing profits – Embraer’s private equity financing dried up and the government’s stake increased to fill the void. Political circumstances further hindered Embraer’s economic adjustment: downturn in the global military industry as the Cold War was winding down, the end of the Iran-Iraq war, the lower intensity of Angola conflict, and the U.S. government’s more aggressive policy in favor of supporting American aircraft producers. All these factors combined to close export markets for Embraer’s military equipment.¹² As delays mounted and orders were cancelled, the cost of managing a growing inventory of unsold planes rose.

To make matters worse, Embraer could no longer count on Brazilian government export subsidies and other state support.¹³ Despite efforts to diversify into services and other activities, the company’s revenues plummeted -- from US\$700-million in 1989 to only US\$177-million in 1994. Responding to this crisis, the company shrunk its workforce from 13,000 to 6,100 as losses mounted.¹⁴ In 1994, the company posted a loss of US\$310-million and its place in the ranking of Brazil’s largest exporters plummeted to 38th.

The writing was on the wall for Embraer by 1992 when the Brazilian government -- despite the opposition of the Brazilian military -- put Embraer on its list of state-owned enterprises targeted for privatization. Following six failed attempts, in December 1994 the government finally sold the company to a consortium that bought a controlling 45% stake for US\$89-million. The consortium included American investors assembled by New York investment boutique Wasserstein Perella; Brazilian financial conglomerate Bozano Simonsen; and Previ and Sistel, respectively Banco do Brasil’s and Telebras’s pension funds.¹⁵ The Brazilian government injected new capital, assumed US\$700-million in debt, and retained 6.8% of the stock (including a “golden share” carrying veto power over, among other things,

¹¹ While turbofans are less powerful than jets, they have wider wings and therefore require shorter runways. They also consume less fuel.

¹² Nearly 40% of all Brazilian arms transfers from 1985 to 1989 went to Iraq. Precise financial data on the importance of the Middle East market for Embraer are not available. The company received orders for the EMB-312 Tucano (110 from Egypt in 1983, 80 from Iraq in 1985, 50 from Iran in 1988, and 100 from Libya in 1986), the EMB-111 marine patrol aircraft (two from Algeria in 1982 and eight from Libya in 1986), and the EMB-121 Xingu (25 from Libya in 1986).

¹³ Antoine van Agtmael, *The Emerging Markets Century: How a New Breed of World-Class Companies is Overtaking the World*, Simon & Schuster, 2007.

¹⁴ Pankaj Ghemawat, Gustavo Herrero, and Luis Felipe Monteiro, *Embraer: The Global Leader in Regional Jets*, Harvard Business School, Cast Study 9-701-006, 20 October 2000.

¹⁵ In June 1995, after Wasserstein Perella’s failure to pay the money it had pledged, Bozano Simonsen bought it out. The three controlling shareholders act in concert to vote 60% of Embraer’s outstanding common stock.

change of control and corporate mission).¹⁶ Clauses inserted into the agreement limited foreign ownership to 40% and imposed a 6-month moratorium on layoffs.

In 1995, Mauricio Botelho, a 53-year-old mechanical engineer with a background in construction and telecommunications but no experience in aviation, was appointed as Embraer's CEO. Botelho strengthened the company's equity base, intensified efforts to improve the profile and conditions of its heavy debt burden, improved production methods and processes, made substantial investments in IT systems, and drastically cut costs including layoffs for 1,200 white-collar employees and 500 engineers. The payroll fell to less than 4,000 by the end of 1996.

These painful measures staunched losses and boosted productivity. Four overseas support centers were created and a fully-owned finance company was set up in the Cayman Islands to help airlines lease, rather than buy, new aircraft and trade in used ones. In June 1995, the first signal of Embraer's renewed confidence came when the company signed a risk-sharing agreement with United Technologies-Sikorsky to design and manufacture the fuel system and landing gear of the S-92 19-seat, twin-engine, turbine-powered civilian helicopter.¹⁷

The big payoff, however, came in 1996 thanks to Embraer's strategic focus on regional jets with the ERJ-145. The aircraft -- lighter, cheaper to buy, and less expensive to operate than its main rival, Bombardier's CRJ-200 -- was presented at the 1996 Farnborough fair and secured its first contract with Continental Express, a subsidiary of Continental Airlines.¹⁸ In July 1997, the company was awarded ISO 9001 certification for quality in design, production, sales, and service. A year later, Embraer finally returned to profitability in 1998 after 11 consecutive years in the red.¹⁹

1999 was milestone year for Embraer. The company became Brazil's biggest exporter that year, accounting for 3.5% of total Brazilian exports. The devaluation of the Brazilian *real*

¹⁶ The government has the right to designate one board member and has customarily chosen one Air Force Major-Brigadier for such position. Until 2001, the second representative, also a Major-Brigadier, was elected by the controlling shareholders. In 2000, then Minister of Foreign Affairs Lampreia argued that the government-appointed representative could be a civilian, possibly a diplomat. He was appointed to the board in January 2001 upon his retirement from government.

¹⁷ Embraer uses CATIA (Computer Aided Three-Dimensional Interactive Application) as a standard geometric modelling platform to reengineer aircraft manufacturing development processes and improve integration of internal operations and relations with international partners.

¹⁸ The ERJ-145 is equipped with Rolls-Royce's engines and flight instruments, such as engine-indication instruments, crew-alert systems, and digital flight control systems, produced by Honeywell.

¹⁹ Operating results have been positive since 1996.

that year reduced the company's wage bill – from 13% to 9.7% of production costs between 1997 and 1999. It also increased the financial costs of raising new debt, as well as servicing outstanding dollar-denominated liabilities, and reduced the dollar-value of the funds budgeted for government export programs. Embraer consequently began assisting some customers by restructuring financial arrangements or, when this proved impossible, by offering special price adjustments.

In October 1999, a consortium of French aerospace companies -- including Aerospatiale/Matra, Dassault, Thomson-CSF and SNECMA -- acquired 20% of the company's equity, thus reducing the Brazilian owners' stake to 69%. The following year, Embraer listed its shares on the New York Stock Exchange (see Exhibit 2 in Annex for stock performance). A few months earlier, the company had announced the launch of a new family of larger regional jets – or “E-jets” -- aimed at the American market. Swiss-based Crossair's 200-aircraft order, the largest ever for regional jets, was worth US\$4.9-billion.²⁰ More orders came from Poland's flagship carrier LOT, Air Canada, Hong Kong Express Airways, start-up Indian airline Paramount Airways, and China's Mandarin Airlines.

Embraer's E-jet was, as noted, a competitive response to Bombardier's aircraft in the same niche. Indeed, throughout the late 1990s Brazil and Canada were engaged in a bitter and lengthy trade dispute concerning government support for their respective aerospace industries. The rivalry became so intense that their market belligerence ended up before the World Trade Organization (WTO).²¹

Since 1998, the WTO has ruled three times that Brazil's interest rate equalization program, Proex (Programa de Estímulo às Exportações), is an illegal export subsidy to Embraer. The Canadian government, for its part, has been found guilty by the WTO for subsidizing Bombardier's regional jets. In May 2000, Canada indicated that it was prepared to invoke US\$3.3-billion in trade sanctions against Brazil in accordance with the WTO decision. Brazil promptly threatened “counter-retaliations or other measures” targeting substantial Canadian investments in Brazil and cutting off airline flights between the two countries. This grubby dispute appeared on the edge of erupting into an all-out trade war in

²⁰ Although Crossair has had to scale down considerably the order, due to the crisis at Swissair, Jet Blue of the US has placed a large order for up to 100 ERJ170/195 planes.

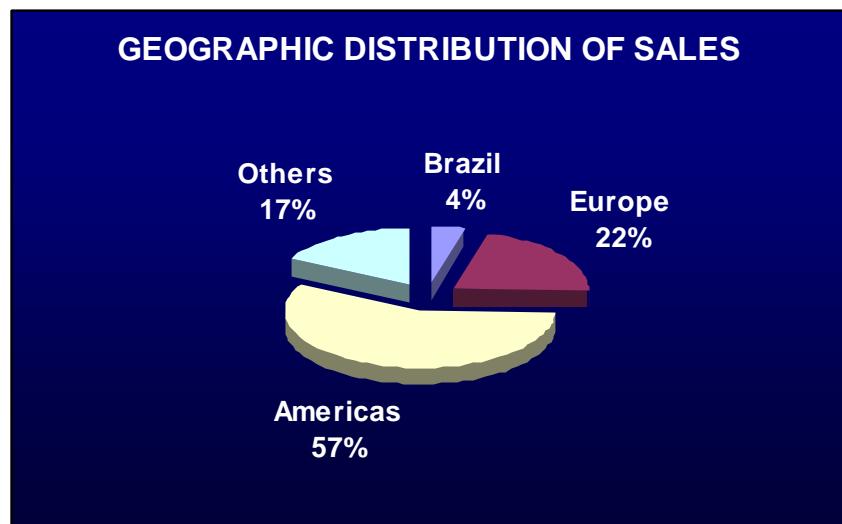
²¹ For the WTO case, see Andrea Goldstein and Steven McGuire (2004), “The Political Economy of Strategic Trade Policy and the Brazil-Canada Export Subsidies Saga,” *The World Economy*, 27(4): 541-66.

February 2001, when Canada banned imports of processed Brazilian beef, citing the risk of mad-cow disease.

On 23 December 2002, Brazil received a Christmas present from Geneva when a WTO arbitration panel report ruled that Brazil should be authorized to impose US\$385-million in counter-measures against Canada. Brazil had originally requested US\$5.2-billion in counter-veiling measures. The decision marked an end to all WTO proceedings in this matter, enabling the two countries to concentrate on negotiating an end to this dispute.

In 2007 the world's major civil aircraft exporting countries -- including OECD countries and Brazil (not an OECD member) -- signed an agreement limiting government support for export deals in an effort to end acrimonious trade disputes. The agreement, covering all types of civil aircraft, concerns the interest rates, loan guarantees and other conditions applied to export credits for aircraft sales.

Going Global



While Embraer has been internationally oriented from its inception due to the nature of the sector, the company stepped up its global strategy following privatization to garner the support of the Brazilian government as a proud national champion conquering international markets. By 2000, the aerospace industry was becoming truly global and building a direct presence outside of Brazil was imperative. Moreover, after September 11, 2001, Embraer's

long dependency on the commercial market and the United States was a source of concern. The company had to diversify its global prospects.

i) Europe: Privatization in Portugal

In 1932, the Portuguese government created the Oficinas Gerais de Material Aeronáutico (OGMA) - a renamed version of its military production unit launched after the First World War - to produce about 200 aircraft a year.²² When the Portuguese Air Force (FAP) was born in 1952, OGMA became one of its departments, focusing on Maintenance, Repair and Overhaul (MRO) operations. By the end of the 1950s, OGMA had signed MRO contracts with the U.S. Navy and Air Force, followed by contracts with the German air force in 1962. In the 1960s, the war raging in Portuguese colonies in Africa gave OGMA a reason to expand its operations significantly as it repaired planes and helicopters.

Following the Portuguese Revolution and the end of the colonial war in 1975, OGMA was left with excess capacity. A new strategy was found: promoting OGMA's facilities northeast of Lisbon as an MRO facility for international customers. In 1993 OGMA became an authorized maintenance center for Rolls-Royce AE2100 and AE3007 engines, which equipped Embraer's ERJ-145 family of jets. Under Portugal's Ministry of Defense since 1994, OGMA began servicing these aircrafts in 1998.

Despite its growing customer base, OGMA's transformation from a military department into a state-owned enterprise selling services competitively turned sour. In 2002, the company's debt peaked at US\$300-million – twice its annual revenues, while the liquidity position became so unsustainable that OGMA could not meet its 1,600-strong payroll on time. At the same time, the company was burdened by the legacy of poor decisions, excessive overhead costs, and high absenteeism. Successive governments, meanwhile, were frequently changing OGMA's strategic orientations instead of providing clear long-term objectives.

In 2003 the Portuguese government finally decided to privatize OGMA, hoping to transform the company into a sustainable competitive firm. The tender made two main stipulations: first, that the winning bidders have a manufacturing capability; and second, that a foreign partner be brought into the deal to guarantee greater international involvement. While the Defense Ministry managed the bidding process, Prime Minister José Manuel Durão Barroso oversaw negotiations. A total of ten potential contenders expressed interest, but most of them pulled out at an early stage for different reasons. The two Portuguese air carriers,

²² Including 27 Potez XXV, 16 Morane Saulnier 233, seven Vickers Valaparaiso, 17 Tiger Moth, 17 Avro 626 and 66 DHC-1 "Chipmunk".

TAP and Portugalia, were also interested, but they were excluded for not fulfilling the two main conditions.²³ Embraer soon emerged as the preferred bidder, since it easily met the two main tests and made a long-term commitment.

A series of political twists also indirectly favored Embraer. The Portuguese Defense Ministry had pulled out -- anxious to maintain a positive relationship with its U.S.-based Hercules supplier Lockheed -- of a European project to build A-400 M military transporters. The Defense Ministry also put out a tender for the acquisition of 12 tactical transport and maritime vigilance planes. There were two bidders: Alenia/Lockheed Martin and EADS/CASA. Eager to make everybody happy, the Portuguese government convinced Embraer and EADS to establish a joint holding company, Air Holding, to buy into OGMA's capital. The motive was simple: the Barroso government, concerned about being regarded as an unfaithful European partner, pressured Embraer to bring EADS into the OGMA buyout. Portugal thus maintained good relations with both Lockheed and EADS. Air Holding nonetheless was a peculiar solution, for EADS held just 1% of the capital, though it could opt to raise its stake to 30% if the decision on the 12 tactical planes favored the EADS/CASA offer.²⁴

To no one's surprise, in December 2004 the Portuguese government announced Embraer-led Air Holding as the winning bidder for OGMA. Embraer and EADS paid US\$23-million, while the Portuguese government wiped out most of the company's debt (with bank liabilities shrinking from US\$304-million to US\$51-million). The Portuguese government kept a 35% stake. Embraer, EADS, and the Portuguese government each had two of the company's six directors, though executive roles were filled only by Embraer.

What did OGMA bring to Embraer? Its decision to invest in Portugal can be explained by several factors. First, since Europe accounted for roughly 22% of Embraer's revenues, developing a services centre close to its European customer base was a priority as Embraer tried to reduce its dependency on the American market. OGMA, for its part, had a large client portfolio (including Embraer carriers such as BMI, Luxair, and Portugalia), a well-trained workforce, and certifications from Embraer, Lockheed, Rolls-Royce and Turbomeca.

²³ TAP's subsidiary TAP M&E (Maintenance and Engineering) showed a strong interest in taking over OGMA. The businesses of both companies were seen as complementary and TAP had also signed a long term contract with OGMA for the maintenance of its smaller planes, a fleet of almost 40 Airbus A 319/320/321. Similar aircraft from other companies may be served by OGMA, but should be brought in by TAP as an intermediary.

OGMA also had deep experience in repairing both civil and military aircraft and helicopters, which was an area in which Embraer wanted to grow to reduce dependency on the commercial and executive aviation markets (which in 2006 accounted for 80% of total revenues). Moreover, OGMA's well-established reputation in serving the military market could serve as a window for possible Embraer investments in this business.

While OGMA's losses in the four years between 2000 and 2003 had averaged US\$66-million plus mounting debt, in 2004 the company was back in the black. After a brief slowdown in 2005 due to a reduction in Portuguese Air Force orders, OGMA's total revenues in 2006 increased to roughly US\$270-million. While OGMA's revenues are generated mainly from MRO operations, manufacturing activities now account for 20% of sales. Despite several contracts with foreign military clients, the Portuguese Air Force remains OGMA's most important customer. Given that OGMA had once been under the Air Force's command, the post-privatization relationship has not always been easy. The establishment of contractual rates, for example, has been contentious since OGMA was charging market prices while opposing competition for Air Force contracts.

An area where the integration of OGMA into Embraer's worldwide activities has been particularly difficult is human resources. When Embraer took over the company, it had 1,600 employees, but no layoffs were possible due to a contractual obligation. Embraer therefore announced its intention to increase sales per worker by 40% by the end of 2007. Several steps were taken to boost productivity. Absenteeism, which was close to 10%, was brought down to 4%. Measures were put into practice to curb unacceptable delays in delivering services and to solve productivity and quality problems. A further quandary was the age structure of the workforce (average 39 years) -- high when compared with Embraer's plants in Brazil. The most difficult issue was the development of individual competencies, with 600 workers having fewer than nine years of education. A number of *ad hoc* training programs were introduced to encourage workers to convert their practical qualifications into credits for formal education. Also, Embraer introduced a profit-sharing scheme following the example of its Brazilian operations. In April 2007, 15% of the previous year's profits were distributed according to individual performance. Finally, in May 2007 the company implemented the Boa Idéia program which Embraer had been using in Brazil to solicit

²⁴ Airbus has certified OGMA for repairing the A 319/320/321 family and TAP already has a contract to provide maintenance on this type of plane.

improvement suggestions from staff.²⁵ Several initiatives have been established to bring best practices from Embraer's Brazilian operations to Portugal.

In sum, since taking over OGMA, Embraer has concentrated on increasing efficiency, improving managerial practices, and articulating a clear strategy. OGMA has begun its transformation into a services centre for Embraer and its European customers, although it maintains a diverse portfolio of activities, including some important assembly contracts for small aircraft. Lacking proper product development expertise, however, OGMA can only aspire to compete on the basis of process capabilities. In these circumstances, and given that salaries in Portugal are higher than in Brazil, Embraer so far has shown no interest in developing ambitious manufacturing plans in Portugal.

ii) China²⁶

The huge Chinese market is as appealing for aircraft manufacturers as for any other global industry. The Civil Aviation Administration of China (CAAC) expects travel demand to grow an average 10% annually through the end of the decade, and China's air transport market to be the world's second biggest – after the United States -- by 2020. The 2008 Olympic Games in Beijing and the World Exposition in Shanghai are a major chance for China to showcase itself to the world. China is expected to build 64 new airports by 2015 for a total of 210.

China's regional airlines are still in their infancy, though the central government's reform and consolidation in the airline industry will lay a solid foundation for network rationalization.²⁷ The government's Great Western Development Strategy (GWDS) – aimed at improving the living standards of the 367 million Chinese living from prosperous coastal China – will also bring improvements to airlines.

²⁵ In Brazil, 2,662 suggestions were made in 2006, resulting in savings of US\$12.5-million. See "Programa Boa Idéia é implementado na OGMA," *EMBRAER notícias*, No. 43.

²⁶ This is based on Andrea Goldstein, "The Political Economy of Industrial Policy in China: The Case of Aircraft Manufacturing", *Journal of Chinese Economic and Business Studies*, 2006 4(3): 259-74; and Andrea Goldstein, "A Latin American Global Player Goes to Asia: Embraer in China", *International Journal of Technology and Globalisation*, 2008.

²⁷ Christopher Findlay and Andrea Goldstein, "Liberalization and Foreign Direct Investment in Asian Transport Systems: The Case of Aviation", *Asian Development Review*, Vol. 21, No. 1, 37-65, 2004.

Many problems remain, however. The load factor, for example, is roughly 10% lower than in the rest of Asia.²⁸ Aircraft fly for only five to six hours a day and night flights are non-existent, even though many domestic routes taking up to six hours. Given the large capital immobilized to manufacture an aircraft, nine to ten hours are estimated to be necessary for positive returns on investment. Moreover, half of airports are underused, as airlines do not have the correct aircraft type to operate many of the routes. Half of the country's airports (72 out of 143) handle fewer than 200 passengers a day, resulting in heavy losses for the airport operators. Moreover, the number of daily passengers is lower than 120 on 466 of China's 795 air routes. Finally, minnow airlines will not get a fair chance to grow if legislation does not outlaw seat dumping, cross-route subsidization, and other anti-competitive practices.

In the 1980s, China made a concerted effort at building an indigenous civilian aerospace capability. Aviation Industries of China (AVIC) built a large airliner, the Y-10, while Xi'an Aircraft Corporation (XAC) developed the Y-7 60-seat turbo-prop regional aircraft. Both proved to be major commercial failures, compounded by safety concerns. Today, China still uses foreign imports for the most important aircraft components.²⁹ In 1999, the Chinese government -- with its aircraft industry reeling and its development strategy in tatters -- decided to split AVIC into two fully integrated parts, AVIC I and AVIC II. The stated goal of the reform was to break up the monopoly and foster fair competition, while also maintaining mechanisms for non-market co-operation. The decision, however, went against trends in the world's aerospace industry towards consolidation.³⁰

Looking for partners to trade technology transfer with privileged market access, Chinese authorities identified German-based Fairchild Dornier as the most amenable regional jet manufacturer. Japan's Mitsubishi Heavy Industries was reported to be planning to develop a 30-passenger jet for the U.S. and Japanese markets at a cost of about US\$400-million.³¹ But China selected Fairchild, which was desperate to make inroads in the global market dominated by Bombardier and Embraer. In November 2001, Germany's Chancellor Gerhard Schroeder visited China to accelerate the process. There was a negotiating snag, however: the Chinese wanted to push through demands of increased technology transfer -

²⁸ "The sky's the limit, if China's airlines reform", *Asia Times*, 4 September 2004.

²⁹ "Outsourcing aircraft parts to China, airliners later", *Asia Times*, 3 September 2004.

³⁰ On the internal inconsistencies of Chinese industrial policy, and in particular of the *zhua da fang xiao* ("grasping the large and releasing the small") approach, see Steinfeld (2004).

³¹ Mitsubishi Heavy cooperated with five other Japanese manufacturers to build the YS-11. During the late 1990s, it was also involved in the YS-X project, which explored the possibility of Japan building a 100-seat regional jet.

such as the production of airframe subassemblies and the joint development of a scaled down 50-65-seat version of the Fairchild 728.³²

Embraer meanwhile had been busy in Asia since the mid-1990s as part of its global expansion plans.³³ Priorities were regional jets for China and the Super Tucano trainer/light attack turboprop. The company was confident that its products – from the 30-passenger EMB-120 Brasilia turboprop to the 110-passenger ERJ-195 jet – set it apart as the only manufacturer capable of serving this market from the bottom to high end. In May 2000, Embraer set up a permanent office in Beijing with about 15 employees. Embraer clinched its first Chinese deal the same year when Chengdu-based Sichuan Airlines purchased five ERJ-145s and took options on more. The following year, Southern Airlines placed 20 firm and ten option orders and Wuhan Airlines an additional ten for the ERJ-145s. However, the sale, with an approximate value of US\$1-billion, was stalled for months as it required final government approval. Brazilian President Fernando Henrique Cardoso personally intervened with his Chinese counterpart Jiang Zemin to speed up approval, but this did not change the situation.³⁴ The bone of contention was the Chinese request to see Embraer produce some of the parts locally.³⁵

In 2001, Embraer complied by establishing a major parts presence in China, working with China Aviation Supplies Import and Export Corp (CASC) to warehouse about US\$20-million worth of inventory. The venture with CASC, China's fifth largest trading company with annual revenues exceeding US\$1.5-billion, was seen as enhancing Embraer's market position in Asia.

In 2002 Embraer made its presence in China effective and permanent by establishing a final assembly line for its regional jets. That year, China's State Council gave its approval for outline plans to assemble the ERJ-145 in China and Embraer signed a US\$50-million agreement with two companies controlled by AVIC II.³⁶ Claiming that it needed a majority equity stake to effectively transfer technology and managerial know-how, Embraer secured a

³² "New Funding Agreement To Bolster Fairchild Dornier", *Aviation Week*, 28 January 2002.

³³ In 2000 Embraer set up a new US\$7.7-million regional headquarters in Melbourne, as part of a push to increase its market share in Asia.

³⁴ "Embraer Sells 40 Jets To China In \$1 Billion Order", *Aviation Daily*, 18 April 2001.

³⁵ "Negócio da Embraer na China não decola", *Folha de S. Paulo*, 4 April 2002.

³⁶ In September of 2003, HAIC signed a cooperation contract with Bell Helicopter Textron Canada Limited and thus became the sole supplier of M430 helicopter body for Bell (Canada).

special authorization from the Chinese government to gain a majority 51% stake in the joint venture.

The new company, Harbin Embraer Aircraft Industry (HEAI), is based in Harbin, 900 kilometers north of Beijing. The plant would manufacture components and assemble planes to be marketed primarily in China. The joint venture has a production capacity of 24 aircraft per year worth about US\$19.5-million each, and between 250 and 300 aircrafts are expected to be rolled out over the next ten years. The aircraft's maiden flight was in December 2003 -- the first Embraer aircraft manufactured outside Brazil. In February 2004, Guangzhou's China Southern Airlines ordered six ERJ-145s for routes in the less-developed mountainous western region of the country.³⁷

Still, making money in China is notoriously difficult for foreign companies, and in the case of Embraer skepticism has not been in short supply. In 2002, Pierre Lau, a Hong Kong analyst with Nomura Securities, argued: "High fixed costs and a comparatively late start [are] likely to work against Embraer's joint venture. Unless they receive at least 20 orders a year, it would be difficult for them to be financially viable". The plant delivered six planes in 2004, less than half the number it had anticipated, and four in 2005. "The speed in which the facts are happening is not the speed that we expected in the very beginning," said CEO Botelho in 2004.³⁸

But what were, beyond the more immediate numerical targets, the expectations? Embraer had been looking to China to reduce the dependence on the United States, which accounts for 56% of its commercial aircraft sales. On the Chinese side, there was a clear desire to develop its industry and Embraer was an ideal candidate since Brazil was also a developing country. The precedent had been set by Sino-Brazilian collaboration in satellite and space research, which culminated in a second successful launch in October 2003. For both partners, the new company promised to provide customers with comparatively low-cost aircraft with low maintenance costs.

The most accurate reading of the initial underperformance seems to be that Embraer's expectations in terms of a more fluid access to the domestic Chinese market were not fulfilled.

³⁷ "China Southern Orders Six Embraer 145 RJs", *Aviation Daily*, 1 March 2004.

³⁸ "Embraer Sees Rising Jet Sales to China as Costs Fall", *Bloomberg*, 30 July 2004.

Although local production avoids import duties of 24%, these were being cut in 2006, so the tariff-jumping argument *per se* is not convincing. Embraer learned that – due to the infant stage of market institutions and capitalist culture -- China requires more patience and *guanxi* (relationships) than in other parts of the world. Also, Chinese state involvement in air transport remains significant despite the gradual shift to a more hands-off Western approach. Airlines still need approval from the state council and from China Aircraft Supply Corp., a government-owned company that decides on the country's aircraft purchases, to place orders.

A promising development for Embraer came in early 2004, when authorities refused Air China the authorization to use 180-seat aircraft to compete with Sichuan Airlines on the Chongqing-Chengdu 300-km route.³⁹ In August 2006, Embraer finally secured a major deal to sell 100 aircraft to Hainan Airlines Co. for US\$2.7-billion. This deal substantially raised the company's firm order backlog, which had been stuck at around US\$10-billion for some time. It also means Embraer will deliver more planes than the 150 that had been predicted for 2007 and increase deliveries in 2008.

Looking Forward

Embraer was born as a state-backed national champion run by a military government with a clear industrial policy, but this business model became unsustainable for reasons discussed above. By the time Embraer was privatized, it had already accumulated considerable experience in export markets, used partnerships to bring new resources and knowledge into the firm, and developed a strong core competence – system engineering for aircraft manufacturing. Under new leadership, the key to Embraer's success was its ability to listen to the market and driving a customer-centric strategy focused on core competencies on the *regional jets* niche.

At the same time, various forms of organizational change led to innovation and improved performance. The hierarchy was flattened and various activities – such as strategic planning, total quality management, market intelligence, the *kaizen* workforce empowerment strategy, and the analysis of system performance feedbacks – were formalized and endogenized in the company's routines.⁴⁰ This process of organizational change required

³⁹ "Leis ameaçam sucesso da Embraer na China", *Folha de S. Paulo*, 12 July 2004.

⁴⁰ The Kaizen (i.e. “improvement” in Japanese) strategy calls for continuous efforts involving everyone in an organization, managers and workers alike.

“vision” – notably from the top.⁴¹ In 2001, CEO Botelho won the annual Laurels Award granted by the industry’s leading magazine for “correctly reading the transformation of the commuter airline industry from turboprops to jets – an insight not gleaned by many established European and American manufacturers – and by focusing on a single overarching objective: customer satisfaction”.⁴² Botelho retired in April 2007, leaving his 45-year-old successor Frederico Fleury Curado, a long-time Embraer insider, with the challenge of keeping the company’s growth on track.

Geographical location has also been a factor in Embraer’s success. São José dos Campos stands in the very heart of the Paraíba Valley with 43 municipalities that host 430 exporters and produce 3% of Brazil’s GDP.⁴³ Multinational corporations such as Ericsson, Volkswagen, Ford, and General Motors have established there some of their largest plants worldwide, attracting additional investments in the component and electronics industries. Embraer could tap into these existing investments, playing the role of coordinator in a network of specialized suppliers.

Government support cannot be understated in Embraer’s success, though the nature of the intervention has changed since privatization. Public sector institutions such as the National Bank for Economic and Social Development (BNDES) and FINEP (Financiadora de Estudos e Projetos, part of the Ministry for Science and Technology) have actively supported this process, contributing 22% of the development costs of the first ERJ family and 100% for the AL-X light-attack jet fighter. Embraer has also been the largest beneficiary of PDTI (Programa de Desenvolvimento Tecnológico Industrial), a program of the Ministry for Science and Technology that provides fresh funding and tax holidays to innovating firms. The total subsidies assigned to Embraer from 1993 to 2000 amounts to US\$79-million. Also important has been the extension of export subsidies – as the WTO controversy showed. The Finamex (now BNDES-exim) facility allows BNDES to finance up to 100% of capital goods exports – and Embraer is the largest individual recipient of such funds. The Programa de Estímulo às Exportações (Proex), managed by Banco do Brasil, is an “interest rate equalization program”, which provides up to a 3.5% cut in interest rates on loans to purchasers of exported

⁴¹ T. Fujimoto, “Evolution of Manufacturing Capabilities and Ex Post Dynamic Capabilities: A Case of Toyota’s Final Assembly Operations”, in G. Dosi, R. Nelson, and S. Winter (eds.), *The Nature and Dynamics of Organizational Capabilities*, Oxford University Press, Oxford, 2000.

⁴² “2000 Laureate Awards”, *Aviation Week and Space Technology*, 7 May 2001.

⁴³ Andrea Goldstein, “High-tech Clusters in the North and in the South: A Comparison between Montreal and São José dos Campos”, in E. Giuliani and R. Rabellotti (eds.), *Clusters and Global Value Chains in the North and the Third World*, Ashgate, 2005.

Brazilian aircraft. Its aim is to offset the so-called Custo Brasil, i.e. the higher risk of doing business in the country due to a number of structural factors.

More recently, Embraer has embarked on a complex and ambitious strategy of diversification with the launch of a larger aircraft and executive jets. In 2007, Embraer was selling a new model of "Phenom" jets, signing a deal with U.S.-based Executive AirShare to supply three Phenom 100 and two Phenom 300 jets. The company has also renewed interest in military planes – and geographical diversification, trying to reduce its dependency on the American market and move decisively into Europe and Asia.

The experience so far with the Chinese and Portuguese investments seems to indicate that Embraer has faced bigger problems in both markets than anticipated. For an emerging multinational from Brazil, dealing with local idiosyncrasies represents a new challenge that requires patience and learning. Moreover, the firm may need deep pockets to enter difficult markets (such as China) where the payoff is far from sure and several years may pass before an investment starts paying back. The amount of these investments may be so significant that they may endanger the firm survival. The third major challenge has to do with managerial resources, which may soon become thin for a firm like Embraer that has traditionally been an employer of choice in Brazil, but is not precisely a household name for ambitious MBAs in the West.

In sum, turning a Brazilian-based, export-oriented firm like Embraer into a "true" multinational means dealing with factors quite different from those of the past. The jury is still out on the final results of this transformation.

Annex

Exhibit 1: Expansion Timeline

Year	Country	Mode of Entry	Target Company/ Partner/Subsidiary/Client (if applicable)	Transaction value (if available)
1974	USA	Partnership	Piper	
1975	Uruguay	Exports	Uruguayan Air Force	
1977	France	Exports	Air Litoral	
1979	USA	Subsidiary	Embraer Aircraft Corporation	
1981	Italia	Agreement	Aeritalia and Aermacchi	
1983	France	Sales office	Embraer Aviation International	
1983	Egypt	Licence	Assembly line	
1985	USA	Exports	Atlantic Southeast Airlines	
1988	China	Partnership	INPE and Chinese Government	
1988	Argentina	Partnership	Fabrica Militar de Aviones	
1993	Spain, EUA, Chile and Belgium	Risk-sharing partnership	Gamesa (Spain), C&D (USA), ENAER (Chile) and Sonaca (Belgium)	
1995	USA	Agreement	United Technologies-Sikorsky	
1996	USA	Exports	Continental Express	
1998	Greece	Exports	Greek Government	
1999	France	Partnership	EADS, Dassault, Thales and Snecma	
1999	Switzerland	Joint Venture	Liebherr Group (Created ELEB)	
2000	Australia	Regional Headquarters		US\$7.7 million
2000	China	Sales office		
2000	Singapore	Sales office		
2001	China	Joint Venture	CASC	
2002	China	Joint Venture	AVIC II (Assembly line)	\$50 million
2003	USA	Exports	US Airways	
2004	Portugal	Acquisition	OGMA	\$23 million
2005	USA	Greenfield (maintenance facility)		
2007	Canada	Joint Venture	CAE	
2007	Singapore	Training services		

Geographical Presence Chart

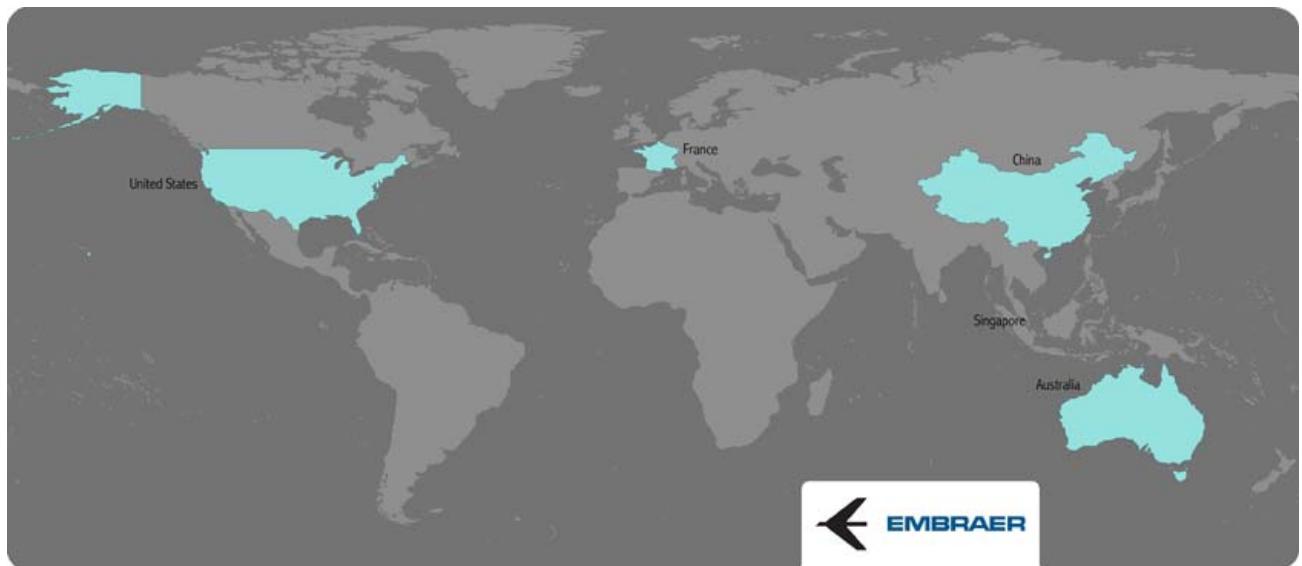
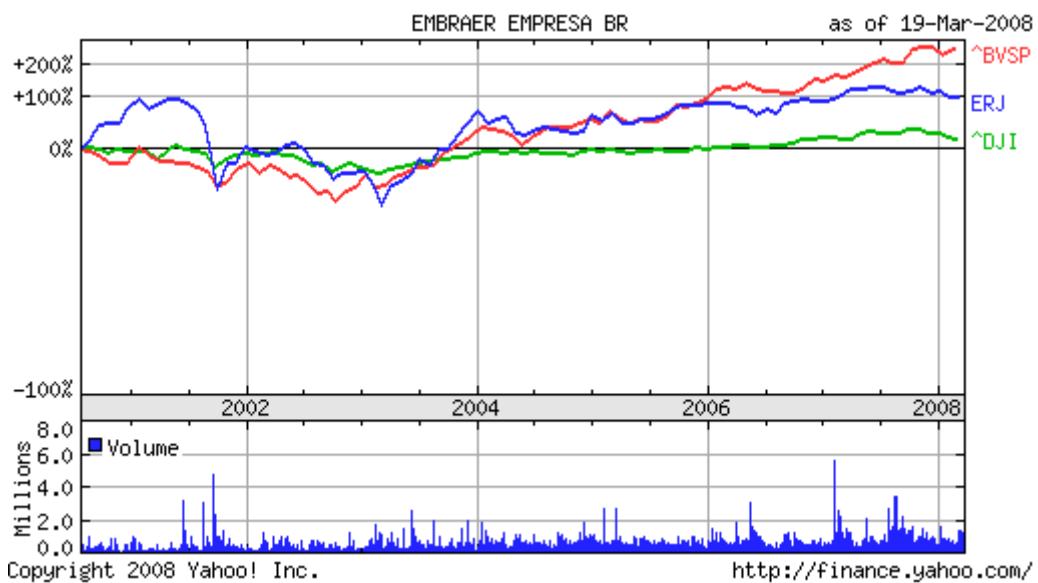


Exhibit 2: Stock Performance vis-à-vis the Dow Jones and the São Paulo stock exchange indexes



ERJ = Embraer trading at the New York Stock Exchange

[^]BVSP = Bolsa de Valores de São Paulo Index

[^]DJI = Dow Jones Index

Grupo BIMBO S.A. de C.V.¹
The Mexican Bakery for the World

Pioneering in packaging and “just in time” delivery has given Bimbo an important competitive advantage for internationalization. Its strategic approach has been similar to other Latin-American companies, first to lock a dominant position at home then expand towards natural markets in Central & South America and the US through acquisitions and joint ventures. Nevertheless, Bimbo is a first-class example of a Mexican company who perceived NAFTA as a good opportunity and with an aggressive M&A and through joint ventures strategy successfully penetrated the US market. Bimbo follows a more conservative approach in its financial management and prefers to reinvest its cash flow when expanding rather than taking on debt.

Introduction

“First came a wave of immigrants from Mexico and elsewhere in Latin America. Next came tortillas and Spanish-language soap operas... Now, a Mexican baker called Grupo Bimbo is distributing English muffins, white bread and ready-made pizza crust across much of the country.”

The New York Times, 2 May 2007.²

Mexico’s Grupo Bimbo, the largest food company in Latin America, is the world’s third-largest bakery behind Japanese-based Yamazaki Baking and U.S.-based Kraft Food’s Nabisco. With more than 91,000 employees worldwide, Bimbo earned a net income of US\$349-million and consolidated sales of US\$6.6-billion in 2007.³ In 2007, *América Economía* ranked Bimbo as the 51st largest company in Latin America.⁴ The same year, the company was ranked 87th in UNCTAD’s listing of non-financial corporations from developing countries as measured by foreign assets.⁵ *Euromoney* named Bimbo as one of the “Best Managed”

¹ The authors are grateful to executives at Grupo Bimbo for their cooperation with the preparation of this chapter.

² Clifford Krauss, “Latin American Companies Make Big Gains North of the Border”, *New York Times*, 2 May 2007.

³ The most important business segment for Bimbo is bread and baking, generating roughly US\$4.5-billion in revenues.

⁴ “500 Las mayores empresas de América Latina”, *América Economía*, July 2007.

⁵ *World Investment Report 2007*, UNCTAD, United Nations, October 2007.

companies in Latin America in 1993; and three years later Arthur D. Little named Bimbo “Best of the Best in Strategy.”⁶ In 2002, *Latin Finance* included Bimbo as one of Latin America’s “Most Admired Companies”.

The company sells over 5,000 pre-packaged food products under some 100 different brands in niches from sliced bread and “*tortillas*”⁷ to snacks such as candies, cookies and pastries. Bimbo derives significant market strength from its vertical integration of production and distribution of baked products. It operates 76 plants, 3 marketing companies, 980 distribution centers feeding over 34,600 delivery routes servicing 1 million points-of-sale daily in more than 18 countries – mostly in Latin America and the United States, but also in Eastern Europe and China⁸. Outside of Mexico, the company sells its delivery routes.

Bimbo plans to become the world’s largest bread maker by 2010. Its expansion into China in 2006 marked a major strategic step towards that goal. (See Exhibit 1 for the company’s expansion timeline).

Global Baked Goods Industry

In 2007, the global market for bakery products was US\$353-billion, while the bread segment of the global market generated estimated revenues of US\$163-billion.⁹ The global bread market is highly fragmented. Besides Bimbo, the leading global players are Italian-based Barilla G&R Fratelli, Russian-based Baltiyskiy Khleb, and Japan’s Yamazaki Baking. None of these major players has more than a 5% share of the worldwide bread market. Bimbo has a 2% share.

Most of the market goes to so-called “artisanal” bread and rolls, accounting for 52% of total sales. Pre-packaged (or “industrial”) bread represents approximately 38% of total sales. The remainder of the market – or 10% -- goes to “in-store” bakeries. The most important distribution system for bread is supermarkets, accounting for 55.4% of the market. Independent retailers have an additional 15.3% of the market.¹⁰

⁶ Siegel, Jordan. *Grupo Industrial Bimbo S.A.*, Harvard Business School, Case study 9-599-066, 4 December 1998.

⁷A round and thin flat bread of Mexico made from unleavened cornmeal or wheat flour.

⁸ Data from company website accessed on February 28, 2008.

⁹ Source: Euromonitor International, 2007

¹⁰ *Global Bread & Rolls: Industry Profile*, Datamonitor, December 2006.

Bimbo: Past & Present

The company's history can be traced to the end of the First World War, when Juan Servitje, grandfather of current CEO Daniel Servitje, patented Mexico's first machine to manufacture mass-produced crusty bread rolls, called "*bolillos*". Servitje was from a Catalan family that had immigrated to Mexico from Spain. In 1936, his son Lorenzo inherited the family bake shop, called "El Molino". Two years later, he opened his own bakery with a group of partners, among them cousins Jaime Jorba and Jose Mata. Immediately following the Second World War, they started selling bread in Mexico City. Bimbo's growth and popularity was facilitated by social changes in Mexican society thanks to rapid economic development and new consumer demand patterns after the Second World War. Specifically, the consumption of bread – long considered a luxury -- increased sharply in Mexico during the period from the 1950s to the 1970s.

Bimbo was well-positioned to take advantage of this trend. The company chose "Bimbo" as a brand name because it evoked a popular Walt Disney character at the time "Bambi". The company's "Bimbo Bear" mascot – a cuddly white cub -- reinforced the friendly, child-like image that the company wished to identify with its bakery products. In the early days, four trucks were used to delivery Bimbo's products to Mexico City's grocery stores and "mom-and-pop" corner stores. Bimbo was highly innovative in a business not known for its interest in technology and R&D. As far back as the 1940s, the company was improving efficiencies in packaging and investing in product innovation.¹¹ The company's bread, for example, was differentiated by its cellophane wrapping, which was a remarkable innovation at the time because it kept bread fresher for a longer period than the wax paper used by other bakers.

In 1960, Bimbo opened its first plant in Monterrey, not far from the U.S. border, and by the end of the decade it was operating throughout the northeastern part of the country and into the Gulf of Mexico region. In the 1970s and 1980s, Bimbo experienced major expansion throughout the entire country by opening new plants – in Guanajuato (1977), Villahermosa (1978), Mazatlan (1981), Chihuahua and Toluca (1982).

Thanks to this solid *organic* growth as the company built production and distribution capacities, Bimbo quickly became one of Mexico's leading producers and distributors of

¹¹ Today about 1.5% of Bimbo's total revenues are channeled towards new product development. See *Grupo Bimbo*, Harvard Business School, Case Study 9-707-521, 23 March 2007.

packaged bread. The Bimbo brand was so successful in Mexico that the word “bimbo” was soon used generically to describe bread of any kind. By the 1980s, Bimbo diversified from bread into pastries, snacks, candies, and chocolates. (See Exhibit 2 in Annex for a list of the company’s selected brands).

Further domestic growth was achieved through *joint ventures* and *acquisitions*. Through these deals, Bimbo underwent a transformation from a “baking” company into a diversified food distribution company. Another key to Bimbo’s success domestically was its decision to vertically integrate “backwards” into wheat production and flour mills to exercise some control over the price of its raw materials. This strategy took shape after Bimbo’s 1986 acquisition of U.S.-based Wonder Bread’s Mexican subsidiary, Continental Baking. Besides becoming Wonder Bread’s exclusive agent in Mexico, Bimbo acquired a Continental flour mill in Mexico City as part of that deal. In the 1990s, Bimbo started building and acquiring more mills, and by the end of the decade was Mexico’s number two flour producer. In 1993, the company entered the ice cream market via a 40% stake in Mexican-based Grupo Quan, the market leader in Mexico and Central America. In 2003, through a strategic alliance, Bimbo acquired exclusive rights to distribute Chicago-based Wrigley’s chewing gum in Mexico.

A milestone year for Bimbo was 1980, when the company listed on Mexico’s stock exchange. Today the publicly traded float represents only 20% of Bimbo shares. Roughly 75% of Bimbo’s stock is controlled by four Mexican families -- Servitje, Sendra, Jorba and Mata – and another 5% is controlled by Bimbo executives. The founding Servitje family is the largest shareholder, with roughly 37% of the stock. Bimbo did not list stock on international markets to raise capital. The company has financed expansion internally or, in some cases, by turning to international development agencies. In 1996, for example, Bimbo received US\$130-million in financing from the World Bank’s International Finance Corporation to build a flour and corn tortillas production plant in Mexico.

As a family-controlled company, Bimbo tends to be conservatively financed with relatively low levels of debt and high levels of reinvestment in its own operations. At the end of fiscal year 2006, Bimbo had US\$500-million in cash on its balance sheet, while net debt was only US\$260-million. This cautious strategy has shielded the company from getting caught with high interest payments on debt borrowed in dollars when the peso has weakened against the U.S. currency. Indeed, it helped Bimbo weather the 1994 Mexican Peso Crisis (though its income fell in 1994 and 1995). The company also limits exposure to wheat price

fluctuations on commodity markets through hedging (buying and selling of wheat futures). This also helps ensure a steady supply of wheat for Bimbo's production needs.

Like many Latin American firms, Bimbo has demonstrated a strong survival instinct by adopting agile strategies when faced with competition, especially from foreign multinationals. A good example is the company's competitive response to global food giant PepsiCo. By the late 1980s, Bimbo had extensive sales and distribution networks throughout Mexico, making 420,000 deliveries daily to local stores. This distribution network was costly to maintain, so Bimbo managers drew up a plan to reduce the number of truck deliveries. In 1991, however, PepsiCo entered the Mexican bakery market, threatening to penetrate Bimbo's territory. Now on the defensive, Bimbo quickly exploited its main competitive advantage: the reach of its vast distribution networks, which constituted a significant barrier to entry for potential rivals. Switching tactics, instead of reducing the number of truck deliveries, they were actually *increased*, though using smaller trucks carrying a wider variety of products. The defensive strategy against PepsiCo worked. Bimbo maintained its grip on local distribution networks.¹²

The company also has a reputation for its efficiency and for making long-term investments to promote optimal operational capabilities. Indeed, Bimbo cites its three main enablers as a "trinity" of *people, processes, and technology*. In the 1990s, for example, Bimbo restructured operations by introducing computers that modernized its distribution systems to provide "just-in-time" delivery of its products. Organizationally, in 2003 the company reorganized its Mexican operations into two divisions: Bimbo, SA de CV which controls domestic bakery operations, and Barcel, SA de CV which manufactures its salted snacks, candies, and chocolate products.

Bimbo is often praised for its "people-oriented" approach towards employees. The company's corporate philosophy emphasizes employee well-being and the dignity of human labor. Managers tend to be promoted from within, thus rewarding loyalty. Bimbo moreover was one of the first Mexican companies to introduce an employee stock-purchase program.

In 2007, nearly 68% of Bimbo's revenues came from Mexico, where its market share for bread was more than 90%. A sign of its market power in Mexico has been its relationship

¹² Niraj Dawar and Tony Frost, "Competing With Giants: Survival Strategies for Local Companies in Local Markets", Harvard Business Review, March-April 1999.

with McDonald's. In the late 1980s as the country's economy began to expand and drive consumer spending, Bimbo invested US\$30-million to produce hamburger buns and become a local supplier to McDonald's, later becoming its exclusive bun supplier. The rest of Latin America represented about 10% of Bimbo's total sales, and the United States accounted for more than 22% of sales. It should be noted, moreover, that the Mexican market is more profitable than other markets, accounting for nearly 90% of Bimbo's EBITDA margins – nearly 20% more than its revenue ratio.

With a heavy dependency on its own domestic market, Bimbo – like other Latin American multinationals – realized that the only way to grow its business was through international expansion.

Going Global



Bimbo's primary motivation for expanding beyond its domestic market has been to seek new markets for its branded products. The food sector is a low-margin business driven by volume, and consequently growth can be achieved largely by driving volume sales. Hence, the incentive to expand into new markets. The company's expansion has been largely focused on Latin America and the United States. Leveraging established brands throughout Latin America and the United States makes strategic sense for a Mexican food company, since the Hispanic populations in these countries represent a "natural" market for their food products.

Whereas Bimbo's domestic growth strategy was largely *organic* product diversification, in the wider Latin American market Bimbo's expansion has been more aggressively *acquisition-based*. As a general rule, the company has targeted the biggest player in each market or, in some cases, opted to form strategic alliances. From an operational point of view, Bimbo's strategy was based on replicating its domestic success in Mexico by controlling the entire supply chain and securing contracts with major partners like McDonald's.¹³

Besides commercial drivers, international trade agreements have played a significant role in facilitating Bimbo's international expansion, especially the North American Free Trade Agreement (NAFTA) in the mid-1990s. Bimbo however has been largely absent from Europe, and it wasn't until 2006 that the company made an acquisition in China.

ii) Latin America (1992 onwards)

Bimbo's expansion into Latin America began in 1990 when it bought a small-sized bakery in Guatemala which, re-baptized Bimbo de Centroamerica, began producing and distributing bread, pound cakes, donuts and pastries under the Bimbo and Marinela brands. The company's real Latin American expansion strategy, however, began in 1992 when it moved into Chile through the purchase of Alessa, a manufacturer of bread and snacks and Ideal. The next year, it acquired Venezuelan-based bread maker Panificadora to market its products under the Bimbo, Marinela and Holsum brands. And in 1994, Bimbo entered Costa Rica through an acquisition of the country's second largest bread maker.

Besides acquisitions, Bimbo has built Greenfield facilities. In 1994, for example, it built a \$30-million plant in Argentina to produce bread, rolls, and cakes, and set up a distribution center in Honduras. Bimbo has also entered certain markets through strategic alliances. In Colombia, for example, it formed a joint venture with cracker and biscuit maker Noel, and in Peru joined forces with country's main food company, Alicorp, to build a bread manufacturing plant in 1997. Joint ventures have allowed Bimbo to gain quick market entry while leveraging its efficiencies in distribution and marketing.¹⁴

¹³ Andrea Goldstein, *Multinational Companies from Emerging Economies*, Palgrave, 2007, p. 71.

¹⁴ Aseem Prakash and Jeffrey Hart (eds.) *Responding to Globalization* (London: Routledge, 2000), p. 195.

By the end of the 1990s, Bimbo was the market leader in packaged bread in Guatemala, Honduras and El Salvador. The company was the exclusive supplier of hamburger and hot dog buns to McDonald's in Peru, Colombia and Venezuela. In 2000, Bimbo acquired Pan Pyc, the second biggest baking company in Peru, as well as the Guatemalan baked goods manufacturer La Mejor.

Bimbo entered Brazil in 2001 through an acquisition of Plus Vita from U.S.-based agribusiness giant Bunge for US\$63.5-million. Today, Brazil represents about 25% of Bimbo's sales in Latin America and is considered a significant growth market going forward. In the fallout of the Argentine economic crisis in 2003, Bimbo acquired a controlling stake in bankrupt Argentine baked goods leader Fargo- another sign of Latin American multinationals (like América Móvil) opportunistically scooping up distressed assets. In 2007, Bimbo expanded into Chile by acquiring family-owned Agua de Piedra, one of the country's largest producers of confectionaries and Easter cakes.

Bimbo's drive towards market leadership throughout Latin America was not accomplished without learning lessons. Bimbo executives discovered, for example, that subtle cultural and market differences exist throughout the region. Outside Mexico, for example, most Latin Americans tend to buy fresh bread, not packaged "industrial" bread. In Mexico, which shares a border with the United States, per capita consumption of packaged bread is four to five times higher than in South America (See Exhibit 4 in Annex for comparative statistics). In Argentina, Bimbo made a mistake by focusing distribution efforts - as in Mexico - on "mom-and-pop" corner stores. The problem, however, was that Argentines buy bread and baked goods in large supermarkets. Bimbo was forced to adjust its distribution strategy accordingly.

A persistent challenge for Bimbo executives has been the weak profit performance of its operations in Latin America outside Mexico. To improve its bottom line, the company has been diversifying its product offering by introducing sweeter baked goods to cater to local tastes and imposing efficiency measures by merging distribution resources, cutting unprofitable routes, and turning truck distributors into "independent" operators.

iii) United States & Europe (1994 onwards)

While expanding south throughout Latin America, Bimbo inevitably turned northward towards the United States. Three factors made the United States an obvious target market.

First: cultural affinities. The large Hispanic population throughout much of the southern United States provides a northern extension of its “natural” market. The gastronomical influence of “Mexican” food in the United States, due to Hispanic immigration, has created strong demand for tortillas and other baked products.

Second: industry structure incentives. While the American market for packaged bread is mature, with only a 2% growth rate, the industry remains highly fragmented among several large regionally-based players and only a few major national brands like Wonder Bread. Also, since Americans buy bread in large supermarkets -- instead of at small “mom-and-pop” shops as in Mexico -- the economics of distribution in the United States are much more efficient.

Third: liberalized trade incentives. In 1994, NAFTA opened up trade between the United States and Mexico and Canada.¹⁵

The first phase of Bimbo’s American market entry was focused on directly *exporting* its branded products, followed by a second phase characterized by *acquisition-driven* growth.

Bimbo products had been available in the United States since 1984, when the company started exporting cakes and pastries to California, Florida, Illinois and Texas via distribution affiliates. In 1992, it formed a joint venture with Sara Lee through Bimbo’s Texas-based subsidiary, Bimar Foods, to distribute Sara Lee products in Mexico. It was through that subsidiary, in the early 1990s, Bimbo first entered the U.S. tortilla market via a number of acquisitions. Most notably, it bought Oklahoma-based tortilla maker Orbit Finer Foods in 1992, followed by buyouts of other tortilla makers in California, Ohio, and Texas.

Bimbo’s first big move in the United States came in 1994 -- the year NAFTA was signed. Bimbo formed a joint venture, called QFS Foods, with Texas-based Mrs. Baird’s Bakeries to distribute tortillas in Texas and Louisiana. The deal appeared to be a “win-win”

¹⁵ ECLAC, *Foreign Investment in Latin America and the Caribbean*, United Nations, 2005, p. 135.

for both companies: Mrs. Baird's was interested in Bimbo's manufacturing strengths, and Bimbo was hoping to leverage Mrs. Baird's brands and distribution networks in Texas to sell its own products. As part of the joint venture Bimbo built a tortilla manufacturing plant in Houston. The company soon controlled 22% of the tortilla market in Texas, just behind Mexican rival Gruma.

The joint venture with Mrs. Baird's dissolved in 1996, however. That year, Bimbo bought its way into the U.S. bread market through a takeover of Pacific Pride Bakeries, based in San Diego. Meanwhile, Mrs. Baird's unexpectedly put itself up for sale – and, in 1998, Bimbo was the happy buyer for about US\$200-million. Subsequently, Bimbo moved its Bimar Foods subsidiary to Texas to co-locate with the corporate headquarters of Mrs. Baird's.

The post-NAFTA years were a boon for Bimbo's business. From 1994 to 1998, the company's CAGR was about 10.5% and its stock price increased by a staggering 200%. (See Exhibit 4 in Annex for Bimbo's stock performance) Still, at the end of the decade the company was only a regional player with operations in Texas and California.

Bimbo's big play came in 2002. It paid US\$610-million for the U.S. assets of Canadian-based food giant George Weston Ltd and moved into 23 states through five production facilities in Oregon, California, Colorado, and Texas. The purchase of Weston's Oroweat assets was strategically shrewd not only as a market consolidation play, but also from a geographical point of view. The Weston assets opened the country's western states to Bimbo and doubled its U.S. revenues.¹⁶

It took some time, however, for the company's U.S. operations to achieve profitability. One reason was that powerful grocery stores were dictating prices and returning unsold bread to suppliers like Bimbo. Also, while Bimbo's brands remained strong amongst Hispanics living in the United States – especially immigrants from Mexico – Bimbo was operating well beyond its “natural” market in America following new acquisitions such as Oroweat. Bimbo brands were not only unknown, but in English the word “bimbo” had a negative connotation that was potentially offensive to women. Also, Bimbo was facing a unionized work force -- notably Teamster-affiliated truckers and plant workers in California, Oregon and Colorado – which hindered the company's attempts to improve efficiencies.

¹⁶ “Grupo Bimbo: Pushing North”, *The Economist*, 20 May 2002.

Responding to these challenges, Bimbo underwent a massive restructuring and rationalization of its U.S. operations in 2004-05. About 15% of its product portfolio was eliminated so the company could focus on well-performing products and de-emphasize the “Bimbo” brand. The company tackled the union problem by encouraging its truckers to become “independent” operators with the carrot of fiscal incentives to increase their net earnings. Thanks to these measures, Bimbo’s U.S. operations finally achieved profitability in 2006, although sales were still largely driven by Mexican-branded products among the Hispanic population.

In Europe, Bimbo’s presence has been limited to its candy factory, Park Lane European Candy Distribution, located in the Czech Republic. The company’s association with Park Lane stretched back to the 1990s, when Bimbo -- realizing that its candy-making technology was obsolete -- contracted out manufacturing to Park Lane, then based in Germany. In 1998, Bimbo bought Park Lane outright and moved its operations to the Czech Republic to take advantage of cheaper labor. The purchase of Park Lane -- which produces fruit gums, Mexican snacks, boxed chocolate assortments, tinned candies and peanuts for global export – gave Bimbo access to know-how and expertise that helped drive international expansion.¹⁷

Europe nonetheless remains a hole in Bimbo’s internationalization strategy – a fact that contains some irony given that, in the 1960s, Bimbo founded the Spanish bakery Bimbo S.A. with U.S.-based Campbell Taggart Inc., before selling out to its partner. The Spanish Bimbo -- the market leader in sliced bread in Spain -- is owned by one of Mexican Bimbo’s global rivals, Sara Lee.

iv) New Growth Markets – China (2006 onwards)

Bimbo’s decision to move into China was taken personally by CEO Daniel Servitje, who wanted Bimbo to be the first major Latin American firm in the Chinese market. In 2006, Bimbo bought Spanish-owned Beijing Panrico Food Processing Center for about US\$11-million. With about 800 employees, Panrico has about 190 routes on which some 4,000 points-of-sale are serviced by trucks and bicycles. This acquisition, while modest, was a crucial step

¹⁷ In 1999, Bimbo bought a confectionery plant in Austria through Park Lane, but it was closed in 2003 due to high operating costs and a tough competitive environment in the European market.

in realizing Bimbo's ambition of becoming the world's largest bread manufacturing company by 2010.

In the past, multinational firms have attempted to penetrate China through a combination of food R&D and marketing campaigns, but have failed to compete with local Chinese firms who understand local tastes. Bimbo executives carefully studied the Chinese market before making the Panrico acquisition. No single firm in China controls more than 2% of the market. The largest firm in baked goods is Ting Hsin International Group, a joint venture between Tingyi Holding Corp of the Cayman Islands and Japanese-based Sanyo. It has only a 1.7% market share thanks to its popular Mr. Kon products. In the bread market specifically, the largest player is AFG -- a joint venture between Artal Holland and U.S.-based Smithfield Foods -- which entered China in 1996 with high brand recognition for its Mankattan and Country Road breads.

Bimbo's due diligence included hiring Chinese immigrants in Mexico as focus groups to taste hundreds of different Bimbo bread products – from black bean bread to shredded beef bread and tortillas. Bimbo has improved the operational efficiency of its Chinese plants and stepped up its marketing efforts by promoting its products via university campuses and schools.

Still, Bimbo is new to the Chinese market and is attempting to understand the culture and develop business relationships in a country that has presented enormous challenges for many Western companies. Given China's strategic importance, if Bimbo's market entry works, the company will likely take a more aggressive approach to acquisitions in China.

Looking Forward

Like other Global Latinas in the mass market consumer sector, Bimbo emerged from a specific historical experience deeply rooted in its domestic market. By focusing on its core business – bakery products – and building its business organically in Mexico, Bimbo acquired knowledge and expertise that it exported to neighboring markets.

More generally, Bimbo's internationalization strategy has been driven by both macro and firm-specific factors. A macro factor common to many Mexican companies is the desire to offset risks of the economic and political instability in its domestic market. Another macro driver was NAFTA, which opened up the huge and fragmented American market. The

acquisition of Mrs. Baird's Bakeries and George Weston's Oroweat operations were major deals for Bimbo.

On a firm-level of analysis, Bimbo's success was based on its proven *expertise* in a core sector, the *efficiency* of its distribution networks, an *innovative* approach to operations and product development, the *leveraging of its brand portfolio* throughout its "natural" market, and its willingness to make *acquisitions* at critical points in order to consolidate its market position.

Also, Bimbo's "backwards integration" into wheat production and flour mills was a shrewd strategy, as it has allowed the company to hedge against price fluctuations and stabilize its supply of raw materials. A possible negative is Bimbo's conservative attitude towards debt, which has constrained its expansion strategy. One reason may be the company's ownership structure: Bimbo is managed at the top by executives from the controlling families. While family-owned companies can provide long-term continuity and stability, they frequently tend to be cautious about taking on debt to finance growth. Bimbo, as noted, keeps a lot of cash on its balance sheet and is highly conservative about debt.

In sum, Bimbo has emerged as one of the world's leading food companies -- especially in baked goods -- on the strength of its dominant market presence in Latin America and strategic acquisitions of a number of large-scale U.S. firms. The company is now in a position to seize further growth opportunities, though it must show more willingness to make major acquisitions and locate operations in foreign countries. This would likely involve diverting management attention to new markets and inevitably undergoing learning experiences about product development and consumer tastes in regions where which Bimbo has no corporate or cultural familiarity. The company's past struggles with making its foreign operations profitable could restrain these efforts. Since Bimbo's move into China, however, its top executives appear committed to pursuing a concerted global growth strategy.

Annex

Exhibit 1: Expansion Timeline:

Year	Country	Mode of Entry	Target Company/ Partner/Subsidiary/Client(if applicable)	Transaction Value (in USD) (if available)
1984	USA	Exports		
1990	Guatemala	Exports		
1992	Chile	Acquisition	Alessa and Ideal	
1992	USA	Acquisition	Orbit Finer Foods	
1992	USA	Joint Venture	Sara Lee	
1992	Honduras	Distribution agencies		
1993	El Salvador	Exports		
1993	Venezuela	Acquisition	Panificadora Holsum	
1993	USA	Acquisition	Fabila Food's and La Frontera	
1994	USA	Joint Venture	Mrs. Baird's	
1994	Argentina	Greenfield		\$30 million
1994	USA	Acquisition	La Fronteriza	
1994	Costa Rica	Acquisition		
1995	USA	Acquisition	C&C	
1995	USA	Acquisition	La Tapatia	
1995	Chile	Exports	Ideal	
1996	USA	Acquisition	Pacific Pride	
1997	Peru	Joint Venture	Alicorp	
1997	El Salvador	Greenfield		
1997	Costa Rica	Greenfield		
1997	Colombia	Greenfield		
1997	Argentina	Greenfield		
1998	Peru	Greenfield		\$25 million

1998	USA	Acquisition	Mrs. Baird's	\$200 million
1998	Germany	Acquisition	Park Lane European Candy Distribution	\$15 million
1999	USA	Strategic alliance	Day Hoff	
2000	Peru	Acquisition	PanPyc	
2000	Guatemala	Acquisition	La Mejor	
2000	Austria	Greenfield		
2000	Czech Republic	Greenfield		
2001	Brazil	Acquisition	Plus Vita	\$63.5 million
2002	USA	Acquisition	George Weston Ltd	\$610 million
2003	Argentina	Acquisition	Fargo	
2003	USA	Joint Venture	Wrigley	
2006	China	Acquisition	Panrico (Spain)	\$11 million
2007	Chile	Acquisition	Agua de Piedra	
2007	Brazil	Acquisition	Panificio Laura Ltda	\$30 million

Source: Authors based on data from the company's annual reports, company website and Capital IQ.

Geographical Presence Chart

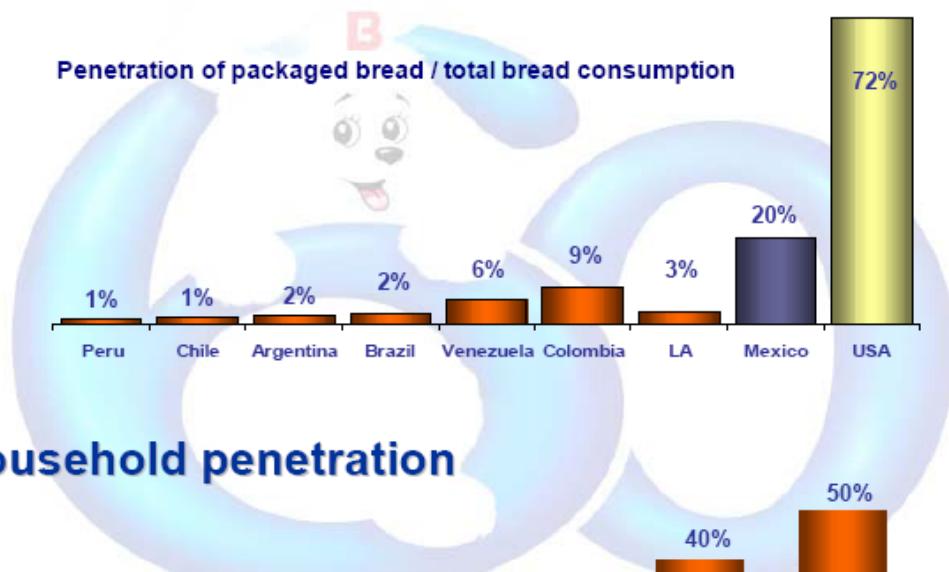


Exhibit 2: Bimbo Selected Brands

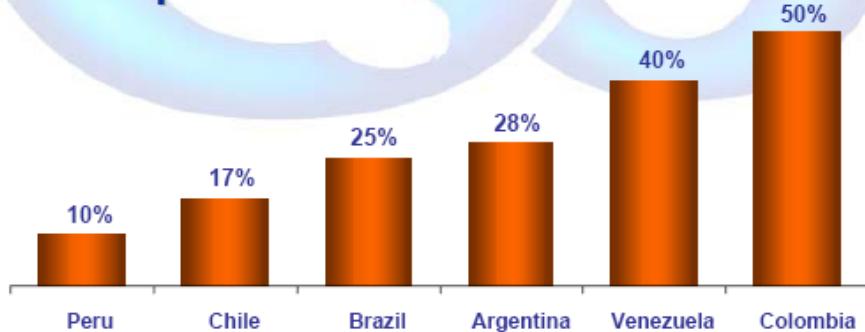
- Lara (Crackers and cookies)
- Barcel (Mexican brand producing potato chips and other fried foods)
- Bimbo (Breads and cakes)
- Cena (Chilean budget bread)
- Coronado (Milk caramel producer)
- El Globo (Mexican bakery)
- Entenmann's (Pastry baker in the United States)
- Ideal (Chilean bread)
- Marinela (Mexican cookies, known as Marisela in Colombia)
- Mrs. Baird's (Bakery with large presence in Texas)
- Oroweat (Bread producer in the United States)
- Ricolino (Candy and chocolates producer)
- Swandy (Butter cookies)
- Tia Rosa (Home-flavor bread and cookies)
- Wonder (Bread producer)

Exhibit 3: Per Capital Household Consumption and Household Penetration of Packaged Bread in Latin America, 2006

- **Low per capita consumption of packaged bread**

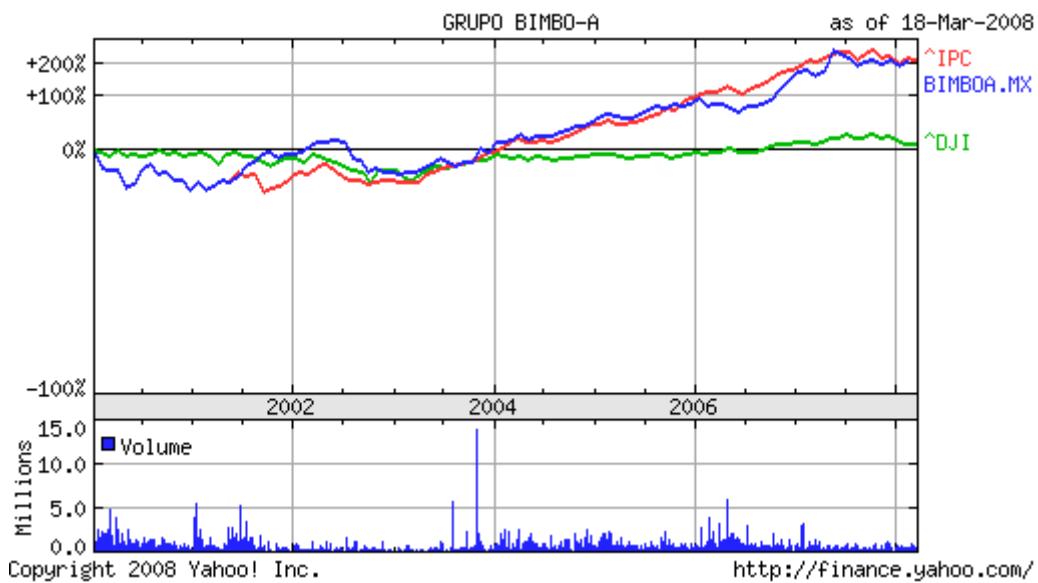


- **Low household penetration**



Source: Grupo Bimbo investors' presentation, March 2006.

Exhibit 4: Stock Price Performance Compared with MSCI Indexes



BIMBOA.MX = Bimbo trading at the New York Stock Exchange

[^]IPC = Bolsa Mexicana de Valores Index

[^]DJI = Dow Jones Index

CEMEX:
A Concrete Case for Going Global¹

CEMEX's internationalization was set off with the arrival of its current Chairman and CEO Lorenzo Zambrano. When he faced important challenges such as an imminent threat from foreign competitors and a saturated market at home, he seized the opportunity to transform CEMEX to become a major global company. Initially, its expansion was mostly directed towards natural and emerging markets but later moved on to developed countries, mainly through acquisitions. One of the most important tools for its quick and successful adjustment to different market environments has been its unique and highly efficient operations and management system, the "CEMEX Way". With a unique business model that relies on IT solutions CEMEX has strengthen its position among its competitors and become a leading global producer and marketer of cement, aggregate and concrete products

Introduction.

"What has globalization meant for us? To summarize a long, complex process, we have harnessed the forces of globalization to transform a Mexican-based company with a few international operations into one of the largest global companies in our industry."

- Lorenzo Zambrano, Chairman & CEO CEMEX, 2002²

CEMEX is today one of the world's three largest cement companies, along with France's Lafarge and Swiss-based Holcim. The company produces, distributes, and markets cement, ready-mix concrete, aggregates and related materials for infrastructure projects, buildings, and residential housing. According to *América Economía*, CEMEX is the 7th largest corporation in Latin America³ and the most global enterprise of the region⁴. The company had EBITDA of US\$4.6-billion in 2007; free cash flows of US\$ 2.6-billion and revenues of US\$21.7-billion. CEMEX has more than 67,000 employees operating on virtually every

¹ The authors are grateful to CEMEX executives for their cooperation in the preparation of this chapter.

² CEMEX, S.A.B. de C.V. (2002). Conference on Winning Globally: Organizing for Global Impact. Transcript of a speech of Lorenzo Zambrano, held at the Stanford University, Stanford, USA, 23 January 2002.

³ Las 500 mayores empresas de America Latina. (21 July 2008). *América Economía*.

continent. In 2008, *Fortune* magazine ranked CEMEX as the 389th largest corporation in the world.⁵ *ired* magazine has named CEMEX as one of the 40 key companies in the world.⁶

CEMEX's global growth strategy has been driven by acquisitions, frequently targeting underperforming corporations operating in markets with long-term growth potential, favorable industry characteristics, manageable risks and attractive financials. In a business driven by volume sales, the company is well-known for its effective integration of acquired assets into overall operations to produce higher margins through maximized efficiencies. The organizational philosophy that drives the company's overall operations and its way of doing business is known as "The CEMEX Way".

From 1985 to 2007, CEMEX achieved annual sales growth rates averaging 19%. At present it is a top cement company in many major markets beyond Mexico and Latin America, including the United States, Spain, Egypt, and the Philippines. Following its acquisition of Australian-based Rinker Group in 2007, CEMEX surpassed Lafarge as the world's biggest building materials company measured by revenues.⁷

Widely considered to be the most remarkable corporate success story emerging from Latin America, CEMEX provides a textbook case study of a Global Latina.

Building Materials Industry⁸

The global construction materials sector generated total revenues of more than US\$523-billion in 2007. The leading revenue source is the brick sector, with over US\$154-billion (or 29.5% of the overall market). Cement is second with nearly US\$145-billion (27.7%), followed by crushed stone with 26%, and finally sand and gravel with 17%. The total market is expected to achieve solid growth rates thanks to robust economic activity and strong demand for construction materials in China, India, the Middle East and Eastern Europe. About half of the global demand for cement comes from China. Following the so-called "sub-prime" mortgage crisis in the United States in 2007, growth forecasts for the U.S. housing construction sector were adjusted downwards.

⁴ Especial Multilatinas – Las 50 empresas más globales de América Latina. (April 2008). *América Economía*.

⁵ Fortune Global 500. (25 August 2008). *Fortune*.

⁶ Kevin Kelleher. (2003). The Wired 40. *Wired Magazine*, Issue 11.07, July 2003.

⁷ HeidelbergCement. (2007). Acquisition of Hanson plc. HeidelbergCement Board Presentation, 15 May 2007. Retrieved October 2007 from www.heidelbergcement.com. However, Lafarge acquired Egyptian Orascom Construction Industries in December 2007, and became the industry leader again.

The cement industry is highly capital-intensive with significant economies of scale effects. The sector's asset intensity, combined with capital requirements and high-cost distribution networks, impose high barriers to entry and exit. There is moreover no substitute for cement in the building materials sector, except for lumber and steel in certain regions.

The largest global players in the building materials universe, as measured by market capitalization in 2007 were, in ranked order: Lafarge (France) at US\$27.4-billion; Holcim (Switzerland) at US\$27.3-billion; CEMEX (Mexico) at US\$22.3-billion; CRH (Ireland) at US\$20.4-billion; HeidelbergCement (Germany) at US\$17.3-billion; Anhui Conch Cement (China) at US\$16.5-billion; Siam Cement (Thailand) at US\$8.9-billion; Grasim Industries (India) at US\$8.5-billion; Vulcan Materials (U.S.)⁹ at US\$8.2-billion; and China National Building Material Group (China) at US\$8-billion.¹⁰

The cement sector is largely a local business that remains highly fragmented. While the big global players enjoy strong market positions, pricing power, and control of trading networks, their market shares are still small. Lafarge holds a global market share of roughly 4.4%, which is equal to Holcim, and followed by CEMEX with 4.1%. The rest of the global construction market – or nearly 90% – is distributed among a large number of smaller firms.

CEMEX: Past & Present¹¹

CEMEX traces its origins to 1906, when Cementos Hidalgo was founded near Monterrey in northern Mexico. In 1920, company founder Lorenzo Zambrano – grandfather of the current CEO – established another cement plant, Cementos Portland Monterrey. Eleven years later, Zambrano merged these two companies to create Cementos Mexicanos, later known as CEMEX.

Monterrey-based CEMEX remained a local player until the 1960s, when it began expanding and vertically integrating cement and concrete production throughout Mexico. Its domestic growth, driven by plant construction and acquisitions, was facilitated in the 1970s by the Mexican government's import-substitution policies, which encouraged national

⁸ Section based on: Deutsche Bank. (2007). *Cement 2007 - Still the place to be*. Analyst Report. 29 January; and Datamonitor. (2008). *Global Construction Materials*. Industry Report No. 0199-2030.

⁹ Vulcan Materials completed its \$4.2 billion acquisition of Florida Rock Industries in November 2007.

¹⁰ Capital IQ. Accessed on October 2007.

players and restricted foreign competition. The company listed on Mexico's stock exchange in 1976.

Throughout the 1980s, CEMEX was a large-scale conglomerate with diversified assets in hotels, mining and petrochemicals. In 1982, a severe economic crisis¹² in Mexico forced the government, following decades of protecting domestic firms, to liberalize its economy to attract foreign investment. This dramatic policy reversal opened up the Mexican market to global cement giants like Lafarge and Holcim, threatening CEMEX's domestic position. Lafarge and Holcim didn't pass on the opportunity. By the end of the decade, Holcim had entered Mexico through Grupo Cementos Apasco, which gained a 25% market share.¹³

It was against this backdrop that, in 1985, Lorenzo Zambrano – grandson of the company founder – was appointed CEO. His arrival at the helm marked the beginning of a new era for CEMEX. An engineering graduate of Mexico's renowned ITESM¹⁴ with an MBA from Stanford Business School, Zambrano's personal management style has been down-to-earth and he frequently gets involved in detailed aspects of the company's operations. He has brought a driven and fast approach that today is embedded in the CEMEX corporate culture.

Facing threat from foreign competitors, Zambrano adopted a two-pronged strategy. First, the company shed its conglomerate baggage by divesting its diversified holdings to focus on its core cement and construction business. Second, CEMEX consolidated its domestic position via acquisitions as a defensive measure against foreign rivals. Its home market was secured through the takeovers of Mexico's two biggest cement manufacturers – Cementos Anahuac (acquired in 1987) and Cementos Tolteca (1989) – for US\$1-billion, giving the company more than half of Mexico's cement market. As of 2007, while the Mexican market represented only 18% of CEMEX's total revenues, it accounted for 29% of EBITDA. (See Exhibit 3 for revenue and EBITDA breakdown).

Operationally, CEMEX is known for its deployment of technology and information systems as management and product-delivery tools to keep its cost structure competitive and leverage organizational knowledge. This approach has gained fame as the "CEMEX Way",

¹¹ CEMEX, S.A.B. de C.V. (Ed.). (2006). *CEMEX - The Centennial Book* (1st ed.). Mexico: Editorial Clío, Libros y Videos, S.A. de C.V.

¹² Mexico defaulted on its debt in 1982 and this economic crisis is considered the beginning of the so-called 'lost decade' in Latin America.

¹³ Vedpuriswar, A. V., & Krishna, T. (2003). *CEMEX - Mexico's Global Giant*. Case Study No. 303-095-1. Hyderabad, India: ICFAI Knowledge Center.

¹⁴ ITESM stands for Instituto Tecnológico y de Estudios Superiores de Monterrey.

which elevates organizational structures to the status of corporate strategy. As the company states: "The CEMEX Way is much more than an information system. Literally, it is the way that CEMEX does business." The company's approach to information technology (IT) solutions is uncharacteristic for an old-economy firm in a heavy industry. Zambrano however has been a tireless advocate of "e-enabling" the company's operations: information systems coordinate production and sales to ensure efficient management and low overheads. As Lorenzo Zambrano put it: "Information is your ally. You use it to detect problems quicker and get better faster, or determine who is better and then you can go and find out why. As we grow, we clearly need more information. I must admit that I want the information for myself."¹⁵

A good example of this approach is the CEMEXnet satellite-based system deployed in 1989 to connect and coordinate all CEMEX plants and get information to make timely decisions. In the early 1990's, a logistics system called Dynamic Synchronization of Operations which uses Global Positioning System (GPS) technology to link delivery trucks to a central control center¹⁶. Since ready-mixed concrete has to be poured within 90 minutes of mixing, a major challenge is the dispatching of trucks so they can transport concrete from plants to construction sites in a timely manner - today, in Mexico you get cement as fast as a pizza.

IT solutions not only changed the way CEMEX delivered products to customers, they also transformed the company's corporate culture¹⁷ and opened up new business opportunities in the small and medium enterprises (SMEs) market, notably through CxNetworks, which launched several projects: Latinexus (July 2000) solutions provider for indirect goods procurement, while Construmix (October 2000) and Construplaza (February 2001) were business-to-business portals for the construction industry in Mexico and Spain, respectively. Arkio (October 2001) was launched as a "one stop shopping" for construction professionals. In contrast to the first four units that later were either merged, transformed into information sources or folded into CEMEX's operations, Neoris (2000) is still operating

¹⁵ Chung, R., Marchand, D., & Kettinger, W. (2005). *The CEMEX Way: The Right Balance Between Local Business Flexibility and Global Standardization*. Case Study No. IMD-3-1341. Lausanne, Switzerland: IMD - International Institute for Management Development.

¹⁶ Dutta, Soumitra. *Technology Excellence in the Developing World: Mission impossible?*. INSEAD Working Paper. Research in Information Systems Excellence. 2001/66/TM/RISE. 2001.

¹⁷ Lee, H., & Hoyt, D. (2005). CEMEX: Transforming a Basic Industry Company. Case Study No. GS33. Stanford, USA: Stanford University.

and was even spun off as a consulting¹⁸ subsidiary, which is now Mexico's largest IT consultant by revenues and second-largest in Latin America.¹⁹

CEMEX also places high emphasis on training its employees on every level. The CEMEX Learning Management System is a tool available to everyone in the company that makes a wide number of courses available online in various languages. In the late 1990s, it established various executive education programs, like the CEMEX International Management Program (CIMP), which is conducted in cooperation with top-tier business schools like Stanford, INSEAD and ITESM.

Today CEMEX boasts a century-long experience in its domestic market, where the company has an intimate understanding of the demand dynamics for cement. Unlike industrialized countries where cement is regarded as a bulk commodity, in emerging markets like Mexico it is purchased in bags depending on homebuilders' economic budget. Since retail customers of bagged cement regard it as a consumer good, brand management is an important part of the product's commercial success. The retail market for cement is significant in Mexico, where the self-construction end-market constitutes from 45% to 50% of total sales. The CEMEX brands are strong throughout Mexico and the prices tend to be high due to the bag sales nature.²⁰

An excellent illustration of CEMEX's understanding of its domestic market was its 1998 launch of "Patrimonio Hoy", an innovative savings-and-loan program for the low-end housing market.²¹ Most of the poor had insufficient savings to purchase building materials, and CEMEX estimated at that time this market to be worth \$500 million to \$600 million per annum. CEMEX's answer was the "Patrimonio Hoy" program, which changed the perception of cement from functional to emotional, creating an uncontested market space. CEMEX's scheme provided low-income urban inhabitants with materials through certified distributors. Inspired by the traditional *tanda* credit-rotation system, members got back their investment in the form of construction materials and related services such as assistance in home construction.²² This innovative marketing scheme, merging business interests with powerful

¹⁸ Neoris provides business and IT value-added consulting, emerging technology solutions and outsourcing.

¹⁹ Fernandez, J. (2006). CEMEX takes the High Road. *NYSE Magazine*, October/November 2006.

²⁰ Bear Stearns (2007). *Cemex S.A. de C.V. - The Cash King*. Analyst Report. 22 March.

²¹ Kim, W. C., & Mauborgne, R. (2005). *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant*. Boston, USA: Harvard Business School Press.

²² Rekha, R., Iyengar, H., & Venkatesh, T. (2005). *CEMEX, Mexico - Revolutionizing Low-Cost Housing*. Case Study No. 505-081-1. Bangalore, India: ICFAI Business School, Bangalore.

socio-economic needs, was a huge success in Mexico. While the competition sold only bags of cement, CEMEX was selling a dream – and demand soared. With “Patrimonio Hoy”, the company achieved differentiation at a low cost.

CEMEX launched a related scheme, “Construmex”, in the United States to capture part of the remittance market. It enabled Mexicans working in the U.S to send money directly to Mexican-based CEMEX distributors, who supplied materials for their families to build houses in Mexico.

Launched in 2001, its third-party retail network, Construrama, has strengthened CEMEX’s solid domestic position. Designed to aggregate retail distributors attracted by better service, lower prices, training, and brand-name advantages in exchange for their loyalty to CEMEX products (though Construrama stores sell a variety of competing products).²³ By the end of 2006, some 2,100 outlets were integrated into the Construrama chain throughout Mexico. From a strategic viewpoint, Construrama represents a significant barrier to entry for potential competitors by allowing CEMEX to lock down its dominant position in the bagged cement market. Additionally, CEMEX uses branding strategies usually associated with consumer goods: distributing T-shirts and baseball caps to small construction teams, paying for “putting-roof-on-house” parties, distributing construction tip booklets at airports where immigrant workers return, and sponsoring local soccer teams.

CEMEX’s deep understanding of its domestic market and intelligent use of innovative marketing strategies has paid off. In 2007, the company had a dominant market share of 55% – more than double the share of the number two player, Holcim Apasco.²⁴

Going Global

In the past half century, CEMEX has transformed itself from a local Mexican cement producer into a leading global provider of building products and solutions. While CEMEX targets any region that fits its investment criteria, the company’s international growth trajectory can be divided, in general terms, into three main phases: (1) expansion throughout its “natural” market; (2) entry in further emerging markets; (3) transforming CEMEX into a Global Latina (See Exhibit 1 in Annex for the company’s expansion timeline).

²³ Segel, A., Chu, M., & Herrero, G. (2004). *Patrimonio Hoy*. Case Study No. 9-805-064. Boston, USA: Harvard Business School Publishing.

²⁴ Bear Stearns (2007). *Cemex S.A. de C.V. - The Cash King*. Analyst Report. 22 March.

Regarding the internationalization strategy, CEMEX prefers to expand via acquisitions. While CEMEX first has moved into “natural” markets similar to its domestic Mexican market, its acquired assets are dispersed globally on virtually every continent. (See Exhibit 4 for the company’s geographical asset spread). The company’s appetite for foreign acquisitions can largely be explained by the internal dynamics of the cement industry. The cement business’s main characteristic is high transportation costs relative to production costs. Since the price of cement is largely determined by costs involved in delivering the product, competition generally occurs at a regional level. Efficient suppliers must be located close to their markets. The majority of cement produced in the United States, for example, is sold within 200 miles of the plant or terminal of origin. Consequently, large-scale cement companies that wish to grow must expand geographically in order to supply new markets. In other words, if CEMEX wants to supply the European or Chinese markets, the best strategy is to own and operate plants in or near those markets. An alternative to capital investments in a particular country is cement trading, which aims at balancing global supply and demand of the often-dispersed plants. CEMEX, a worldwide leader in the field, has established a network of grinding mills and storage facilities and uses a huge maritime bulk freighter fleet to redirect its excess capacity to where it is needed most. Furthermore, in some cases, the company utilizes these cement exports, facilitated through its Trading Division, to establish client relationships and investigate a possible target market before making any decision about strategic acquisitions.

On an operational level, CEMEX’s acquisition strategy is famous for its efficient due diligence and integration of assets. CEMEX generally targets undervalued and/or underperforming assets with potential for operational efficiency improvements. Preferred target companies should also be well-established players and possess a high market share. When identifying acquisition opportunities, CEMEX also takes the broader view and examines the potential for restructuring the respective market as a whole.²⁵ It has three key objectives when targeting an asset. First, the targeted company must be a good “CEMEX Way” candidate – in other words, capable of being streamlined into overall operations. Second, the investment must in no way deviate the company from its financial targets. Third, the investment must offer superior long-term returns and be located in a country that is, or promises to be, a profitable growth market.²⁶ Therefore, CEMEX’s due diligence includes strong emphasis on country-analysis factors such as population size and GDP development.

²⁵ Ghemawat, P., & Matthews, J. L. (2000). *The Globalization of CEMEX*. Case Study No. 9-701-017. Boston, USA: Harvard Business School Publishing.

²⁶ Miller, S. (2002). Emerging titans. *Foreign Direct Investment*, December/January 2003. Retrieved October 2007 from <http://www.fdimagazine.com>.

The company sometimes takes advantage of economic crises to shop for cement assets carrying lower valuations. Shareholders of targeted companies are often more than happy when CEMEX comes calling.

CEMEX is also able to digest acquisitions very quickly due to its integrations approach, which derives from the overall “CEMEX Way”.²⁷ The Post Merger Integration has three main goals:

- (1) Detecting cost savings;
- (2) Identifying and retaining talent; and
- (3) Implementing the CEMEX business model.

This business model is based on a single global identity (acquired companies are almost always renamed “CEMEX”), common organizational structures and operating processes, a common IT platform, centralized back office functions, and a strong emphasis on operational best practices, business process gap analysis, benchmarking and performance measurement. Reporting lines are adjusted depending on the function: back office functions such as finance, risk management, procurement and IT must report to global headquarters, while commercial and other activities report to country headquarters. At the end of the day, the CEMEX subsidiaries focus on making and selling cement, while centralized functions are tightly controlled by the parent company in Mexico.

The Economist has described this integration approach in more graphic terms: “In each case, ‘post-merger integration teams’ — i.e., executives armed with laptops — were dispatched to analyze the new acquisition, to cut costs, and to harmonize its technical systems and management methods with CEMEX’s. The CEMEX Way specifies everything, down to the make of computers that employees must use. It can seem authoritarian at times, but it does at least ensure that communication across the company is seamless.”²⁸ However, the CEMEX Way is not a one-way street. Best practices of acquired firms are disseminated throughout the firm and integrated into the “CEMEX DNA”.

Acquisitions have undeniably been an important instrument of the company’s internationalization strategy. Strategically, CEMEX’s expansion moves starting in the 1990s

²⁷ For a detailed description of the post merger integration approach of CEMEX see: Austin, M. (2004). Global Integration the Cemex Way. *Corporate Dealmaker*, 1 March 2004.

²⁸ The CEMEX Way. (14 June 2001). *The Economist*.

were a well-timed hedge against market uncertainties in Mexico. By expanding beyond its domestic market, CEMEX stabilized consolidated cash flows with less dependence on a single market known for its turbulence political and economic climate.

i) Natural Market: Best Defense is a Strong Offense (1992-2000)

"We suddenly found ourselves competing with very large international companies at a time of consolidation in the world cement industry. There were few independent producers left. Either we became large and international, or we would end up being purchased by a bigger player."

- Chairman & CEO Lorenzo Zambrano, 1997.²⁹

An early phase of CEMEX's international expansion had begun, not surprisingly, just north of the border in the United States. In 1986, the company entered into a 20-year joint venture with Southdown Inc. to market its cement and clinker in the southern United States. The partnership, known as Sunbelt Cement, paid management fees to Southdown and split the remaining earnings equally. Southdown soon complained, however, that CEMEX was reducing the joint venture's management fees and increasing its imported cement prices to squeeze profits and take more out of the partnership.

In 1989, CEMEX bought out Southdown's share and began operating Sunbelt as a subsidiary.³⁰ Less than a month later, however, Southdown, seven other U.S. firms and two labor unions filed an anti-dumping petition against CEMEX, claiming that it had been deflating cement prices to gain market share.³¹

CEMEX's foray into the United States, it seemed, was off to a bad start – especially when, in late 1989, the U.S. Department of Commerce hit the company with a punitive 58% countervailing duty.³² Zambrano later confided that this duty was a severe blow.

CEMEX's milestone year was 1992. The experience with the anti-dumping setback had convinced Zambrano that he needed to broaden the company's geographic reach. So he turned his attention to Spain, which was an ideal country in Europe because it had solid growth potential.

²⁹ Crawford, L. (1997). Long Reach Opens New Source of Finance. *Financial Times*, 7 November 1997.

³⁰ Sarathy, R., & Wesley, D. (2003). *CEMEX - The Southdown Offer*. Case Study No. 9B03M013. London, Canada: Richard Ivey School of Business.

³¹ Claire Poole, C. (1990). Cement Wars. *Forbes*, 1 October 1990.

³² In 1992 a GATT ruling sided with CEMEX, but the anti-dumping persisted until early 2006, when officials from the Mexican and U.S. governments finally reached an agreement in principle to end the long-standing dispute over imports of Mexican cement into the United States. Under the agreement, the U.S. agreed to ease restrictions during a three-year transition period and then revoke the US anti-dumping order, allowing cement from Mexico to enter the United States without duties or volume limits.

After securing financing from Citicorp, Zambrano made his big move: a US\$1.8-billion takeover of Spain's two biggest cement companies: Valenciana and Sanson.³³ The two companies were merged to create Spain's largest cement producer, with a market share of 25%, and lay the foundations for the CEMEX Way of post-merger integration. Within two years, the merged company's profit margins soared from 7% to 21%.

"For Spaniards, the idea of a Mexican company coming to Spain and changing top management was unthinkable," recalled Zambrano. "They said a Mexican company could never manage in Europe."³⁴ He also confided that the Spanish takeovers were a "make-or-break" deal for CEMEX: "And I admit, in retrospect, we did it without having acquired a fair understanding of the operational risk. But we were willing to work very hard to put those two companies back on top of their markets."³⁵

The icing on the cake was that CEMEX could deploy cement output from its newly acquired Spanish operations to bypass the punitive U.S. import duties. The acquisition in Spain facilitated the company's access to international capital markets, and the consolidation of debt into its new subsidiary allowed CEMEX to reduce its interest payments (about US\$100 million per year). Spain enjoyed an investment-grade sovereign rating, and interest expenses are tax-deductible. The Compañía Valenciana de Cementos became the umbrella-holding corporation for all of CEMEX's future international acquisitions. The new subsidiary was indeed helpful when raising funds became especially challenging for Mexican companies during the Mexican peso crisis of 1994-1995.

In the 1990s, meanwhile, domestic U.S. firms were reducing investment in the commodity cement sector and diversifying into other lines of business. This retreat created opportunities for foreign cement manufacturers for two reasons: cement shortages opened the U.S. market to imported cement and U.S. assets in the sector were now on the market - and CEMEX was definitely a buyer. In 1992, its subsidiary Sunbelt Enterprises purchased U.S. Pharris Sand & Gravel, while in 1994, CEMEX paid competitor Lafarge US\$100 million for the Balcones cement plant in Texas, not far from CEMEX's corporate headquarters in Monterrey.

³³ Holland, K. (1992). Citicorp Leads 1.2 Billion Bridge Loan for CEMEX. *American Banker*, 14 August 1992.

³⁴ Dombey, D. (1997). Well-Built Success. *Industry Week*, 5 May 1997.

³⁵ Van Agtmael, A. (2007). *The Emerging Markets Century: How a new breed of world-class Companies is overtaking the World*. New York, USA: Free Press.

This latter purchase again had the virtue of allowing CEMEX to bypass, at least partially, the anti-dumping action by its ownership of domestic production capacity in the United States.³⁶

At the same time, CEMEX was expanding its operations throughout Latin America where it faced fierce competition from Lafarge and Holcim. In 1994, the company took a controlling stake worth US\$320-million³⁷ in Venezuela's largest cement company, Corporación Venezolana de Cementos (Vencemos). CEMEX bought the valuable Venezuelan assets from a distressed conglomerate, and their location on the coastline facilitated cement exports by ocean vessels and trading activities to northern Brazil, Panama, and the Caribbean.³⁸ This strengthened CEMEX's risk-reduction efforts by utilizing cement trading as a buffer to match supply and demand.

CEMEX entered Panama in 1994 by acquiring the local producer Cemento Bayano after a government auction. The following year, it bought Cementos Nacionales, the largest cement player in the Dominican Republic. In 1996, it took controlling stakes in two of Colombia's leading cement manufacturers, Cementos Diamante and Inversiones Samper, for about US\$700-million – and became the third largest cement producer in the world. In 1999, CEMEX took a 12% interest in Chile's largest cement producer, Cementos Bio-Bio for US\$34-million (though it was later divested). The same year, CEMEX consolidated its presence in Central America and the Caribbean by acquiring a 95% stake in Costa Rica's largest cement producer, Cementos del Pacífico. CEMEX entered the Nicaraguan market in 2001 by leasing a cement plant from the Nicaraguan government, and the following year bought the Puerto Rican Cement Company.

³⁶ Emerging Multinationals. (21 May 1994). *The Economist*.

³⁷ Economic Commission for Latin America and the Caribbean (ECLAC). (2006). *Foreign Investment in Latin America and the Caribbean, 2005*. United Nations publication No. E.06.II.G.44. Santiago, Chile: United Nations.

³⁸ In 1993, CEMEX also acquired Concem, which operated six cement-shipping terminals throughout the Caribbean to facilitate trading operations. During 1999, two terminals in Haiti were acquired.

ii) Forging a Ring of Grey Gold³⁹ (1998-2001)

"We like investments in emerging markets because there is more opportunity to improve cash flow. Margins on sales are higher on average than in mature markets because cement behaves a lot like a consumer product. This means you can differentiate your brand."
– Rodrigo Treviño, CFO CEMEX, 1998. ⁴⁰

Expansion into emerging markets beyond Latin America has offered CEMEX a number of advantages. Emerging markets enjoy relatively strong growth rates compared with developed economies, and high growth goes hand-in-hand with infrastructure investment and residential construction. Also, under-performing cement companies with potential for restructuring are more likely to be found in emerging markets where cement is sold as a branded product – and CEMEX's bagged cement brands have strong recognition. The company's strategy to focus on emerging markets has created a "ring of grey gold" – an expression by Pankaj Ghemawat describing its string of assets circling the world north of the equator in high-growth emerging markets, forming a geographically contiguous but dispersed region.

By the mid-1990s CEMEX had a significant presence in Asia as a cement trader, but still had not made an acquisition. CEMEX's first acquisition was in the Philippines, where in 1997 it paid roughly US\$70-million for a 30% stake in Rizal Cement Company (a year later, the company bought an additionally 40% for US\$128 million).

The big opportunity came with the Asian economic crisis of 1997-1998, which had a negative impact on the construction sector. When local firms began selling non-core assets and governments started divesting their stakes in cement operations, CEMEX was a buyer again.⁴¹

From 1998 to 2000, CEMEX turned to Indonesia, subsequently investing over US\$200-million for an overall 25% stake in state-owned Semen Gresik Group, the country's largest cement producer, which was born out of a merger of various regional companies. Because of its strategic location, size, significant growth potential, and role as an anchor for the company's Southeast Asian cement trading network, Indonesia was seen

³⁹ Ghemawat, P. (2005). Regional Strategies for Global Leadership. *Harvard Business Review*, 83(12).

⁴⁰ Euromoney Institutional Investor PLC. (1998). Corporate Dialogue: Cemex. *Institutional Investor - International Edition*, 23(12). Retrieved October 2007 from Business Source Premier database.

⁴¹ Lasserre, P., & Picoto, J. (2007). *CEMEX: Cementing a Global Strategy*. Case Study No. 307-233-1. Fontainebleau, France: INSEAD.

as an important segment of CEMEX's Asia strategy.⁴² However, after several years of dissension with the Indonesian administration, CEMEX sold its stake in 2006 for US\$346 million to Indonesia-based Rajawali Group, because it could not exercise an embedded option to acquire a majority stake in Gresik due to the government's objection. CEMEX anticipated a similar situation in Thailand, where the company did due diligence in 1998 on market leader Siam Cement.⁴³ In the end, CEMEX did not pursue the acquisition, because of the monarchy's involvement⁴⁴ and the fact that local management favored an alliance, with a preference for Lafarge and Holcim as potential partners. ⁴⁵

In 2000 the company signed an exclusive long-term agreement with Taiwan's Universe Cement, thus signaling its entry into the Taiwanese cement market and reinforcing its presence in Southeast Asia. In March 2002, however, CEMEX terminated the partnership. These experiences taught the company the importance of *qualitative* variables in its risk assessments. But in spite of the previous setbacks, CEMEX came to Asia to stay.

In 1999, CEMEX bought APO Cement Corporation, the lowest cost producer of the Philippines, for \$400 million, making it the biggest cement producer in that country.⁴⁶ In the same year, the company created an investment vehicle – CEMEX Asia Holdings (CAH) – with insurance giant AIG and other institutional investors to co-invest in cement-related opportunities in Asia.⁴⁷ CAH had a committed capital totaling US\$1.2-billion and allowed CEMEX to lay off a part of its future Asian acquisition costs on the partnered fund. As its first investment, Cemex Asia Holdings purchased the economic rights of APO Cement and Rizal from CEMEX. Venturing into Thailand again in 2001, CEMEX used CAH to buy the cement manufacturer Saraburi Cement for an enterprise value of approximately US\$73-million. The same year, CEMEX built, as one of its few Greenfield facilities in the Far East, a grinding mill in Bangladesh to serve the regional markets. The mill is integrated in the cement trading networks and supplied with clinker from existing operations in Thailand and the Philippines.

⁴² CEMEX Annual Report 1999.

⁴³ Williamson, P., & Butler, C. (2001). *Siam Cement*. Case Study No. 301-140-1. Fontainebleau, France: INSEAD.

⁴⁴ The Thai royal family's Crown Property Bureau held over 30% of the company's equity.

⁴⁵ Vedpuriswar, A. V., & Krishna, T. (2003). *CEMEX - Mexico's Global Giant*. Case Study No. 303-095-1. Hyderabad, India: ICFAI Knowledge Center.

⁴⁶ Williamson, P., & Butler, C. (2001). *Cemex in Asia*. Case Study No. 301-078-1. Fontainebleau, France: INSEAD.

⁴⁷ CEMEX Annual Report 1999. CEMEX's ownership of CAH stood at 77%, while institutional investors owned 23%. The group of investors included the AIG Asian Infrastructure Fund II; GIC Special Investments; Metropolitan Life Insurance Company; the Asia Equity Infrastructure Fund; Capital International Asia; and a consortium of investors led by Navis Capital Partners.

In the Middle East, the company acquired a 77% stake⁴⁸ in Egypt's largest cement producer, Assiut Cement Company, in 1999. The acquisition marked a shift in strategy from exporting cement to Egypt to buying production capacity in one of the fastest-growing cement markets in the region. The Egyptian market was highly fragmented, with Assiut controlling only 17%. Cement prices moreover were controlled to a significant degree by the Egyptian government, which controlled almost 50% of the industry's capacity and maintained low prices. In 2001, CEMEX has established a sound and competitive position in the regions of Cairo and the Nile Delta. It enjoys strong brand presence through a network of more than 500 retailers.⁴⁹

iii) Building a Global Latina (2000-2006)

Throughout this phase CEMEX made three milestone acquisitions: Southdown (2000), RMC (2005) and Rinker (2007). While all acquisitions of CEMEX are purely debt-financed, the company listed in the New York Stock Exchange American Depository Receipts (ADRs)⁵⁰ in 1999 to enhance its visibility to the investor community. (See Exhibit 2 in Annex for stock performance).

With its first foray having limited success, CEMEX returned to the American market in 2000 – but this time entering through the front door. It paid US\$2.6-billion in a surprising takeover of the second largest U.S. cement producer, Houston-based Southdown Inc. – the same company, ironically, that had led the anti-dumping campaign against CEMEX. The Southdown deal instantly made the company the biggest cement producer in North America. The deal moreover provided a further hedge against exposure to turbulent emerging markets. As the *Financial Times* observed: "The deal reduces CEMEX's dependence on volatile emerging markets. Developed countries, largely Spain and the U.S., will now account for a third of cash flow and the latter market should continue to grow nicely even if the economy slows."⁵¹ The Southdown deal also gave the company a large portion of its income in U.S. dollars. Southdown was merged into the company's existing U.S. business in 2001, creating CEMEX Inc., which that year accounted for nearly 30% of the parent company's total revenues.

⁴⁸ A year later, the participation was stepped up to 90%.

⁴⁹ CEMEX Annual Report 2001.

⁵⁰ ADRs allow U.S.-based investors to buy stock in foreign companies without undertaking cross-border transactions. This type of security is priced in U.S. currency, pays its dividends in dollars, and can be traded like any share of U.S. companies.

In 2004 CEMEX stunned investors with the announcement of yet another mega transaction: a US\$5.8-billion takeover of U.K.-based RMC Group, Britain's biggest cement maker. It is not often that a little-known Mexican company marches into Britain and takes over a major industrial asset. As *The Economist* noted: "Queen Victoria, whose subjects built or financed much of Latin America's infant infrastructure, would not have been amused."⁵² The buyout of RMC, which had finished fiscal 2003 with revenues of US\$8-billion, was not only the largest takeover ever undertaken by a Mexican company but at that time also the most expensive acquisition in the global construction materials business.⁵³ RMC was in fact a classic "CEMEX Way" target: a low-margin, underperforming company having just undergone an intense restructuring process. CEMEX's offer therefore came close to the bottom of the firm's business cycle.⁵⁴ RMC shareholders embraced CEMEX's takeover bid that put a 43% premium on the pre-offer stock price.

After the RMC deal, which was closed in 2005, CEMEX went from managing companies in two languages (Spanish and English) to sixteen with new operations in Germany, France, Norway, Sweden, Denmark, Finland, Poland, Croatia, Hungary, Latvia, Israel, Malaysia, the UAE and the Czech Republic. In the United States, the company was now the largest ready mixed concrete producer with more than 210 plants. RMC was also a major customer of Holcim in the United States. Now CEMEX could weaken its competitor's position by diverting RMC's business internally.⁵⁵ In France, RMC is the largest cement customer of Lafarge.

In late 2006, the CEMEX acquisition machine was still roaming the globe. And once again, the company surprised the cement industry and financial community with an even bigger takeover: a US\$15.4-billion⁵⁶ bid for Australian-based ready-mix concrete and aggregates producer Rinker Group, a major player in the heavy building materials sector with about 80% of its capacity in the United States. While the first round attempt to acquire the company was considered hostile by Rinker's management, the offer was recommended after CEMEX raised the bid in a second round. When the deal was approved in June 2007, *América Economía* observed: "It seems that there are no limits to CEMEX's appetite for expansions

⁵¹ Lex Column – Cemex. (9 October 2000). *Financial Times*.

⁵² One Giant Leap for Mexico-Cement. (30 September 2004). *The Economist*.

⁵³ RMC takeover would transform Cemex into 20 million+ yd. U.S. ready mixed gigante. (1 September 2004). *Cement Americas*.

⁵⁴ Citigroup Smith Barney. (2005). *CEMEX S.A. de C.V. (CX) - Concrete Punch!* Analyst Report. 03 March.

⁵⁵ Deutsche Bank. (2004). *Global Cement Update – Mexican wave*. Analyst Report. 26 November.

⁵⁶ Capital IQ. Accessed on October, 2007.

abroad.⁵⁷ Indeed, the deal made the company the world's largest supplier of heavy building materials.

While some analysts were critical of the Rinker acquisition due to its poor timing with a U.S. housing construction slowdown, the deal allows CEMEX to strengthen its position in the United States, enhance its vertical integration, and build further economies of scale. The Rinker deal also underlines CEMEX efforts in reducing the cement-based revenues in its portfolio to become an integrated global player in heavy building materials. With this transformation, CEMEX's operations are now more decentralized, which doubtless will present a challenge to the uniform "CEMEX Way" culture at the head office in Mexico.

Industry observers still note that CEMEX, despite its robust war chest, has pursued a relatively cautious approach towards the so-called BRIC (Brazil, Russia, India, and China) markets. It is true that, while the company has purchased assets in many emerging markets, it has yet to establish itself – unlike its rivals Lafarge and Holcim – as a major player in China or India. However, this behavior underlines CEMEX disciplined approach towards acquisitions, as Lorenzo Zambrano explained: "Not investing in countries that superficially look very interesting has been good for us."⁵⁸ Nonetheless, CEMEX has now a limited presence in China thanks to its 2007 takeover of Australian-based Rinker Group. Following that deal, the company operates four concrete plants in the northern cities of Tianjin and Qingdao.

CEMEX's Success Factors

CEMEX's stunning success as a Global Latina has been the result of a complex matrix of macro and firm-specific factors.

On the macro level, the Mexican government's switch from protectionist import-substitution policies to market liberalization encouraged CEMEX to react defensively in its domestic market. The company consolidated its position and upgraded its operations in response to potential competition by foreign giants such as Lafarge and Holcim – a familiar pattern among Latin American multinationals in their home markets. At the same time, Lorenzo Zambrano decided that the company needed to expand internationally or risk being

⁵⁷ Bigger Than Ever. (September 2007). *América Economía*.

⁵⁸ Thomson, A. (2006). CEMEX preparing for entry into Chinese market. *Financial Times (FT.com)*, 27 April 2006. Retrieved on October 2007 from Factiva database.

swallowed by a bigger rival. Also, economic crises in Mexico – in the early 1980s and mid-1990s – forced CEMEX to turn towards foreign markets to stabilize its cash flow and hedge against domestic uncertainties.

The general climate of trade liberalization in the 1980s and 1990s gave CEMEX a further motivation to expand internationally. The company's unpleasant experience with the U.S. anti-dumping suit in 1989, however, taught CEMEX that it had to diversify its expansion ambitions beyond the American market. As a consequence it focused on acquiring assets in natural markets south of the Mexican border, in Spain and the "ring of grey gold".

On the firm-specific level of analysis, CEMEX's major competitive advantages have undeniably been related to its strengths as a rigorously managed organization with a sophisticated acquisition-driven strategy. Specifically, CEMEX's strengths are due to five primary factors: *visionary leadership, operational discipline, innovative technologies, business model innovation, and strong financials*.

First: *visionary leadership*. Lorenzo Zambrano has been a charismatic leader of CEMEX since his appointment as CEO in 1985. Zambrano clearly has been a driving force behind CEMEX's innovative approach to technology and acquisition strategy that have transformed the company into a global player. One of his key strategic decisions was to focus CEMEX on its core cement business – a strategy that was quite different when compared to the conglomerate-controlled Mexican economy at that time.⁵⁹ Zambrano's strategy has produced impressive results. In the two decades since he was appointed as CEO, CEMEX's revenues grew from US\$275-million to more than US\$18-billion in 2006.

Second: *operational discipline*. CEMEX's operational strengths are the result of the "CEMEX Way": its IT-based organizational architecture, its disciplined investment strategy, and its rigorous post-merger integration approach. The CEMEX Way is the engine that has driven the company's global expansion and robust cash flows. In many respects, this way of doing business has helped give many targeted firms, once parochial, a more global outlook towards the industry. One potential caveat is that, as CEMEX continues to expand into developed markets, its rigidly centralized operational integration may become less suitable in a global company that effectively has become highly decentralized.

⁵⁹ The Master Builder. (15 October 2005). *The Economist*.

Third: *innovative technologies*. CEMEX leads the global building materials industry in the use of information technology. Driven by Zambrano's personal commitment to IT solutions, CEMEX's information systems allow it to coordinate production and sales on a global basis to ensure efficient management and low overheads. This idea of a Mexican company leading a low-tech commodity industry with a high-tech organization is a somewhat counter-intuitive finding. Although the efforts of always doing things better is deeply rooted to most corporate cultures, at CEMEX the marginal concept of continuous improvement is not enough. International expansion moreover has brought international exposure, and with it a continuous window on new knowledge.

Fourth: *business model innovation*. CEMEX has revolutionized the way of doing business in a commodity industry. It has observed that above all, its emerging market customers do not want mere cement – but a building solution from CEMEX. With its business model shift towards an exposure to all elements of the value chain, the company is able to capture additional revenues, enhance its profitability and differentiate itself from the competition. As a consequence, it is now more appropriate to refer to CEMEX as a building materials solution provider instead of a cement company.

Fifth: *strong financials*. Despite lower revenues than its two global rivals, Lafarge and Holcim, CEMEX generates more cash flow than these two companies thanks to a combination of relatively low capital expenditures, lower interest payments, and lower fiscal exposure. The company's robust cash flow gives it considerable flexibility to make acquisitions, to expand current operations, to reduce debt, and if necessary to buy back shares or pay dividends.⁶⁰ The company's constant need for capital nonetheless has led to some concerns about debt. Restructuring its non-Mexican assets in a Spanish subsidiary, which helped to protect its finances from a potentially unstable Mexican peso and benefit from Spain's investment-grade status, has improved its debt position.

CEMEX is undoubtedly the most successful globally-oriented Latin American multinational. In a business where the leading global players must build scale and drive cash flow in order to finance further growth, CEMEX is a model Latin American corporation with world-class reputation in M&A strategy. In every respect, CEMEX is a genuine Global Latina.

⁶⁰ Bear Stearns (2007). *Cemex S.A. de C.V. - The Cash King*. Analyst Report. 22 March.

Annex

Exhibit 1: CEMEX International Expansion

Expansion Timeline (until late 2007)

Year	Target	Mode of Entry	Target Company/ Partner/Subsidiary/Client	Size	Source
	Home Country			mm\$	
1969	Mexico	Acquisition	Cementos Maya	n.a.	
1976	Mexico	Acquisition	Cementos Guadalajara	n.a.	
1986	USA	Joint Venture	Southdown	n.a.	
1987	Mexico	Stake: 49%	Holding of Cem. de Chihuahua	n.a.	
1987	USA	Joint Venture (JV)	Heidelberger, Aalborg, Lehigh	n.a.	
1987	Mexico	Acquisition	Cementos Anáhuac	1.000	^a
1989	Mexico	Acquisition	Cementos Tolteca		
1989	USA	Acquisition	Gulf Coast Portland Cement		
1989	USA	Acquisition	Houston Shell and Concrete		
1989	USA	Acquisition	Houston Concrete Products	45	^a
1989	USA	Acquisition	Aggregate Transportation		
1989	USA	Buyout	Sunbelt (JV w/Southdown)	n.a.	
1992	USA	Acquisition	Pharris Sand & Gravel	n.a.	
1992	Spain	Acquisition	Valenciana	1.800	
1992	Spain	Acquisition	La Auxiliar de la Construcción		
1993	Bahamas*	Acquisition	Concem	23	^b
1994	USA	Acquisition	Balcones Cement Plant	100	
1994	Venezuela	Acquisition	Vencemos	320	^h
1994	Trinidad	Stake: 20%	Trinidad Cement	10	^b
1994	Panama	Acquisition	Cemento Bayano	60	^b
1995	Dom. Republic	Acquisition	Cementos Nacionales	111	^h
1996	Colombia	Acquisition	Cementos Diamante	400	
1996	Colombia	Acquisition	Samper	300	
1997	Philippines	Stake: 30%	Rizal Cement	93	^d
1998	Indonesia	Stake: 14%	Semen Gresik	114	^c
1998	Philippines	Stake: 40%	Rizal Cement	128	^d
1999	Indonesia	Stake: 8%	Semen Gresik	49	^c
1999	Indonesia	Stake: 4%	Semen Gresik	28	^c
1999	Singapore	Private Placement, JV	Institutional Investors	1.200	
1999	Philippines	Acquisition	APO Cement	400	^d
1999	Costa Rica	Acquisition	Cementos del Pacífico	72	^k
1999	Egypt	Stake: 77%	Assiut Cement	319	^a
1999	Chile	Stake: 12%	Cementos Bio-Bio	34	^d
1999	Haiti	Acquisition	Cement Terminals	n.a.	
2000	USA	Acquisition	Southdown	2.800	^d
2000	Taiwan	Partnership Agreement	Universe Cement	n.a.	
2000	Egypt	Stake: 13%	Assiut Cement	56	^e
2001	Nicaragua	Leasing Agreement	Nicaraguan Government	n.a.	
2001	Thailand	Acquisition	Saraburi Cement	73	^d
2001	Bangladesh	Greenfield	Grinding Mill	26	^g
2001	France	Acquisition	Pastorello Travaux Routiers	n.a.	
2001	Japan	Acquisition	Wangan	23	^f
2002	Puerto Rico	Acquisition	Puerto Rican Cement Co.	281	^a

Exhibit 1 (cont'd): CEMEX International Expansion

2003	USA	Acquisition	Dixon-Marquette Cement	84	j
2005	United Kingdom**	Acquisition	RMC Group	5.800	
2005	Puerto Rico	Acquisition	Concretera Mayaguezana	30	m
2005	Central America	Acquisition	Package of various minor companies	21	m
2006	Guatemala	Stake: 51%	Cementos Global (Grinding Plant)	17	m,o
2007	Australia***	Acquisition	Rinker	15.624	p

a) CEMEX S.A.B. de C.V., "CEMEX - The Centennial Book", Mexico, 2006
 b) http://www.luxner.com/cgi-bin/view_article.cgi?articleID=403
 c) Pankaj Ghemawat, "The Globalization of CEMEX", 29 November 2004
 d) Deutsche Bank, "Global Cement Review", 11 April 2002
 e) <http://www.secinfo.com/dRE54.523w.d.htm>
 f) http://findarticles.com/p/articles/mi_hb5563/is_200105/ai_n22866174?tag=artBody;col1
 g) http://findarticles.com/p/articles/mi_m0EIN/is_2000_March_29/ai_60909310
 h) www.eclac.org/publicaciones/xml/2/24302/lcg2309i_Chapter_IV.pdf
 i) http://cementamericas.com/mag/cement_positioning_profit_us/
 j) <http://www.cemex.com/ar1999/html/en199928.asp>
 m) CEMEX Annual Report 2006
 o) <http://www.centralamericatoday.com/e5/industry.html>
 p) CapitalIQ

* Concern was involved in joint ventures to import and distribute cement regionally to such islands as Bermuda, Haiti and Cayman. ** The acquisition of RMC gave CEMEX access to the following further markets: Germany, Austria, Ireland, France, Scandinavia,

Source: Authors.

Geographical Presence Chart

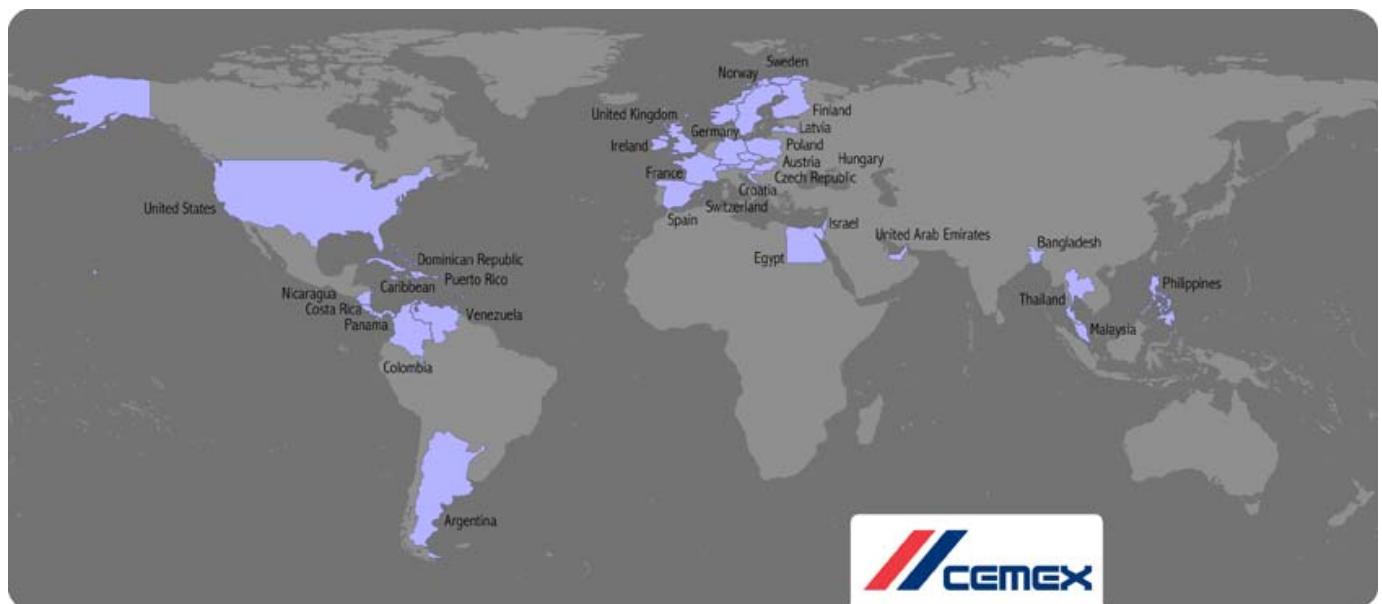
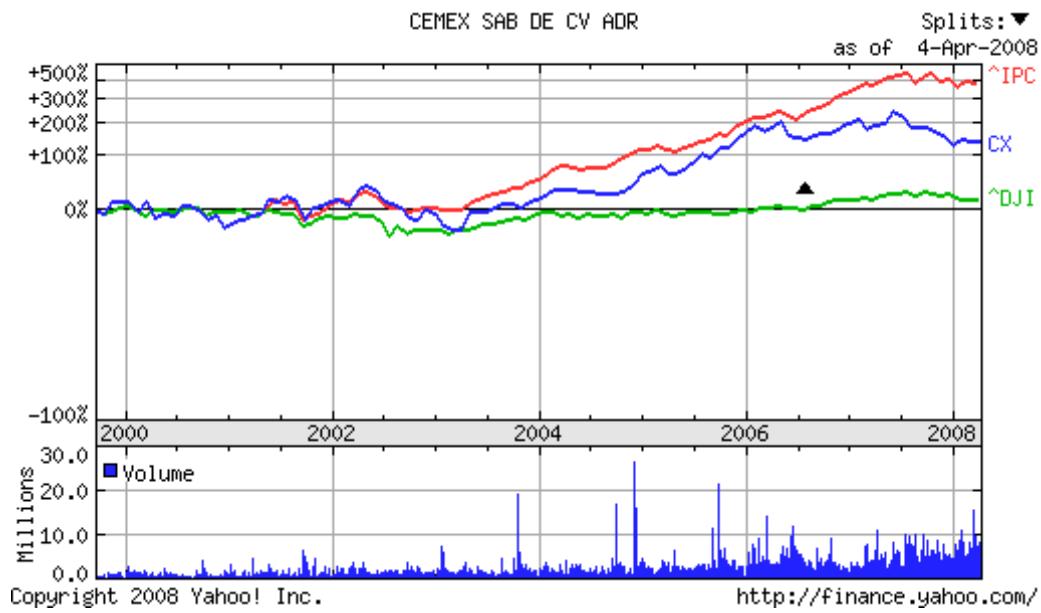


Exhibit 2: CEMEX Stock Price Performance Compared with Dow Jones and the Mexican Stock Exchange Indexes



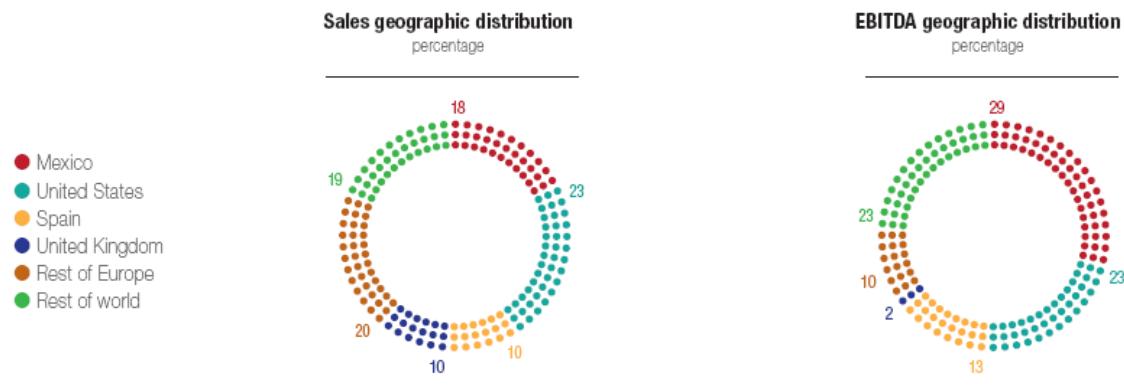
CX = Cemex trading at the New York Stock Exchange

IPC = Bolsa Mexicana de Valores Index

DJI = Dow Jones Index

Source: Yahoo!Finance, accessed April 2008.

Exhibit 3: CEMEX revenues and EBITDA by geographic area, as of 2007



Source: CEMEX Annual Report, 2007.

Exhibit 4: CEMEX Global Operations, as of 2007

As of December 31, 2007	CEMENT PRODUCTION CAPACITY MILLION METRIC TONS/YEAR	CEMENT PLANTS CONTROLLED	CEMENT PLANTS MINORITY PART.	READY-MIX PLANTS	AGGREGATES QUARRIES	LAND DISTRIBUTION CENTERS	MARINE TERMINALS
Mexico	27.2	15	3	325	24	86	8
United States ¹	15.4	14	4	552	130	40	10
Spain	11.4	8	0	114	27	9	18
United Kingdom	2.8	3	0	250	76	28	6
Rest of Europe ²	11.9	8	4	640	181	51	27
South / Central America and Caribbean ³	15.6	14	3	127	23	31	15
Africa and Middle East ⁴	5.0	1	0	76	11	6	1
Asia ⁵ and Australia	7.4	4	4	281	92	23	12
Total	96.7	67	18	2,365	564	274	97

¹ Includes operations from joint venture with Ready Mix USA.
² Includes operations in Austria, Croatia, Czech Republic, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Norway, Poland, and Sweden.
³ Includes operations in Argentina, Colombia, Costa Rica, the Dominican Republic, Guatemala, Nicaragua, Panama, Puerto Rico, and Venezuela, as well as other operations in the Caribbean region.
⁴ Includes operations in Egypt, Israel, and the United Arab Emirates.
⁵ Includes operations in Bangladesh, China, Malaysia, the Philippines, Taiwan, and Thailand.

Source: CEMEX Annual Report, 2007.

América Móvil

Going Móvil: Growth of a Mexican Telecom Giant¹

With a saturated domestic market and an excellent potential growth in Latin America, América Móvil has been an opportunistic buyer of distressed assets during crisis such as the one following the Argentinean in 2001. However, most of its acquisitions are comparatively small to the standard in this sector. Its prepaid cards model, to serve low-income customers, has revolutionized not only the Mexican but also the Latin American and global markets. Also, its client outreach scheme of using vendors with a bright yellow outfit that sell cards at major cross points has been a grand business innovation model that has given a competitive advantage to the company. Carlos Slim has been a key player, his leadership and ability to create an empire but still maintain fast decision-making has been essential to the achievement of the company's success.

Introduction

"As he expands beyond his base in Mexico, Carlos Slim's mergers-and-acquisitions offensive is creating one of the world's largest emerging-market telecom empires."
– Business Week, 29 March 2004.

América Móvil is the biggest telecom company Latin America as measured by revenues. The company, created as a spin-off from Mexico's privatized telephone ex-monopoly Teléfonos de México (Telmex), is controlled by Mexican billionaire Carlos Slim, who by some accounts was the world's richest person in 2007.

América Móvil is often cited as a leading example of an innovation-driven, high-growth Latin American company. In 2007, it took the number two spot, after Amazon.com, in *Business Week's* InfoTech 100 ranking of top global tech companies. The same year, América Móvil was ranked the 330th biggest corporation in the world by *Fortune* magazine and added to the Innovation Index of North America's top 20 innovative companies.² In UNCTAD's

¹ The authors are grateful to América Móvil executives for their cooperation in the preparation of this chapter.

² Others on the Innovation Index list include Amazon.com, Apple Computer, Cisco Systems, Dell, eBay, General Electric, Google, Intel, Microsoft Corporation, Research In Motion Limited, Starbucks, and Yahoo! For the *Fortune* ranking, see "2007 Global 500", *Fortune*, July 2007.

2007 World Investment Report, the company was ranked 16th among non-financial corporations from developing countries as measured by foreign assets.³

As of October 2007, América Móvil was the most valuable corporation in Latin America with a market capitalization of roughly US\$117-billion. Listed on the Mexican stock market, the company represents 20% of the total weighting of the key index. According to *América Economía*, the company – ranked the 5th largest corporation in Latin America as measured by sales. In 2007, América Móvil earned US\$5.3-billion in profits and revenues of US\$28.5-billion. It counts more than 153 million wireless customers and 3.8 million fixed phone line subscribers (in Central America). The company counts more than 40,000 employees in 17 countries. (See Exhibit 1 in Annex for the company's expansion timeline).⁴

América Móvil has achieved spectacular expansion with a market value that has grown six times since the spin-off in 2000. One of the keys to its success has been "pre-paid" (or calling card) mobile phone service which appeals to low-income customers with no established credit rating and a very limited budget for telecom services. This market model has proved tremendously successful in Latin America where mobile phones are popular as an alternative to high-cost fixed phone lines.

Despite its rapid expansion, América Móvil has been largely restricted to Latin America -- though Carlos Slim has long harbored ambitions to make a major foray into the global telecom market. One reason América Móvil is a fascinating company to follow is precisely because the company seems driven by international ambitions. Thus the tantalizing question: What next?

Wireless Mobile Sector

In 2007 the global telecom industry was worth roughly US\$1.8-trillion. The top 10 companies worldwide as measured by market capitalization were, in ranked order: China Mobile (China) at US\$387-billion, AT&T (U.S.) at US\$252-billion, Vodafone (UK) at US\$193-billion, Telefónica (Spain) at US\$153-billion, Verizon (U.S.) at US\$129-billion, América Móvil (Mexico) at US\$117-billion, France Telecom (France) at US\$88-billion, Deutsche Telekom

³ *World Investment Report 2007*, UNCTAD, United Nations, October 2007.

⁴ "500 Las mayores empresas de América Latina", *América Economía*, July 2007. Since the company has been achieving high growth rates and making acquisitions, these numbers would likely be higher going forward.

(Germany) at US\$83-billion, China Telecom (China) at US\$67-billion, and Nippon Telegraph & Telephone (Japan) at US\$62-billion.⁵

It is estimated that wireless revenues will account for more than half of the telecom sector's total revenues by 2010. Most of it from converged voice and data services, Internet browsing, emails access, mobile video, music and other downloads, plus other value-added services that require high network bandwidth.⁶ Whereas it took until about 2001 for penetration rates of mobile phones to match fixed telephone lines, since then (see Exhibit 2 in Annex) mobile phone penetration has been soaring and today is nearly double that of wire line telephones. The total number of mobile subscribers worldwide, roughly 2.7 billion in 2007, is expected to reach approximately 4 billion by 2011. Since the world's population is expected to increase from 6.5 billion to 7 billion in the same period, worldwide mobile phone penetration is expected to hit the 50% threshold by 2009. The strongest growth will occur in Asia -- especially China and India -- which is expected to add 1 billion subscribers by 2011. Africa is expected to add roughly 265 million subscribers, followed by Latin America with 205 million new subscribers by 2011. In Latin America, Brazil is regarded as the highest-growth market, with an expected 73 million new mobile subscribers by 2011.

The unique feature of the Latin American mobile phone market, as in other emerging markets, is that roughly 90% of customers have adopted the pre-paid model. One reason is that low-income customers can manage how much they spend on their phone usage. Another reason is because mobile operators are reluctant to provide post-paid service to customers on whom there exists no record of credit information, due in part to the fact that a significant portion of the population work in the informal economy. Another factor is that the "calling party pays" scheme, with a huge imbalance in terminating rates, favors mobile networks.

Mobile phone growth rates in Latin America have been spectacular. In the decade from 1995 to 2005, the number of mobile subscribers soared from only 4 million to roughly 200 million.⁷ Some estimates foresee the mobile penetration rate at 76% by 2012 -- or 476 million customers. Forecasts put total telecom revenue in Latin America at US\$108-billion in 2010, with more than half going to mobile service. This trend marks a rupture with figures five years earlier in 2005, when more than half of the total US\$79-billion in telecom revenues

⁵ Ranking by Capital IQ, October 2007.

⁶ Gary Eastwood, *The Ten Top Telecom Operators*, Business Insights, 2006.

went to fixed wire line phone service. This trend line in favor of mobile wireless is expected to continue.

The mobile phone market in Latin America is largely a duopoly. The two main competitors are América Móvil and Spanish telecom giant, Telefónica. Both companies, as “national champions” in their home markets, have benefited from regulatory decisions facilitating their dominant domestic market position. Competition between the two in Latin America is fierce. Telefónica has dominated the Brazilian mobile market, while América Móvil has been the market leader throughout the rest of the region.⁸

América Móvil: Past & Present

Telcel almost failed to become the dominant mobile player in Mexico despite the advantages of being owned by the country’s giant telephone monopoly, Telmex. A poor market performer for many years, the company’s wireless operator consolidated its position in Mexico thanks to a combination of regulatory favor and savvy marketing.

Its domestic wireless brand, Telcel, traces its origins back to the 1950s when an affiliate of Telmex with another brandname, called Radio Móvil DIPSA (DIPSA= Directorios Profesionales, S.A.), was publishing phone directories for Mexican telephone subscribers. In 1981, long before cellular telephones were widely popular, the Mexican government granted Radio Móvil DIPSA a concession to operate a wireless telephone system in Mexico City. Another company -SOS, parent of Iusacell (owned then by the Peralta family), was another competitor with a larger and former presence in mobile radio communication equipment linked to the public telephone network. Neither one had a cellular license at the time.

Telmex, originally a state-owned monopoly, at first did not seize the market potential of wireless telephones because its mobile concession in 1990 required it to be second player in every Mexican region. The early market leader was another company, Iusacell --now part of the Azteca corporate empire controlled by Ricardo Salinas -- which targeted high-end customers at a time when mobile phones were still a luxury that the vast majority of Mexicans could not afford. It wasn’t until the early 1990s that Telmex was finally granted access to the market potential of wireless mobile telephony. Its existing mobile subsidiary, Radiomóvil

⁷ Judith Mariscal and Eugenio Rivera, “Mobile Communications in Mexico in the Latin American Context”, *Information Technologies and International Development*, MIT, winter 2006.

⁸ “A Race to Get People Talking”, *Business Week*, 2 July 2007.

Dipsa, started offering cellular service under the Telcel brand. Telcel expanded its cellular network to cover the Mexico City region as well as the cities of Cuernavaca, Guadalajara, Monterrey, Tijuana, and Toluca. Telcel also scored a major regulatory victory in 1989, when it obtained from the Mexican government the sole nationwide wireless license, but with the restriction of always being the second player in every Mexican region (see Telmex Concession, 1-7).

In 1990, the Mexican government privatized Telmex by selling a controlling 20.4% stake. Following a bidding process that was considered controversial, Carlos Slim's consortium -- including France Telecom and U.S.-based Southwestern Bell -- beat out two other groups, one of them led by Spanish-based Telefónica. Slim won control of Telmex with a US\$1.76-billion bid. The newly privatized Telmex was quickly dubbed "Taco Bell" – a double reference to the favorite Mexican food and Slim's American "Bell" partner.⁹ After the auction, Telmex's competitors were rankled by the six-year monopoly in long distance (at that moment it was, without a doubt, the lucrative part of the telecom services) that was handed to Slim, though similar clauses were common in telecom privatizations throughout the region and have benefited other acquirers such as Telefónica. The rationale for the six-year competition protection in long distance was the cross subsidies imbedded in the rate structure from long distance services to local service. The Mexican government had to decide between this protection period and a drastic increase in local rates.

Now controlled by a private company, Telcel was still running a distant second to Iusacell into the 1990s. That changed, however, following the Mexican Peso Crisis in 1994-95. Iusacell ill-advisedly decided to stick with its business model of selling expensive locked-in plans to high-end customers. Telcel, on the other hand, pioneered the pre-paid model to attract low-income Mexicans and created the "Amigo"¹⁰ system to sell more prepaid cards. This marketing strategy proved to be a huge success. By the end of the 1990s, Telcel had become the market leader.

In 2000, Telmex – following the strategies of European telecoms at the time -- spun off its wireless subsidiary. The move had two main motivations: first, to unlock value for Telmex shareholders; and second, to use the new entity, named América Móvil, as a vehicle for

⁹ Some observed that Slim's winning bid may have been related to his political connections in Mexico, notably with Mexico's president at that time, Carlos Salinas de Gortari. There seems to be little doubt that Slim won the auction partly because of his roots and long-established business presence in Mexico, in contrast to foreign-led consortiums like Telefónica.

¹⁰ Created as a subsidized handset in 1996.

international expansion in the wireless telephone business. In the following years, América Móvil's aggressive expansion strategy would make the company the market leader throughout Latin America.

The company is on the leading edge of mobile technology, operating GSM networks in the region. The soaring popularity of GSM allowed the company to expand its customer base throughout the region on the same technological platform (except in Brazil, where it operated using TDMA digital technology). Above all, its successful marketing of pre-paid cards in Mexico proved to be a winning formula that provided the company with invaluable strategic insights that could drive subscriber growth throughout the region. One insight was that, since pre-paid customers are less loyal and spend less money as locked-in customers, the mobile market is driven by volume. América Móvil grasped the importance of marketing and aggressive sales tactics in order to drive revenues with a customer base that was constantly "churning".

In Mexico, América Móvil has taken a creative marketing approach by engaging battalions of salespeople dressed in bright yellow jumpsuits – making them resemble pit-crew members on a Formula 1 racing circuit – and commissioning them to aggressively hawk Telcel pre-paid cards in public. They flog the cards to drivers stopped at intersections, pedestrians on street corners, and users of public transportation.¹¹ América Móvil also drives revenue growth by flooding the market with mobile handsets as "loss leader" giveaways. Since a major obstacle to mobile phone usage is the up-front cost of a phone handset, mobile operators can drive subscriptions by giving out handsets for free.¹² As a Datamonitor report on the company observed, this practice can be regarded as smart marketing because promotional packages, including free handsets and low monthly fees, encourages new customers and current prepaid customers to subscribe to postpaid plans.¹³ The company also invests heavily in customer service to keep paying customers satisfied and prevent churn. Approximately 50% of Telcel employees work in customer service.

América Móvil's aggressively creative marketing model has paid off. In 2007, its Telcel service in Mexico counted more than 50 million customers -- four times more than

¹¹ "A Race to Get People Talking", *Business Week*, 3 July 2006.

¹² *América Móvil: Company Analysis*, Stifel Nicolaus Equity Research, 16 May 2006.

¹³ *América Móvil: Company Profile*, Datamonitor, 5 April 2006.

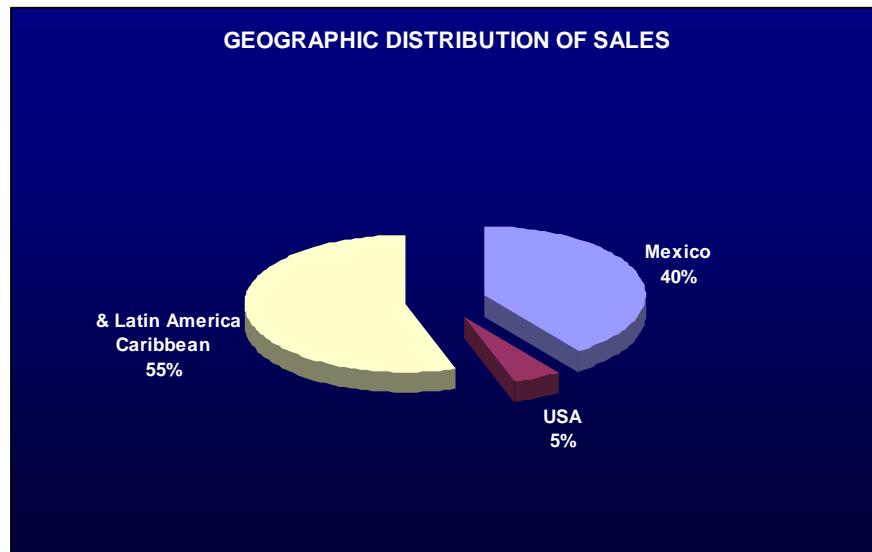
nearest rival, Movistar¹⁴ (with 12.5 million customers). Third-place Iusacell (3.9 million customers) has clearly suffered – at least in terms of customer numbers -- for sticking to its high-end market niche.¹⁵ There have been some unexpected setbacks, however. América Móvil joined forces with parent Telmex to buy Verizon's stake in Venezuelan-based Compañía Anónima Nacional Teléfonos de Venezuela (CANTV) for US\$676.6 million, but in 2007 Venezuela's President Hugo Chavez nationalized CANTV.

Carlos Slim remains América Móvil's controlling shareholder with a 30% stake. SBC International, the international division of its partner Southwestern Bell – now AT&T - holds a 27% minority stake. Slim controls both Telmex and América Móvil via his holding, Carso Global Telecom, which is separate from his industrial conglomerate holding, Grupo Carso. Since 2004, América Móvil's stock price has outperformed both the MSCI Emerging Market Index and MSCI World Index (See Exhibit 3 in Annex for the company's stock performance).

¹⁴ A commercial brand of Telefónica.

¹⁵ "Mexico's Iusacell Eyes Expansion into Latin America", Dow Jones Newswire, 28 August 2007.

Going Global



One of Telmex's primary motivations for spinning off América Móvil in 2000 was, as noted, to leverage the subsidiary as a vehicle for international expansion. América Móvil moreover had a compelling reason to expand beyond Mexico: its domestic market was becoming saturated and consequently offered diminishing growth prospects. Its Telcel brand was by far the biggest mobile player in Mexico with more than an 80% market share. A growth strategy therefore had to look beyond the domestic market.

i) Becoming the Latin American Market Leader (2000 onwards)

In 2000, América Móvil's spinoff was well-timed for international expansion. Latin American governments were continuing to liberalize their telecom sectors. At the same time, major American telecom players, increasingly concerned about economic uncertainty in the region, were selling off their Latin American assets in the wake of the Internet meltdown in 2000. The region was again going through an economic crisis which had started with a contagion effect from the Asian Crisis in 1997 and the Russian Crisis in 1998 and was followed by currency devaluations – the Brazilian Real in early 1999, and the Argentine Pesos in late 2001. Against this backdrop, América Móvil was well-positioned as an opportunistic buyer of privatized or distressed telecom assets.

The company's strategic positioning was complicated, however, by legacy assets inherited from a complex corporate restructuring of its parent company. When Telmex spun off Telcel into América Móvil, a number of international telecom assets were also folded into the new entity to kick-start its international expansion strategy. Specifically, América Móvil inherited a portfolio of wireless operators in Guatemala, Ecuador, Puerto Rico, Brazil and Argentina.

In late 2000, América Móvil formed a joint venture, Telecom Américas, with partners Bell Canada International and U.S.-based SBC International. It was essentially a holding that merged the triumvirate's Latin American assets in Brazil, Colombia, Venezuela, and Argentina with the goal of jointly consolidating their position in those markets. In that sense, Telecom Américas was not, strictly speaking, a vehicle for *global* expansion; but was created to enhance the scale of *existing* assets in Latin America with a view to future expansion. Specifically, its strategy was based on exporting throughout Latin America the pre-paid market model that had achieved spectacular success for América Móvil's Telcel's brand in Mexico.¹⁶

Shortly after its creation, Telecom Américas bought a controlling 77% stake in Colombian wireless operator, Comcel. Also, Telecom Américas, facing competition in Brazil from Spanish-based Telefónica and Telecom Italia Mobile, bought mobile carrier Tess in the Brazilian state of São Paulo for US\$950-million.

The América Móvil-BCI-SBC joint venture proved short-lived, however. When the break-up came in 2002, América Móvil emerged in the driver's seat, taking control of Telecom Américas with a new focus on the Brazilian market. The timing, once again, was excellent. América Móvil was soon buying up distressed telecom assets at knockdown prices, including Brazilian wireless operators ATL, Tess, Telet, Americel. The incursion into Brazil was strategically important, since América Móvil's arch-rival Telefónica was strong in Brazil thanks to its acquisition of parts of the state-owned phone giant, Telebras, which had been privatized in 1998.¹⁷ Telefónica later became the biggest wireless player in the region after its US\$6-billion purchase in 2004 of U.S.-based BellSouth's Latin American assets.¹⁸

¹⁶ Lourdes Casanova, "América Móvil: Building a Wireless Leader in Latin America", INSEAD case 09/2005-5308, INSEAD, Fontainebleau, 2005.

¹⁷ The Brazilian government raised US\$19-billion through the sale of a broken-up Telebras. Telefónica, Portugal Telecom, Iberdrola, BBVA, and RBS bought the most valuable parts of the company, fixed line Telesp operating in São

In 2002, América Móvil won wireless licenses from the Brazilian government to operate in various regions, including São Paulo and Santa Catarina. The following year, the company bought control of Brazilian wireless operator BSE, and several months later purchased another Brazilian wireless operator BCP -- which operated in the urban São Paulo area -- from BellSouth Corp for US\$800-million. Following these two transactions, América Móvil controlled six wireless operators in Brazil. These deals were classic examples of Carlos Slim's shrewd acquisition strategy of buying distressed assets on the cheap. BellSouth was selling off the remainder of its Latin American assets to raise cash to finance the US\$41-billion offer made by its U.S. joint venture, Cingular Wireless, to acquire AT&T Wireless. Compared with Telefónica's US\$6-billion purchase of BellSouth's Latin American assets, however, Slim paid 50% less than his Spanish rival on a per-customer basis. Whereas Telefónica paid BellSouth a premium, Carlos Slim got a bargain.

Strengthened by a solid market position in Brazil, América Móvil brought all its assets in the country under the Claro brand to compete with market leader Telefónica/Portugal Telecom's Vivo and Telecom Italia's second-place TIM. Claro was also expanding its reach in Brazil by acquiring licenses. At the same time, moreover, América Móvil's sister company, Telmex, bought AT&T's telephone assets in Latin America for US\$207-million as well as MCI's long-distance incumbent, Embratel, for US\$628-billion. Once again, the two purchases confirm Carlos Slim's talent for acquiring assets at bargain prices. AT&T, for example, had spent US\$2-billion on building fiber-optic networks to service business customers, and MCI had paid the Brazilian government US\$2.3-billion for the privatized Embratel. The reason for these knock-down prices were two-fold: first, the region was going through an economic crisis following Argentina's peso devaluation; and second, bankrupt telecom giant MCI was selling off its distressed Latin American assets. After these acquisitions, Slim was a major player in the Brazilian wireless, fixed telephone, and long-distance markets. Today, Claro counts approximately 30 million subscribers in Brazil, still trailing Vivo with 33 million customers and TIM's 31 million subscribers.

Elsewhere in Latin America, América Móvil was similarly growing through acquisitions. In 2003, it bought a controlling 92% stake CTI, a nationwide wireless operator in

Paulo and wireless operator Tele Sudeste Celular. U.S.-based MCIworldcom bought the long-distance part, Embratel, which was purchased by Carlos Slim in 2004 for US\$360-million.

Argentina (rebranded as “CTI Móvil”). CTI Móvil had more than 7 million subscribers. In 2005, América Móvil paid Spanish-based Endesa Participadas US\$472-million for the number three Chilean wireless operator, Smartcom, adding roughly 1.7 million customers. The same year, it closed the acquisition of Hutchison Telecommunications Paraguay, bought from Hong Kong-based Hutchinson Telecom. Also in 2005, it paid Telecom Italia US\$503-million for Peruvian wireless operator, TIM Peru.

In both Colombia and Ecuador, América Móvil is the largest wireless operator. The company also owns wire line and wireless services in Guatemala, El Salvador, and Nicaragua. Since América Móvil was buying existing mobile operators with installed customer bases, it maintained existing brand names. It operates under the Claro brand in Brazil, Chile, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Peru, and Puerto Rico. The company offers mobile service under the “Comcel” brand in Colombia and Ecuador. In Argentina, Uruguay, and Paraguay it uses the CTI Móvil brand. This multi-brand strategy is different from that of its competitor Telefónica, which operates under a single brand, Movistar (except in Brazil, where Telefónica’s joint venture Portugal Telecom uses the “Vivo” brand). More than half of América Móvil’s revenues in 2007 came from outside its domestic Mexican market (see Exhibit 4 in Annex for the company’s total revenues by geography).

América Móvil was still on the acquisition trail in 2007. It paid US\$3.7-billion for U.S.-based telecom giant Verizon’s Latin American assets in Puerto Rico and the Dominican Republic, and announced a buyout of Jamaican wireless operator, Oceanic Digital.

i) **Triumph and Failure: Europe and USA**

Slim could also look northward to the United States with satisfaction. When América Móvil was born in 2000, the company was already operating in the U.S. market through a wireless unit, Topp Telecom, created in 1996 in Miami. In 1999, Topp received a major cash infusion from Telmex, which paid US\$57.5-million for a 55% controlling interest in the company. In 2000, Telmex folded Topp into América Móvil and, later that year, renamed the U.S. subsidiary TracFone Wireless Inc.

¹⁸ Reinhardt Krause, “Rivals América Móvil, Telefonica Locked in Tough Brazilian Battle,” *Investor’s Business Daily*, 21 May 2007.

Tracfone is a reseller of pre-paid wireless service in the United States, Puerto Rico and the US Virgin Islands.¹⁹ It does not own its own networks, but "resells" wireless service from more than 30 providers, including AT&T, Verizon Wireless, Sprint, and T-Mobile. TracFone requires a new customer to *activate* a mobile phone by calling a hotline number or via its website.

When América Móvil took control of Tracfone, it was servicing some 700,000 customers via resale agreements. It is now the sixth-largest mobile operator in the United States with more than 8 million customers. Its growth in the American market is owed largely to its marketing of the same pre-paid model that succeeded in Mexico. Tracfone also sells pre-paid mobile service in the United States under a second brand, Net 10. The United States nonetheless represents a relatively small percentage of América Móvil's total revenues.

Slim so far has failed to gain a strategic foothold in Europe, though he has had long made it known that one of his driving ambitions is to make an incursion into Telefónica's home market in Europe – even in Spain itself. In 2005, Slim was reportedly preparing to bid for a wireless license in Spain, but that plan never came to fruition. In June 2007, the share price of the Spanish bank BBVA shot up on rumors that Slim was about to buy a significant stake in the bank.²⁰ But that proved to be speculation only.

A more concrete plan was América Móvil's spectacular bid, with partner AT&T, to take control of Telecom Italia, the number 5 telecom player in Europe with a market capitalization of US\$53.4-billion. In April 2007, AT&T/América Móvil offered US\$6.4-billion in an indirect bid for Telecom Italia through a purchase of shares in its holding company, Olimpia. AT&T was interested in acquiring control of Telecom Italia in order to make an incursion into the European market. While Carlos Slim was not indifferent to the prospect of entering the European market as a major player, he was primarily interested in Telecom Italia's wireless assets in Brazil in order to strengthen América Móvil's position against Telefónica/Portugal Telecom's mobile assets in Brazil.²¹

¹⁹ América Móvil, Paul Budde Communications, 27 May 2007, p. 21.

²⁰ "Shares in Spain's BBVA jump on Carlos Slim talk", Reuters, 14 June 2007.

²¹ "AT&T, América Móvil seek Telecom Italia deal", Reuters, 1 April 2007.

After weeks of negotiations, however, AT&T/América Móvil withdrew their bid, reportedly due to political pressures in Italy against foreign ownership of a former state-owned telephone monopoly.²² Telecom Italia was sold instead to Telefónica and a number of Italian partners. Telefónica's move to thwart the joint AT&T/América Móvil bid was a tactically defensive maneuver against its nemesis in Latin America.

The irony of arch-rival Telefónica's role as the spoiler must have been particularly difficult for Carlos Slim. Telefónica paid under US\$6-billion for control of Telecom Italia – less than the AT&T/América Móvil bid. But Telefónica possessed two major tactical advantages: first, it was a European player making an offer for another European telecom company; and second, its bid was backed by two Italian banks, an Italian insurance company, and Italy's wealthy Benetton family. It was believed that Italy's Prime Minister, Romano Prodi, had called on the Italian banks to form a consortium in order to keep majority control of Telecom Italia in Italian hands with an acceptable European telecom partner.

It was believed, however, that Brazilian regulators would evaluate carefully the implications of allowing Telefónica to merge its market-leading Vivo operator in Brazil with Telecom Italia's second-ranked TIM. Undeterred, in mid-2007 Telefónica secured a wide lead in the Brazilian wireless market through a US\$640-million purchase of fifth-ranked Telemig, adding another 5 million customers. The deal also included another small wireless operator, Amazon Celular.²³

América Móvil's setback, while perhaps temporary, illustrates the paradox of Carlos Slim's corporate ambitions. While a Spanish telecom giant has become a major player in the Latin American market, no Latin American telecom player has made a major foray into the European market. The Telecom Italia defeat means that, for the moment at least, América Móvil remains a wireless telecom giant contained within a single hemisphere.

Looking Forward

América Móvil's international expansion has been driven by *market-seeking* strategies, especially in its "natural" market of geographically proximate countries in Latin America where customers share the same language and thus make marketing efforts less costly. Like

²² "Telecom Italia Becomes National Drama", *International Herald Tribune*, 8 April 2007; and "AT&T Drops Offer to Invest in Telecom Italia", *New York Times*, 17 April 2007.

²³ "Vivo seizes lead in Brazilian telecoms", *Financial Times*, 3 August 2007.

Mexican multinationals Bimbo and CEMEX, América Móvil was initially pushed to expand internationally by realities in its domestic market – notably its dominant position in a saturated market.

Its solid position in the large Mexican market gave the company the financial strength to expand successfully throughout Latin America – and into the huge U.S. market. América Móvil, to its credit, successfully exported the pre-paid marketing model throughout the region. In short, América Móvil possessed a deep understanding of its markets and therefore was able to expand with the benefit of solid expertise and know-how. Indeed, América Móvil successfully transformed itself from its legacy as an old-style Mexican telephone company driven by largely engineering and regulatory concerns to a *marketing*-based multinational.

América Móvil followed pattern that is characteristic of Mexican multinationals: while its growth in its domestic market was achieved organically, once outside of Mexico it drove growth mainly through *acquisitions*. The Mexican government's relatively early privatization of Telmex -- nearly a decade before Brazil's landmark telecom privatization – gave the company a head-start in developing a "business" culture focused on M&A-based expansion. The company's growth strategy was also driven by the dynamics of the wireless sector. Wireless operators are driven to consolidate their market position via expansion due to the large capital investment required to establish wireless networks. The wireless industry is "saleable" because the same infrastructure costs must be invested to serve 100 or 100 million customers. Wireless operators therefore are driven to aggregate customers to amortize capital investments.

A major competitive advantage has been América Móvil's leading-edge *technology platform*. By investing in GSM infrastructure, the company was ahead of the market because GSM handsets were rare in Latin America for many years. The market has now overwhelmingly gone GSM. América Móvil is credited with making foresighted technology investments in networks as it has expanded throughout Latin America.²⁴

While América Móvil has been willing to expand via joint ventures, it ultimately seeks control. The company's most notable joint venture was the short-lived Telecom Américas partnership with BCI and SBC. Other mobile operators in the region have suffered

²⁴ América Móvil: *Company Profile*, Datamonitor, 5 April 2006.

from joint ownership – for example, Teléfonica and Portugal Telecom in Brazil – when making decisions on issues like technology platforms and financing. América Móvil, for its part, has largely avoided these pitfalls by taking control of assets it operates. This has given the company competitive agility that some of its rivals lack.

América Móvil also boasts a solid *financial position* thanks to strong cash flows generated by its operations. In 2007, the company had US\$23-billion in cash for acquisitions, share purchases, or paying down debt. Its strong financial position has been, for obvious reasons, a major factor driving its expansion strategies, for it has sufficient cash requirements to fund acquisitions. However, the company has indicated that, after a long “shopping spree”, it is now focusing on “profits”.²⁵

Finally, the role of *leadership* has been key for the company. América Móvil clearly has benefited from its identification with Carlos Slim, the most powerful businessman in Latin America. Known as an opportunistic buyer who acts fast, Slim has moved in swiftly to seize opportunities to buy privatized and distressed assets at low prices. He is also famous as a disciplined buyer, preferring to buy distressed assets at bargain prices. That strategy has paid off hugely for the company in Latin America. Shifting his interests from business to philanthropy in recent years, Slim has channeled a portion of his personal fortune to economic development projects such as his Telmex Foundation. He has been turning over much of the daily management of his conglomerate to his sons, Carlos, Marco Antonio, and Patrick Slim Domit.²⁶

It should be noted that América Móvil’s strong balance sheet is predicated on a number of variables: favorable macro-economic climate in Latin America, high demand for mobile telecom services, and growing penetration rates. The company’s sales are denominated in local currencies, while roughly 70% of its consolidated debt is generally denominated in U.S. dollars. Also, the bulk of the company’s equipment purchases are made in U.S. dollars and it keeps a portion of its cash in U.S. dollars to reduce its currency risk.

In 2007, América Móvil was a stock market superstar whose long-term outlook looked robust. The Latin American economy continues to enjoy explosive growth, inflation is

²⁵ “América Móvil to focus on profits after shopping spree”, Reuters, 22 March 2007.

²⁶ “Carlos Slim: The Mexican tycoon who could soon be the world’s richest man”, *The Independent*, 10 March 2007; and “About to hang up? His sons in charge, Mexico’s Slim now looks to his legacy”, *Financial Times*, 25 September 2007.

relatively low, countries have small current-account deficits and sometimes even surpluses, public-sector spending is under control, and GDP growth is solid. The trumpeted rise of a “new middle class” throughout Latin America can only be good news for a company selling mobile phone service. Predictions of soaring wireless penetration rates in Latin America are even more encouraging.

At the same time, América Móvil remains a Global Latina that has yet to go global. Like other Latin American multinationals, it has combined domestic market advantages and innovative marketing to expand throughout Latin America and to some extent in the United States, but has shown less determination when confronting the challenge of conquering markets beyond the Americas. Its aborted attempt to take control of Telecom Italia may, to be sure, provide counter-evidence. If so, even bolder international moves by América Móvil can be expected in the future.

Thus far, though, América Móvil has yet to execute a successful expansion strategy beyond the familiar boundaries of its “natural” market.

Annex

Exhibit 1: Expansion Timeline

Year	Country where it operates	Mode of Entry	Target Company/ Partner/Subsidiary/Client (if applicable)	Sellers	Transaction Value (in USD) (if available)
2000	USA	Acquisition	49 % CompUSA ²⁷		
2000	Ecuador	Acquisition 61.3%	Conecel		
2000	Guatemala	Market entry	Telecomunicaciones de Guatemala		
2000	Argentina, Brazil, Colombia and Venezuela	Joint Venture	Telecom Americas		
2002	Colombia	Acquisition	Comunicación Celular and Occidente y Caribe Celular	Telecom Americas	
2002	Brazil	Acquisition	Telecom Americas partners (39.1% BCI and 11.1%SBC)	Bell Canada International and SBC Communications	
2002	Brazil	Greenfield	Sao Paulo, Bahia-Sergipe and Parana-Sta. Catarina		
2003	Brazil	Acquisition	BSE	BellSouth Corp. and Verbier	\$180 million

²⁷ In December 2003, America Móvil sold its 49% stake in CompUSA to US Commercial

Exhibit 1: Expansion Timeline (cont.s)

2003	Brazil	Acquisition	BCP	BellSouth Corp and Verbier	\$643 million
2003	El Salvador	Acquisition	Compañía de Telecomunicaciones de El Salvador S.A. de C.V.	France Telecom	\$417 million
2003	Argentina	Acquisition	CTI Holdings	The Blackstone Group, Private Equity Group, Verizon Communications	\$221.5 million
2003	Nicaragua	Greenfield	Sercom		
2004	Nicaragua	Acquisition	49% Empresa Nicaraguense de Telecomunicaciones (ENITEL)		\$49.6 million
2004	Honduras	Acquisition	Megatel		
2004	Uruguay	Greenfield			
2005	Paraguay	Acquisition	Hutchison Telecommunications Paraguay	Hutchison Telecommunications International	
2005	Chile	Acquisition	Smartcom	Endesa	\$472 million
2005	Peru	Acquisition	American Móvil Perú	TIM International	\$503.4 million
2005	Brazil	Greenfield	State of Minas Gerais		
2006	Dominican Republic	Acquisition	Verizon Dominicana ²⁸	Verizon Communications	\$2.06 billion
2007	Puerto Rico	Acquisition	Telecomunicaciones de Puerto Rico	Verizon Communications, Popular, Puerto Rico Telephone Authority	\$939 million
2007	Jamaica	Acquisition	Oceanic Digital Jamaica Limited	Oceanic Digital Communications	\$72 million

²⁸ Verizon Dominicana is the largest telecommunications service provider in the Dominican Republic with over 750,000 wire line and broadband subscribers and 2.1 million wireless subscribers as of September 30, 2006.

Geographical Presence Chart

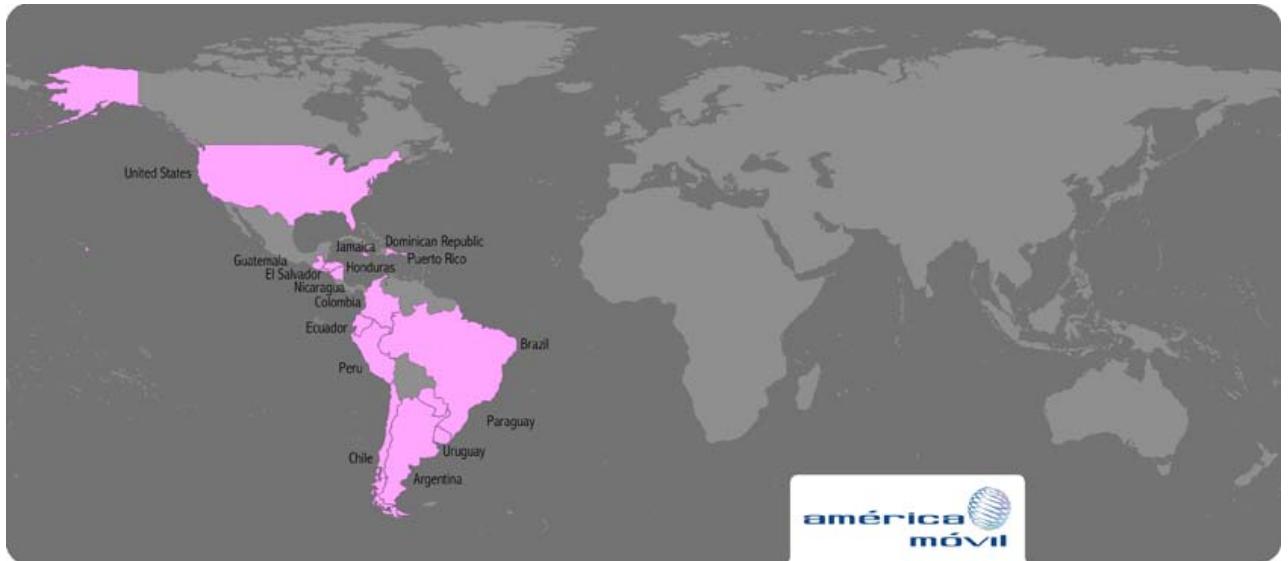
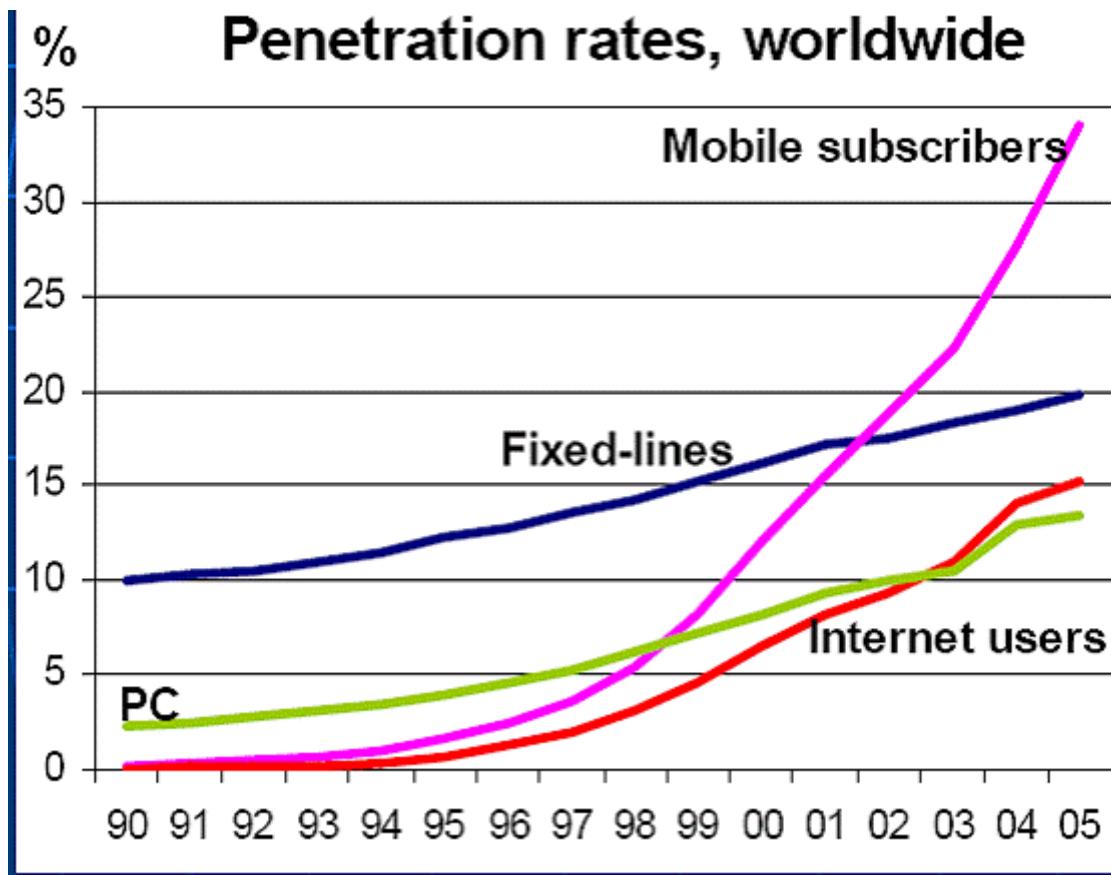
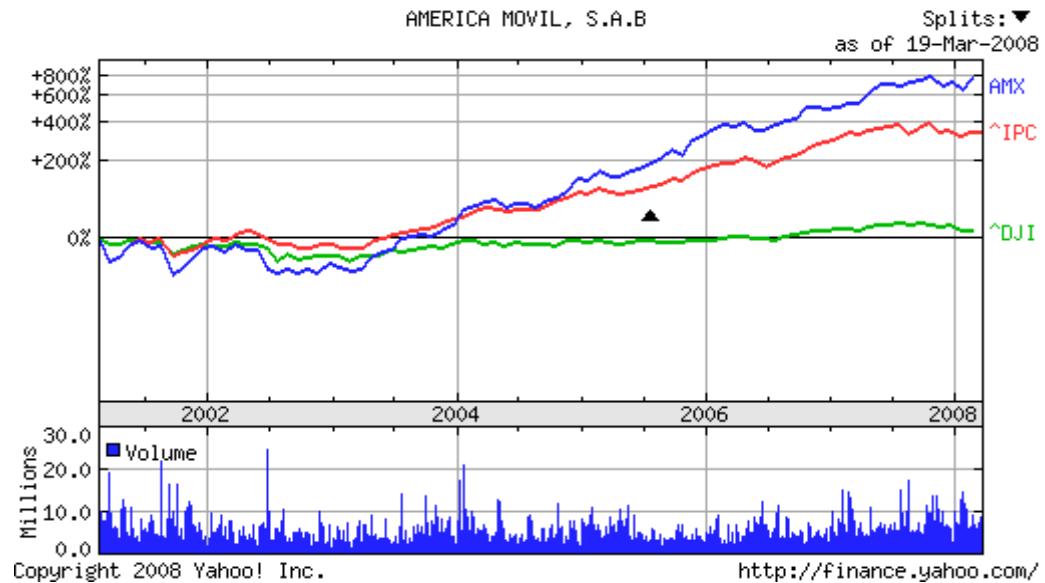


Exhibit 2: Global Penetration Rates: Mobile, Fixed Phone, Internet.



Source: ITU 2007

Exhibit 3: Stock Price Performance Compared with the Dow Jones and the Mexican stock exchange Indexes



AMX = América Móvil trading at the New York Stock Exchange

[^]IPC = Bolsa Mexicana de Valores Index

[^]DJI = Dow Jones Index

Pollo Campero¹

A Guatemalan Chicken Flying Across Global Borders

A family business that offers an exotic Latin flavor in its products and a positive customer experience in a country-rooted strong brand restaurant is emerging as a true Global Latina. Lessons learned through their internationalization process have paved the way for a successful strategy by means of a franchise model that has been both thriving and profitable.

Introduction

"To provide the best chicken-eating experience to our customers, delivering profitability for our partners (shareholders, franchisees, suppliers), and continued development for our collaborators, while maintaining social responsibility in our community."

– Pollo Campero mission statement, 2007.²

Pollo Campero, which in Spanish means “country-style chicken”, has emerged from its origins in Guatemala to become the most inspiring international restaurant chain from South America. It counts more than 7,000 employees working in more than 260 restaurants worldwide – with outlets in Guatemala, El Salvador, the United States, Honduras, Costa Rica, Mexico, Ecuador, and Nicaragua. Beyond the Americas, the company operates restaurants in Europe (Madrid) and Asia (Shanghai, China and Jakarta, Indonesia).

Pollo Campero ended fiscal 2007 with estimated revenues of nearly US\$450-million and achieved 25% to 40% growth rates over the 2002-2007 period. The company's financial performance is especially impressive in the U.S. market. With a per-outlet industry average of US\$850.000,³ Campero's restaurants generate average annual sales of US\$1.8-million. Pollo Campero has followed its customers along traditional immigration routes to U.S. cities like Los Angeles, Chicago, Dallas, Houston, San Antonio, Washington D.C. and New York, which have provided the company with a sizable base of Hispanic customers. Its goal is to open 500 units in the United States by 2012. The new tenant/landlord relationship with Wal-Mart Stores announced in November 2007 will definitely assist in this endeavor.

¹ The financial support of Orkestra, the Institute of Competitiveness of the Basque Country, for the development of this chapter, is gratefully acknowledged.

The authors are grateful to the executives of Pollo Campero for their cooperation with the preparation of this chapter.

² Pollo Campero corporate website, www.campero.com. Accessed October 2007.

While other restaurant chains from Latin America mainly have entered the U.S. market, Pollo Campero has pursued its expansion into Europe as well and was the first Latin American restaurant group to make a foray into Asia. The chain has gone from operating in 3 countries in 1994 to 11 countries in 2007.

Global Quick Service Food Industry

The global quick service – or “fast food” – restaurant market is usually broken down into four segments. First, quick service restaurants (QSR) are locations where full meals are provided but without table service. Second, takeaways provide freshly prepared food for immediate consumption off the premises. Third, mobile and street vendors are individual mobile stalls or vans offering a limited range of freshly prepared food and beverages. Fourth: leisure locations such as cinemas and theatres, where food and drinks are served for immediate consumption on their premises.

While Pollo Campero offers table service and take-out food, it competes in the first segment: quick service restaurants. Major competitors in this segment include global brands such as Kentucky Fried Chicken (KFC), McDonald's, Burger King, Taco Bell, Subway, Panera, and Pizza Hut. Pollo Campero's main competitor in most markets is Kentucky Fried Chicken. While KFC's chicken is fried, Pollo Campero's food is grilled and side orders and desserts are catered to each specific market – from soups and rice in China to *tortas* and *sincronizadas* in Mexico. This is referred to as “tropicalization” of the menus.

Global revenues in the global restaurant sector were nearly US\$200-billion in 2007. The “fast food” segment was worth more than US\$100-billion and is expected to reach US\$125-billion by 2011. As of October 2007, the ten largest restaurant groups, as measured by market capitalization, were in ranked order: McDonald's Corp (U.S.) at US\$68-billion; Starbucks Corp (U.S.) at US\$19.5-billion; Yum! Brands (U.S., owner of Pizza Hut, Kentucky Fried Chicken, Taco Bell, etc.) at US\$19.3-billion; Compass Group (U.K.) at US\$12.6-billion; Sodexho Alliance (France) at US\$10.7-billion; Enterprise Inns (U.K.) at US\$14.9-billion; Tim Hortons (Canada/U.S.) at US\$7.4-billion; Whitbread (U.K.) at US\$6.5-billion; Mitchells & Butlers (U.K.) at US\$6.2-billion; and Darden Restaurants (U.S.) at US\$6.1-billion.⁴ Vendors of classic “American” fast food – like burgers and pizzas – have shown only modest growth in

³ Un pollo al que le quedó chiquita Centroamérica. (12 Febuary 2007). *El Periódico de Guatemala*.

⁴ Capital IQ. Accessed on October 2007.

recent years, while chains serving South American food have grown rapidly.⁵ The market for “ethnic” food in the U.S. is estimated to be worth US\$75-billion, with some 75% of revenues generated by non-ethnic customers.⁶

Pollo Campero: Past & Present

The history of Pollo Campero can be traced to the early 20th century when Juan Bautista Gutiérrez – the grandfather of the company’s current CEO Juan José Gutiérrez – migrated from his tiny Spanish village of Campiellos in Asturias to Latin America. Settling in Guatemala, he acquired a small business buying wheat and selling it to local mills. Gutiérrez later entered milling himself and soon was selling flour to bakeries. Fate intervened when one baker could not pay for flour but offered a farm with 2,000 chickens to cover his debt. Gutiérrez suddenly found himself in the industrial agriculture business, delivering processed chicken to grocers and supermarkets.⁷

In 1971, Gutiérrez decided to forge a direct relationship with customers – and thus Pollo Campero was born. His youngest son Dionisio (current CEO’s Juan José’s father) was appointed to run the restaurant. The family’s poultry-producing company, called Avícola Villalobos, was a vertically integrated component of the restaurant business, ensuring a stable supply of chickens at predictable prices. Pollo Campero therefore has been an integrated restaurant chain from the very outset.⁸

In its earliest days, Pollo Campero was exposed to unsuccessful attempts by the major American chain, Kentucky Fried Chicken, to crack the Guatemalan market. Faced with this threat, the company was pursuing its own expansion: it opened seven restaurants in Guatemala and two in El Salvador between 1971 and 1974. In October 1974, however, tragedy struck the Gutiérrez family. Dionisio and his sister’s husband were killed in a plane crash on a Rotary Club humanitarian mission taking food to hurricane victims in Honduras. While the restaurants continued operating for several years under a key family executive,

⁵ Bouza, T. & Sama, G. (2003). Latin American Fast Food Makes Inroads in the U.S. *The Wall Street Journal Online*, 2 January 2003. Retrieved on September 2007, from <http://online.wsj.com/article/SB1041459191815079753.html>

⁶ Pollo Campero arranca plan de expansión en EU. (10 May 2007). Retrieved on September 2007, from http://www.franquiciashoy.com/franchise_news_may_2007%5Cpollo-campero-arranca-plan-de-expansion-en-eu161.cfm.

⁷ Interview with authors, 22 February 2007.

⁸ Wiese, N. M. (2005). *Pollo Campero: Going Against the Grain*. Case Study. Tacoma, USA: School of Business and Leadership, University of Puget Sound.

Francisco Perez de Anton, the business experienced slow development as it faced fierce competition by a group of cafeterias selling from fried chicken to hot dogs and soft drinks.⁹

In 1982, third-generation Juan José Gutiérrez took over Pollo Campero and quickly consolidated its operations and restructured the company into a single entity. He also focused the restaurant chain on corporate development, initiating an expansion process with the ambition of further internationalizing the chain. In 1994, Pollo Campero launched its franchise program to take the brand around the world. Today, Pollo Campero – rejecting the notion of “fast food” – considers itself as a family dining restaurant chain, where good food is served quickly, offering customers table service, take-out, drive-in and home delivery. Its core product is marinated, breaded and fried chicken, sold as single meals or family-size packages with side dishes. Other Central American-style food, like burritos and salads, are also on the menu.

Privately-owned and family-controlled, Pollo Campero is in fact – like many internationally oriented Latin American companies – an operating subsidiary of an industrial conglomerate, Corporación Multi Inversiones (CMI). Sometimes known as “Grupo Gutiérrez”, CMI is the largest holding corporation in Central America and the Caribbean. It ranks among Latin America’s largest agro-industrial conglomerates, controlling some 300 companies with over 30,000 employees in 14 countries, including the United States.¹⁰ Through six divisions, CMI produces and distributes flour, pasta, cookies, packaging materials, poultry (including Avícola Villalobos), pork products, and animal foods. CMI is also active in real estate, hydro generation plants, banking and finance. Pollo Campero is a downstream retail component of the company’s poultry farming operations. Vertical integration has allowed CMI to improve the capacity utilization of its poultry farming business and market chickens directly to the consumer at competitive prices via its wholly-owned restaurants.

In the three years after Pollo Campero’s first outlet opened in 1971, the company launched seven restaurants in Guatemala. In 1986, another five restaurants opened domestically. Pollo Campero today counts more than 112 outlets throughout the country.

⁹ Interview with authors, 22 February 2007.

¹⁰ Wiese, N. M. (2005). *Pollo Campero: Going Against the Grain. Case Study*. Tacoma, USA: School of Business and Leadership, University of Puget Sound.

Growth has been organic, building a network of outlets through direct investment.¹¹

The Pollo Campero brand is intimately connected with its Guatemalan roots – indeed, it is the company's most important and valuable asset. The Campero brand has four essential attributes. First is its emotional connection with Guatemala. Thus, the restaurants target domestic customers with the slogan: “As Guatemalan as you”. A second brand attribute is related to Pollo Campero’s Corporate Social Responsibility ethos and its humanitarian campaigns in the wake of natural disasters and emergencies. As a result, Pollo Campero’s image is not just as a companion in the good times, but also in bad times. A third brand attribute is its ability to bring together different market segments. A taste for Guatemalan-style fried chicken unites all ethnic groups, social classes and ages under the slogan: “Campero is for everyone”. The fourth brand attribute is cost: Pollo Campero boasts an attractive price-performance ratio.¹²

The company has an ambitious Corporate Social Responsibility program. In Guatemala, it founded the Universidad Campero for continuous education programs on key skills needed in its business operations, and Instituto Campero to provide basic education for employees. Pollo Campero also sponsors two foundations: the Ayuvi Foundation for children with cancer, and the Juan Bautista Gutiérrez Foundation dedicated to promoting the ideals of community service that founder Juan Bautista Gutiérrez believed in.¹³

Going Global

Pollo Campero had two primary reasons to expand its business beyond the Guatemalan borders. The first was *market seeking*: having successfully marketed a concept and product in its domestic market, the company sought to grow the business in untapped markets with similar consumer characteristics. The second was *macroeconomic*: Pollo Campero’s expansion into neighboring countries was – similar to that of other Latin American multinationals – aimed at reducing its dependence on a single market, Guatemala. Moving into the U.S. market, in particular, was highly desirable for risk-reduction reasons: dollar-denominated cash flows and less economic volatility.

¹¹ Un pollo al que le quedó chiquita Centroamérica. (12 February 2007). *El Periódico de Guatemala*.

¹² Sánchez, G. (2006). *El Potencial Competitivo de Guatemala - Casos de Éxito de Empresas Guatemaltecas Competitivas*. Guatemala: INCAE Business School.

¹³ Corporate website www.campero.com. Accessed on September 2007.

These two factors also affected the ability of raising capital, although cheaper financing conditions were not a primary motive for the company to launch operations in North America.

i) Natural Market

Pollo Campero began expanding outside of Guatemala in the early 1970s when it opened two outlets in El Salvador. In 1986, four years after Juan José Gutiérrez took over the company, the company tried to gain a foothold in the United States. Given the large Hispanic population in America, especially in southern states, Gutiérrez saw this region as an extended fragment of its natural market.

Gutiérrez chose Miami, with its large Hispanic population, as the company's entry point into the American market. He quickly learned, however, that the formula for Pollo Campero's success in Guatemala and El Salvador was not directly transferable to the United States. Gutiérrez, who personally opened and operated the Miami restaurant, was confronted with high employee turnover rates at this outlet. He consequently had to train 10 to 12 people every three months – a situation that turned out to be unmanageable. This problem was compounded by the more fundamental realization that, in fact, Pollo Campero had entered the American market with a weak understanding of its dynamics.¹⁴

In 1987, Gutiérrez closed the Miami restaurant and put expansion plans on hold. This setback brought two important lessons. The first was the advantage of *franchises* over a direct ownership. Owning and operating the Miami restaurant had been a mistake. In 1994, Pollo Campero established an international franchising arm starting on familiar territory: the first franchises were sold in Central America. The second lesson was the necessity to standardize operational processes in restaurant outlets. With high staff turnover rates in the United States, the company needed to impose standardization to achieve more efficient workforce management.

Since the Miami setback, expansion has continued into other parts of Pollo Campero's natural market and has achieved better results. In 1992, the company expanded into Honduras, followed by Nicaragua in 1996, Costa Rica a year later, then Panama and Ecuador, and finally southeast of Mexico in 1999.

¹⁴ Contreras, J. (2005). Forging a New Path. *Newsweek*, 20 June 2005.

ii) America and Europe

Even though Juan José Gutierrez failed in his first attempt to establish the Pollo Campero brand in the United States, he ventured again into the country, after putting down strong enough roots in the Central American market.

Important facts that caught his attention and contributed to his decision were the branches at the airports in Guatemala City and San Salvador. U.S.-bound passengers stocked up with products for stateside relatives and in some cases, even to resell the fried chicken at higher prices in America. When aircraft serving the routes to Guatemala started to complain about the smell of chicken, Pollo Campero was asked by a carrier to use scent-proof packaging. The airline's surprising request reminded Campero of the potential for demand abroad and inspired the company to rethink about expansion to the U.S.¹⁵

After executives found out that Pollo Campero had big brand recognition in major cities in the USA, even among non-Hispanics, in 2002 Campero and restaurant operator Adir opened a franchise in Los Angeles, where the largest concentration of Guatemalans outside Guatemala City are found.¹⁶ The restaurant was a hit. Whereas a normal fast-food restaurant have average annual revenues between US\$650.000 and US\$2.5-million,¹⁷ Pollo Campero in Los Angeles had record-setting revenues of US\$1-million in three weeks.¹⁸ This phenomenal success attracted a great deal of attention from the media and restaurant industry, which further boosted Pollo Campero's brand recognition. Following the Los Angeles triumph, the company further developed the American market in Hispanic immigration hot spots.¹⁹ The Washington and New York restaurants billed \$1-million each in less than two months.

Pollo Campero's success in the United States was surprising given the saturated nature of the U.S. chain restaurant business. True, Canadian-based Tim Horton's coffee and donut shops had gained a U.S. foothold in the Great Lakes region, and Brazilian steakhouse chain Fogo de Chão had moved into the higher-end meat-lover's market; but the brand-

¹⁵ Ibid.

¹⁶ Bouza, T. & Sama, G. (2003). Latin American Fast Food Makes Inroads in the U.S. *The Wall Street Journal Online*, 2 January 2003. Retrieved on September 2007, from <http://online.wsj.com/article/SB1041459191815079753.html>

¹⁷ Interview with authors, 22 February 2007.

¹⁸ El Vuelo de Campero. (9 July 2004). *América Economía*.

¹⁹ Interview with authors, 22 February 2007.

cluttered U.S. restaurant business was nonetheless a tough market to crack.²⁰ Latin restaurant chains moreover faced numerous pitfalls, including complex U.S. franchise legislation. In addition to federal franchise rules, 15 states impose their own laws. California, for example, sets strict environmental regulations. These countless rules and regulations can inhibit foreign fast-food operators, according to a Los Angeles official of Mexico's foreign-trade bank, Bancomext.²¹

This time Pollo Campero clearly had a recipe for success in America. As of 2007, Pollo Campero counted some 36 restaurants in the United States – in Los Angeles, Chicago, Washington, New York, Dallas, San Antonio and Houston. Most are based strategically in cities where the concentration of Latin Americans is high - in most of its markets, 50% of the local population is Hispanic. Pollo Campero moreover undertook research with the consultancy Bain & Company, which found and validated a tendency towards “tropicalization” of tastes in the United States.

In 2007, Pollo Campero opened a U.S. headquarters, Campero USA Corp in Dallas, Texas. While it staffed U.S.-based positions with Guatemalan managers, the company also hired a team of experienced restaurant professionals to lead growth in the U.S. market. Besides Adir, another major Pollo Campero franchisee is Levy Family Partners, a subsidiary and investment arm of Levy Restaurants, a well-known contract caterer. As mentioned before, the company made a strategic deal with supermarket giant, Wal-Mart, to locate Pollo Campero outlets in Wal-Mart stores. “The relationship with Wal-Mart gives us an unprecedented opportunity for a wide variety of people to indulge in our distinctive menu,” said Roberto Denegri, president of Campero USA. “Pollo Campero is not your typical food chain. It is a familial gathering place, and we are energized about our new relationship with Wal-Mart, America’s favorite family store.”²²

Pollo Campero had first targeted Europe in the 1990s, with Spain as an obvious “natural” market. Besides its consumer base, market conditions in Spain were also favorable: the only comparable restaurant chain in the Spanish market was Kentucky Fried Chicken. In 2000, Pollo Campero moved into Spain through a strategic alliance with an established and experienced domestic player, Tele Pizza. According to the terms of the joint venture, both

²⁰ “Chain using Latin flavor to sell fried chicken”, *Dallas News*, 20 June 2007.

²¹ Bouza, T. & Sama, G. (2003). Latin American Fast Food Makes Inroads in the U.S. *The Wall Street Journal Online*, 2 January 2003. Retrieved on September, 2007, from <http://online.wsj.com/article/SB1041459191815079753.html>

companies agreed to exchange restaurant space on both continents: in Latin America, Pollo Campero integrated Tele Pizza corners into its restaurants, and Tele Pizza was obliged to reciprocate in its Spanish locations. The deal worked, in theory, because two groups were considered more complementary than competitive.²³ Pollo Campero's products are also home-delivered via Tele Pizza's scooter fleet. Competitors Kentucky Fried Chicken and Pizza Hut also have used the formula of combined restaurants. Pollo Campero located its European and Asian headquarters in Madrid, and its long-term objective is to operate about 50 outlets in Spain by 2010.²⁴ For the development of the Campero brand all over the Iberian Peninsula, it has entered an alliance with the Eat Out Group, the franchise business arm of the leading Spanish consumer goods company Agrolimen.

The success of Pollo Campero in Spain has attracted a lot of attention and demand for franchises in Europe, from neighboring Portugal to distant Poland.

iii) New Growth Markets: Asia & Middle East

Pollo Campero is the first Latin American restaurant chain to enter Asia. Backed by Asian investors, the decision to move into Asia was based on encouraging statistics about per capita poultry consumption in Asia – which are even higher than in Central America.

In early 2007, Pollo Campero opened a restaurant in Sarinah, a historic department store in Jakarta's business district "Coming to Indonesia marks a very important and strategic step in the worldwide development of the Pollo Campero brand," declared CEO Gutiérrez at the outlet's opening. Its franchisee in Indonesia is PT Prima Multi Rasa.²⁵

Some fine tuning of the menu was necessary in Indonesia: 30% of the menu stayed intact, 45% needed to be "tropicalized" (mostly by changing sauces and enhancing spiciness) and 25% consisted of new products. Products include traditional chicken, extra crispy chicken, chicken wings, chicken bowls, sandwiches and salads. The targeted price segment is medium/medium-low cost. Some 25 restaurants are planned for Indonesia by 2014.

China was next. In May 2007, the company opened an outlet in Shanghai with a population of 10 million. Other targeted Chinese cities are Beijing and Guangdong. Pollo

²² Wal-Mart Celebrates Latin American Flavor With Pollo Campero. (14 November 2007). *MarketWire*. Retrieved on October, 2007, from <http://www.marketwire.com/mw/release.do?id=792889&sourceType=3>.

²³ Interview with authors, 22 February 2007.

²⁴ El socio americano de Telepizza llega a España en plena puja por la cadena. (15 July 2006). *Expansión*.

Campero's American rival, Kentucky Fried Chicken, had moved into China back in 1987 and now counts more than 1,200 restaurants throughout the country. Despite Kentucky Fried Chicken's first-mover advantage, the Chinese market is still untapped. In market tests, 4 out of 5 Chinese customers preferred Campero chicken over KFC chicken.

Still, Pollo Campero is aware of the pitfalls of the Chinese market, which lacks adequate intellectual property protection. This issue is a concern for both management and analysts. As for KFC, the unique country-style taste of Campero products is a key ingredient to its differentiation strategy. Since flavoring is a key strategic advantage, recipes are kept top secret. Pollo Campero has countered a potential threat by outsourcing only the most necessary operations in China, like poultry production and expendable goods. Everything related to flavoring will be imported directly from the Americas.

There is high demand for Pollo Campero franchise licenses in the Middle East, where chicken is very popular. The company has received franchise requests from Lebanon, Kuwait, Bahrain, United Arab Emirates, Egypt and Jordan. Still, Pollo Campero poses high requirements to entrepreneurs who want to acquire a franchise for the Middle East.²⁵

The Essence of Pollo Campero's Success

A lesson learned early in Pollo Campero's internationalization process was that the Campero concept – low-cost, fast-food chicken tailored to the tastes and preferences of the Central American customer – can attract demand internationally. This fact became the core of Pollo Campero's competitive strategy. Pollo Campero has been able to compete with established multinationals like KFC thanks to two basic competitive advantages: the strong Campero brand and a positive customer experience that offers a piece of exotic Latin lifestyle.

It is clear, however, that Pollo Campero's recipe and customer experience at that time were not enough to achieve success, as the company's initial failure in Miami demonstrated. The business began to take off only after Pollo Campero adopted a professional franchise business model, sharing risk with local partners. The main portion of risk was pushed down to the entrepreneur running the operation. Income is generated not by direct involvement or

²⁵ Pollo Oriental. (12 March 2007). *América Economía*.

²⁶ In the beginning of 2008, the company sold franchises to five countries in the Middle East, to Korea and the United Kingdom.

from direct ownership, but through royalties and license fees charged to the franchisee for using Pollo Campero's brand, conceptual framework, research findings and best practices.

It should also be noted that Pollo Campero benefited from the powerful backing of its conglomerate parent company, CMI, including a vertically integrated structure that gave the restaurants favorable access to its raw products – chicken. In 2005, for example, CMI acquired Costa Rican integrated poultry farmer Propokodusa. Building an integrated network of operations is central to CMI's investment strategy. Even if it is diversified into six major divisions, the company is able to create synergies and mutual advantages for its portfolio companies.

The conglomerate affiliation has another advantage stemming from specialization effects. For example, time-consuming and cost-intensive M&A transactions are executed by the holding corporation CMI. Pollo Campero thus can focus on its day-to-day business, handling successful franchise operations. This advantage of affiliation to the CMI empire makes Pollo Campero well-positioned for future global growth, though it should be noted that, to date, Pollo Campero remains essentially a Latin American restaurant chain on the threshold of global expansion. The company's strategy, as its entry in to Spain demonstrated, shows clear signs of preferring "natural" markets as a priority. The coming years will be a test for Pollo Campero.

Astrid & Gastón¹

A Mega-Merger of Tastes

The rising demand for innovative restaurant concepts and a shift for more exotic tastes have facilitated Astrid & Gastón's internationalization strategy to promote Peruvian cuisine through their restaurants worldwide. Under the visionary leadership of Gastón Acurio, the company has stepped up the pace of its expansion, putting stronger strategic emphasis on growth through franchising. Using local culinary resources along with Novo Andino cuisine concepts has been a recipe for success.

Introduction

"My vision is to globalize Peruvian cuisine and contribute to the reduction of poverty in Peru."
– Gastón Acurio, founder of Astrid & Gastón, 2007.²

Astrid & Gastón is a restaurant company that unites several brands of specialized Peruvian restaurant concepts. The company is named after and managed by Gastón Acurio and his German wife Astrid, both graduates from the prestigious French gastronomical school, "Le Cordon Bleu". As of 2007, the Astrid & Gastón culinary empire includes 23 outlets in 12 countries.

The first Astrid & Gastón restaurant opened in 1994 after their return from France. The restaurant was funded with borrowed money from family and friends. Today the company owns restaurants in Peru, Ecuador, Chile, Colombia, Venezuela, Panama, Mexico and Spain. In their respective locations, the establishments are not only generating profits, but also leading the culinary landscape. The group is planning to expand further via franchise operations in the next years.

The restaurant group's estimated 2007 revenues are US\$30-million, including US\$12-million for Astrid & Gastón, US\$6-million for cellar-style restaurant chain T'anta, US\$6-million for La Mar, US\$4-million for traditional Peruvian sandwich restaurant Pasquale

¹ The authors are grateful to executives of Astrid & Gastón for their cooperation with the preparation of this chapter.

Hermanos, and US\$2-million for events, catering and publications. Acurio plans to double the company's revenues in 2008. He also has a TV program and has published twelve cookbooks and a culinary encyclopedia. In 2005, *América Economía* magazine named him Latin American Entrepreneur of the Year and in 2007 "Astrid & Gastón" was named by the World Economic Forum as a "Global Growth" company.

The Peruvian restaurant market is informal and highly fragmented, with many small and non-branded restaurants and street vendors. Over the centuries, Peru has been a crossroads for several cultures which has created a unique way of preparing food.³ The traditional Incan cuisine became mixed with new ingredients introduced by the Spanish conquerors who arrived in the early 1500s and the African slaves who came later. After the independence of the country in 1821, immigrants from Europe contributed French, Italian, and German twists. New frying techniques, soy and ginger were brought by Chinese cheap plantation labor in the mid-19th century. And at the turn of the 20th century the Japanese taught Peru about fresh, raw fish and seafood. ⁴ Peru offers a rich base of ingredients and tastes, as it has 80 of the world's 120 microclimates, which provide a huge biodiversity in the country.⁵

The original Astrid & Gastón concept targeted a premium customer segment serving cocktails with Pisco⁶ and tropical fruits.⁷ In 2003 Acurio launched T'anta, which means "bread" in the ancient Quechua language. In contrast to Astrid & Gastón, this bistro-style venture aims at serving the mass market. Next, Acurio opened a fish and seafood restaurant, La Mar, which quickly became trendy with its traditional lime-marinated raw shellfish, *cebiche*. The restaurant is a hybrid between a casual roadside café and sushi bar.⁸ Traditional Peruvian sandwiches are served at the chain Los Hermanos Pascuale, which is hoping to replicate Peruvian-style the global success of the hamburger. The Panchita restaurant concept allows customers to taste typical Andean barbecue. The company is also launching boutique hotels under the Nativa brand, combining wellness, nature, traditional medicine, Peruvian folklore and excellent food. Furthermore, outlets for Peruvian-style grilled chicken, which

² Interview with authors, October 2007.

³ Schexnayder, C.J. (2006). Have Fish, Will Travel. *Latin Trade*, 01 August 2006. Retrieved on October 2007 from Factiva database.

⁴ Harman, D. (2006). Incan Fusion at a Chevichería Near You. *The Christian Science Monitor*, 20 April 2006. Retrieved on October 2007 from Factiva database.

⁵ Just Add Spice. (29 January 2004). *The Economist*.

⁶ Pisco is a liquor from Peru and Chile.

⁷ Interview with authors, 22 August 2007.

also represent a potential means to enter the U.S. market, and Chinese food outlets (or so-called *chifas*), are also on Acurio's "to-start-up" list.⁹

Starbucks and other globally branded outlets will face competition from Acurio when he launches a coffee shop chain called Astrid & Gastón Café and juice bars called Juguería. Based on evaluations of previous projects, the company is confident that future plans will achieve similar success.

Acurio has a hands-on leadership style that is common to successful, family-owned Latin American firms. He walks up and down the markets and streets of Lima in search of new tastes and ingredients to incorporate into his famous recipes. The whiteboards in his office are filled with his daily discoveries of the Peruvian savory arsenal.¹⁰ As a cook himself, Acurio is in close contact with his employees worldwide. He cites his corporate values as "being ethical and loyal, having integrity, being honest, demonstrating leadership and dedication, showing respect for the product, for his employees, and ultimately for the customer."¹¹ The company's philosophy is: "Use the best products possible, buy the products daily, keep the best people, all the chefs and all the managers, keep them in the organization."¹²

Acurio acknowledges that opening a French-style restaurant after returning to Peru was a mistake. As a Peruvian chef with local ingredients available, he should not have opted for French cuisine and looks back on that mistake as a learning experience. He also admits that the company took too long to execute an internationalization strategy – namely six years, to move into Chile, and another four years to enter Colombia. Acurio is now focused on leveraging his brand to promote his country's cuisine worldwide.¹³

The company therefore has stepped up the pace of its expansion, putting stronger strategic emphasis on growth through franchising, though without neglecting thorough due

⁸ Schexnayder, C.J. (2006). Have Fish, Will Travel. *Latin Trade*, 01 August 2006. Retrieved on October 2007 from Factiva database.

⁹ Yamada, G., & Chacaltana, J. (2007). *Generación de empleo en el Perú: Seis casos recientes de éxito*. Lima, Peru: Centro de Investigación de la Universidad del Pacífico.

¹⁰ Milliken, M. (2006). Chef prepares Peruvian cuisine to conquer the world. *Reuters News*, 01 March 2006. Retrieved on October 2007 from Factiva database.

¹¹ Hernández, E. (2006). Gastón Acurio: El Emperador en el Reino de la Gastronomía. *Mosaico* (Sunday supplement to La Prensa), Panamá, 19 February 2006.

¹² Schexnayder, C.J. (2006). Interview with Gastón Acurio. *Expatperu.com*, 06 December 2006. Retrieved on October 2007 from http://www.expatperu.com/detalle.php?topic_id=429.

¹³ Interview with authors, 22 August 2007.

diligence when selecting start-up locations. The Astrid & Gastón group believes it is finally on the right track to global growth – forecasting a worldwide market of over 50,000 restaurants of Peruvian-style food.

Going Global

“Astrid & Gastón” has been expanding mainly through wholly-owned restaurants with financial backing of investors and franchises, with La Mar as the flagship. Almost daily Acurio gets offers from Saudi Arabia to Australia from people who want to invest in Peruvian restaurants. He rejects most of these offers because he believes everything has its opportune time and place.¹⁴ In their premium brands the company will own the restaurants or keep a major stake in the franchises to maintain and oversee quality. In the concepts directed at the mass markets, franchises will be more broadly available. The enterprise aims to team up with local partners to be able to handle specific market characteristics, people and customs better.¹⁵

In 1999, Astrid & Gastón made a foray into Chile with a single restaurant, followed by Colombia in 2003, then Venezuela and Ecuador.¹⁶ Beyond South America, the company’s global flagship brand is La Mar. In 2007, a La Mar outlet opened in the tough Mexican market, where many U.S. restaurants and others have failed, and currently the company has three outlets in Mexico. The company also ventured into Europe in 2007, opening a 600-square-meter Astrid & Gastón outlet in the Spanish capital. “Madrid is the natural gateway to Europe for any Latin American proposal”, said Acurio.¹⁷ The 600-square-meter Madrid restaurant, which was an instant success, is a showcase for future openings in Europe, targeted for London, Paris, Germany, and Italy. A restaurant opening is planned for Hong Kong in 2009. Pasquale Hermanos has four restaurants in Lima, ten more are planned for 2008, and the company is planning to go global with that brand in 2009.

The group plans to further expand in its natural markets: various openings of Astrid & Gastón restaurants in Latin America – San José in Costa Rica, São Paulo in Brazil, Buenos Aires in Argentina, and Panama – are scheduled for early 2008.

¹⁴ Acurio, G. (2006). Transcript of a speech held at Universidad del Pacífico, Lima, March 2006.

¹⁵ Interview with authors, 22 August 2007.

¹⁶ Interview with authors, 22 August 2007. T'anta has four restaurants in Lima and planned opening outlets in Bogota and Santiago de Chile in 2008.

¹⁷ Peru's Astrid & Gastón Restaurant Opens in Europe. (22 May 2007). Retrieved on October 2007 from http://www.theperuguide.com/peru_travel_adventure_news/2007/05/22/perus-astrid-gaston-restaurant-opens-in-europe.

More importantly, the company is planning a foray into the United States with the opening of a La Mar outlet in San Francisco (in the luxurious Ferry Building). The company is spending \$6-million on the restaurant located in the newly renovated San Francisco harbor district. A total of 20 La Mar restaurants are in the works for the American market, with plans to open restaurants in Las Vegas, Florida, and New York with investments totaling US\$20-million.¹⁸

In South America, start-up costs for each of La Mar outlet are approximately US\$500,000. These costs triple for entering the U.S. market.¹⁹ Besides looking for private investment, Acurio has explored financing by the IFC of the World Bank Group, though he says the bureaucratic process is too complex to navigate.²⁰

Elsewhere in the Pacific region, the company is hoping to make inroads into China in 2009.

The Essence of Astrid & Gastón's Success

Astrid & Gastón has followed a remarkably similar expansion trajectory as Pollo Campero: moving from its domestic market to other parts of Latin America, and then into parts of the United States and Spain. In a word, it has largely been a “natural” market strategy, with ambitions to expand into other global markets.

Both Pollo Campero and Astrid & Gastón have successfully leveraged Latin American culinary traditions to go global, and that is unique. While most Latin American companies are commodity handling businesses, capitalizing on the comparative advantage of access to the subcontinent’s rich geological resources, Astrid & Gastón – like Natura Cosméticos – has found alternative natural resources to exploit. Food offers an alternative way to exploit resources other than oil and metals for the benefit of society. While Pollo Campero has exploited its distinctive Latin style and flavor for its chicken menus, Astrid & Gastón has successfully exported its brand as a distinctively Peruvian restaurant.

The restaurant’s Peruvian origins indeed have been an important differentiator in a market for “exotic” food. Thanks to the country’s cultural heritage, Peru has long been a

¹⁸ Banquete Latino. (08 October 2007). *América Economía*.

¹⁹ Schexnayder, C.J. (2006). Have Fish, Will Travel. *Latin Trade*, 01 August 2006. Retrieved October 2007 from Factiva database.

melting pot for various cooking styles that has produced a rich tradition of mixing different tastes. Proof that this competitive advantage is more than corporate imaging; Astrid & Gastón has opened a laboratory for gastronomic research in Lima.

Acurio's says his mission is not only his own business growth. He wants to promote his country's cuisine worldwide and create a renowned Peruvian brand that will boost national pride in a country whose people have suffered under dictatorships and terrorism.²¹ Acurio believes, for example, that tourism in Peru should not be limited to Machu Picchu or Cuzco. The country's gastronomical richness should also be an attraction. By promoting Peruvian products, he says, the domestic economy will become much more dynamic and boost employment.

In Peru, by partnering with different levels of government, Acurio has succeeded in getting traditional open-air street barbecues reinstalled. These are an ideal promotional network for Peruvian cooking style on a small scale, enabling him to draw on the knowledge of the roadside vendors to incorporate it in his recipes. This bottom-up R&D strategy brings mutual benefits: it provides new income sources for street vendors and brings new ideas to Acurio's gastronomic concepts.

²⁰ Interview with authors, 22 August 2007.

²¹ Interview with authors, 22 August 2007.

Natura¹
Brazilian Cosmetics for the World

A high per-capita spending on cosmetics plus a growing demand for natural products equals a great opportunity for a company like Natura to capitalize. To attain risk reduction and market seeking strategies it takes advantage of its eco-friendly products Brazilian roots and value-based "well being". All the necessary elements for a successful internationalization seem to be in place but it still lacks a consistent internationalization strategy with the current sector trends. This is a good example of a potential Global Latina who still has to prove itself in the international arena.

Introduction

"It is not clear to the management that in order to create a global brand it is necessary to have an international partner... To preserve our values and beliefs is fundamental."
-- Luiz Seabra, founder of Natura, 2006.²

Natura Cosmeticos, the world's 7th largest personal care products company measured by market capitalization, sells premium cosmetics and related products that have an eco-friendly appeal because they are made from extracts of local Brazilian plants. The biodiversity theme is underscored not only by the company's name, but also by its motto: *bem estar bem* -- or "wellbeing well".

The company's product portfolio – counting some 600 different products -- is divided into eight segments: fragrances, makeup, skin treatment, sun creams, hair care, deodorants, soaps, and shaving creams. Among its well-known product lines are Ekos, Chronos and Mamãe e Bebê.

Natura has consistently been listed in Latin American rankings such as "Best Companies to Work For". *Exame* magazine named Natura the best company for women

¹ The authors are grateful to executives at Natura for their cooperation with the preparation of this chapter.

² Geoffrey Jones and Ricardo Reisen de Pinho, "Natura: Global Beauty Made in Brazil", Harvard Business School, Case 9-807-029, 12 December 2006.

employees in both 2003 and 2004. It also was named the “most innovative” company by the Monitor Group survey in 2003. The same year, *Forbes* named Natura the “most desirable” company in Brazil.³

Natura sells its products – like its foremost U.S.-based competitor Avon – mainly through door-to-door direct sales. This market model has proved highly successful in Brazil, where the company has a network of more than 560,000 independent sales representatives, called *consultoras*. In total, the company has about 5,000 employees and more than 600,000 sales representatives. It earned US\$215-million in profits on 2006 and revenues of US\$1.3-billion. More than 95% of total sales come from the Brazilian market. This overwhelming exposure to its domestic market explains why Natura is pursuing an internationalization strategy.

Outside of Brazil, Natura operates in Argentina, Chile, Peru, Bolivia, and Mexico. The company entered the French market in 2005 with a store in Paris, and plans are under way for expansion into Russia, Eastern Europe and the United States.

Cosmetics Industry

The global cosmetics, fragrance and toiletries (CFT) industry is concentrated in the hands of several major players that have consolidated their market presence in order to achieve scale and drive volume sales. The ten biggest players – including L’Oreal, Procter & Gamble, Unilever, and Avon – represent more than 50% of the total global CFT market, which in 2006 was worth US\$270-billion. In the “personal products” industry, the top 10 global companies as measured by market capitalization are, in ranked order: L’Oreal (France) at US\$78-billion; Beiersdorf (Germany) at US\$17-billion; Avon Products (U.S.) at US\$16-billion; Shiseido (Japan) at US\$9-billion; Estée Lauder (U.S.) at US\$8.4-billion; Wella (Germany) at US\$8.3-billion; Natura (Brazil) at US\$5.4-billion; Hengan International (Hong Kong/China) at US\$4.6-billion; Amorepacific Corp (South Korea) at US\$4.4-billion; and Clarins (France) at US\$3.1-billion.⁴

The cosmetics industry is driven by the release and marketing of new product lines. For this reason, significant R&D spending is required to finance product development. Thus, *innovation* constitutes a barrier to entry, as the enormous costs associated with product development require deep pockets. Generally speaking, the market is divided into three

³ Source: www.natura.net as of October 2007.

⁴ Capital IQ, October 2007.

broad categories: first, *premium* lines such as Channel and Dior (sold in department stores and boutiques); second, *mass-market consumer* brands such as Oil of Olay and Cover Girl (sold in pharmacies and supermarkets); and third, *low-end* brands (sold door-to-door through direct-sales).

In Latin America, the CFT business is a US\$36-billion market, more than half of which is located in Brazil (where cosmetics alone achieves sales of US\$9-billion). Brazil is an ideal market for cosmetics products. Besides its large population, the country is renowned for its culture of self-image. Brazil's per capita spending on cosmetics and toiletries is roughly 1.7% of GDP – more than double of that in France (0.7%), triple per capita spending in Britain (0.5%), and more than quadruple per capita spending in the United States (0.4%). The only countries that came close to Brazil's high per capita spending figure in Latin America were: Colombia (1.4%), Chile (1.2%), Venezuela (1.2%), Argentina (1.0%), and Mexico (0.8%).⁵

Brazil is the world's third-largest CFT market, worth US\$18.2-billion, after the United States (US\$50.4-billion) and Japan (US\$29.8-billion), but ahead of France (US\$14.1-billion). More importantly, the Brazilian market has the highest growth rate in the world at 26% (compared with only 2.9% in the United States and a global average of 4.1%).⁶ Brazil is by far Latin America's biggest cosmetic market due mainly to the country's large population of roughly 190 million and high per-capita spending on beauty products.⁷ As the *New York Times* observed: "Another equally important factor is Brazil's rich history of miscegenation. The mix of European, indigenous, African and Japanese blood has created a nation with every conceivable skin tone, hair type and body shape. Manufacturers of beauty products are forced to cater to them all, meaning that no matter which overseas market is the target, they have a product to sell."⁸

In Brazil, Natura competes with multinationals in a highly segmented market characterized by a broad range of socio-demographic and ethnic profiles. This has given Brazilian firms a natural competitive advantage. Brazil's market was protected until the 1980s due to import-substitution policies imposing high tariffs. In cosmetics, the only foreign multinationals marketing their products in Brazil were those manufacturing locally, such as

⁵ Geoffrey Jones and Ricardo Reisen de Pinho, "Natura: Global Beauty Made in Brazil", Harvard Business School, Case Study 9-807-029, 12 December 2006.

⁶ Euromonitor International, 2007.

⁷ Per capital spending on CFT in Brazil is roughly US\$100 -- higher than in Russia (US\$60), but lower than in the United States (US\$174). *Cosmetics and Toiletries - World*, Euromonitor International, Global Market Insight, June 2007.

Dutch-based Unilever and Avon. Other foreign multinational were refraining from the Brazilian mass consumer market at that time due to concerns about hyper-inflation and unstable political conditions. This isolation of the Brazilian market facilitated the growth of domestic cosmetics firms, such as Natura and O Boticario.

Natura: Past & Present

Founded by Luiz Seabra in 1969, Natura began modestly as a small laboratory-supported cosmetics store in the Rua Oscar Freire shopping district in São Paulo. The company did not achieve significant growth until 1974, when it made a strategic shift from a retail model to direct-sales. Natura decided to copy the market model of its biggest competitor, Avon, using networks of female sales reps selling cosmetics to other women. Avon, which has sales in Brazil of US\$1-billion, sells its products in 120 countries. Brazil is Avon's biggest market after the United States.⁹

There was a major difference between Natura and Avon: whereas Avon targeted the low-end market of women with modest disposal income, Nature occupied the higher end of the market with cosmetic brands in the premium category. This meant that Natura's products had higher price points – in fact, two thirds higher than most Avon products. If successfully marketed, however, Natura's products generated higher volumes and produced fatter margins.

Natura indeed proved highly successful at managing its network of female *consultoras*. The company not only built up a bigger sales force than Avon, it proved more effective at recruiting and retaining its women sales reps. Maintaining loyalty was paramount to achieve this objective. The company accomplished this by merging its corporate objectives with deep-seated social needs among its female sales force. For example, Natura provided social meeting places – or *centros de convivência* -- where its reps could get together and network. The official function of these centers was for sales reps to use computer terminals to place their orders. In reality, they served as family-oriented meeting places where relatives of Natura employees could access the Internet and take part in activities such as cooking classes.¹⁰ Natura's products, too, have been intimately in touch with

⁸ Andrew Downie, "Beauty and the Brazilians", *The New York Times*, 24 August 2007.

⁹ *Natura Cosmeticos*, Euromonitor International, June 2007.

¹⁰ *Natura Cosmeticos SA: Cosmetics and Toiletries - World*, Euromonitor International, December 2006.

Brazilian culture. The Mamãe e Bebê (Mother and Baby) branded creams, for example, have a strong appeal in Brazil thanks to their evocation of the *Shantalla* baby massage.

The debt crisis that hit Brazil in the 1980s turned out to be an unexpected blessing in disguise for Natura when many foreign multinationals left the region. The negative impact on the labor force was good news for Natura because the company suddenly had an instant pool of female candidates to become *consultoras*. During the crisis, sales increased by a staggering 43% annually from 1979 to 1989. By the 1990s, Natura was a highly-trusted and successful brand in Brazil whose positive image was reinforced by its association with the values of “bio-diversity”.

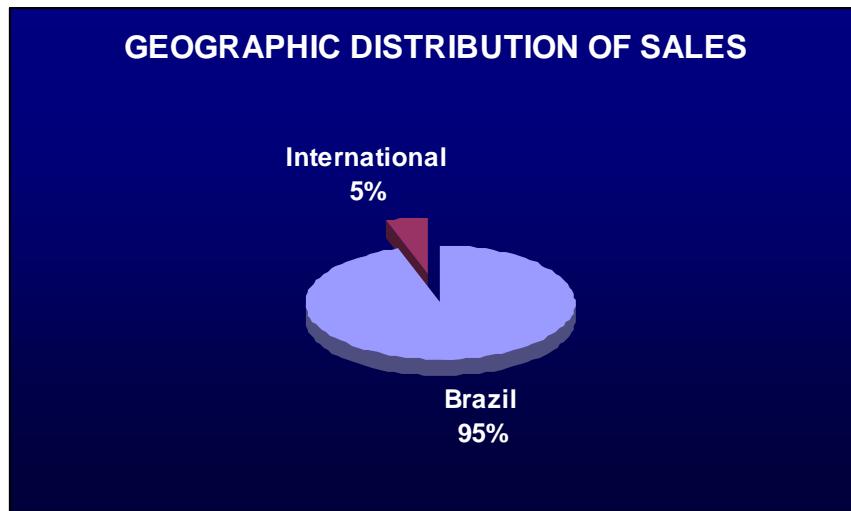
As Luiz Seabra says: “For Natura Cosmeticos, sustainable development is second nature. It's just like a person thinking of their skin. Cosmetics enable people to become more intimate with their own bodies. And once that's happened, people no longer have any desire to make war. Being at peace with our bodies and with our time changes our hearts and our consciences.”

Natura's solid domestic share is partly due to head-start advantages, as large foreign multinationals were barred from the Brazilian market until liberalization in 1990. While they had most of the market to themselves, Natura's founders had initiated a diversification strategy that broke up the company into five separate businesses. This strategy proved ill-advised, however, after Brazil's economic crisis of 1989 and market liberalization the following year. Like other Latin American companies, Natura decided to streamline its operations and improve competitiveness by focusing on a core business: eco-friendly products marketed around the concept of transparency. The corporate motto was now: “truth in cosmetics”. As Seabra later recalled: “The world was waking up to the need for greater ethics and transparency. We decided to anchor the transformation around these values.”

The rationalization strategy involved consolidating disparate offices into a single head office, buying out partners who did not agree with the new strategic focus, and recruiting top executive talent from P&G, Unilever and Johnson & Johnson to take the company to the next level.¹¹

¹¹ “Natura's back-to-business success”, *World Business*, 10 July 2006.

Going Global



It would be difficult to argue that Natura has always been an ambitious global market seeker. The company was for many years intensely focused on building its direct-sales business in Brazil. This domestic focus had the effect of delaying the company's entry into foreign markets.

A major challenge that Natura had to overcome in its home market was competition from large-scale foreign competitors with deeper pockets for research and new product development. This reality forced Natura to demonstrate strategic agility in order to beat foreign giants at their own game, but at lower cost. It did so through "Campus Project", a joint program that took a collaborative approach to R&D through combined projects with universities and research centers in the United States and France. This approach, which produced a new product every three days and dozens of patents every year, also kept Natura's research and development spending down. In 2004, for example, R&D spending was 2.7% of net income, compared with 3.5% on average for competitors. Natura counted only 150 employees working in R&D, whereas a giant player like L'Oreal employed 3,000 researchers. Also, in 2000 the company merged its R&D and marketing units to bring together technology and sales and, by doing so, accelerate the time in which the company could estimate a new product's commercial acceptance.¹²

¹² Amitava Chattopadhyay, Betania Tanure and Nina Paavola. *Natura: Expanding Beyond Latin America*, INSEAD case study, No. 06/2007-5635, INSEAD, Fontainebleau, 2006; and Donald Sull, Alejandro Ruelas-Gossi, and Martin Escobari, "Innovating around obstacles", *Strategy & Innovation*, Harvard Business School, November-December 2003.

The years following 2000 were marked by high growth: Natura's share of Brazil's cosmetics market increased from 14.3% in 2001 to 23% in 2007.¹³ It was against this backdrop of soaring growth that, in 2004, Natura went public by listing 25% of its shares on the Sao Paulo Stock Exchange (see Exhibit in Annex for the company's stock performance). At that time, Natura was Brazil's biggest cosmetics brand with annual revenues of roughly \$1.5-billion and some 480,000 sales representatives.¹⁴ Yet sales outside Brazil constituted only 3% of total revenues.

For Natura, like for many Latin American multinationals, expanding beyond its domestic market allowed the company to diversify its risk exposure while leveraging its brand – in short, *risk-reduction* and *market-seeking*. Comparably high per-capita spending on cosmetics in neighboring countries was another motivating factor. In 1983, during the so-called “lost decade” in Latin America, Natura had entered neighboring Chile through an outsourced distributor, an arrangement that produced disappointing results mainly because the company failed to take into consideration the specific nature of the domestic market. For example, Natura stuck to its marketing strategy of premium products, which were priced higher than most existing brands in Chile. Also, Natura's direct-sales marketing approach did not produce the same results in Chile, a country in which women generally buy cosmetics products in retail stores. Natura moreover realized that building and retaining *consultoras* in Chile was a challenge. Unlike Brazil, Chile enjoyed full employment and therefore households had much higher disposal incomes. Women in Chile consequently were less inclined to work in door-to-door sales to supplement family income. Facing these challenges, Natura struggled in Chile and its operations did not generate positive cash-flow until 2006.

Natura waited more than a decade, until 1994, before making a foray into another Latin American country: Argentina. But this experiment largely failed, too, mainly because the company suffered a high turnover rate in its *consultoras* sales force -- a major setback in a business based on the network-building skills. And as in Chile, Natura discovered that while Argentina was geographically close it was not receptive to the company's direct-sales business model.

¹³ *Natura Cosmeticos: Tackling the Challenge of Sustaining Growth*, Goldman Sachs, 6 August 2007.

¹⁴ Natura's sales force, mostly lower-middle-class and middle-class women, do not have exclusive contracts with the company. Sales representatives operate in informal networks of friends and colleagues. While about 30% of orders in Brazil are made via the Internet, the company does not directly process these orders in order not to bypass its sales force which represents the bulk of revenues.

In December 2001, Argentina went through its worst political and economic crisis in history when the country suffered 300% currency devaluation, triggering a deep recession. As in Brazil a decade earlier, Natura's business took off in Argentina in this context of crisis. While its competitors raised their price points to recover increased costs, Natura kept its prices stable. The strategy worked: by 2005, Natura had the biggest market share in Argentina and was forecasting 24% annual growth till 2009.¹⁵

The lessons learned in Argentina were quickly applied to other Latin American markets where Natura was facing similar challenges. In late 2005, the company entered Mexico, which is the biggest direct-sales market in Latin America. The previous year, the Mexican cosmetics and toiletries market generated US\$5.3 billion in total sales. Still, Natura's main competitors – Procter & Gamble, Colgate-Palmolive, and Avon – were already well established in Mexico. Avon had a sales force of some 400,000 women and ranked among Mexico's 50 biggest companies. In short, the Mexican market was crowded. As a late entrant, Natura took a flexible approach with a hybrid model that mixed retail outlets and direct sales.

From 2001 to 2005, Natura grew its top line by 30% and its margins reached 25%. In 2005, a new CEO was appointed, Alessandro Carlucci, under his leadership Natura began to articulate a more coherent international expansion strategy. Its first truly international expansion effort targeted Paris -- an obvious choice given that it is traditionally considered to be the fashion capital of the world. The company also had existing links with French suppliers and R&D centers at universities. On the negative side, France is a mature cosmetics market with large-scale market belligerents such as L'Oréal and Dior. As *European Cosmetics Markets* magazine observed: "The choice of France for Natura's debut into Europe may well strike an observer as odd – surely Portugal or Spain would have been a more obvious target."¹⁶

In early 2005, Natura jumped on a "Year of Brazil" marketing drive in France to bring its eco-friendly Ekos brand to Paris. In April, a Natura flagship store was opened in the posh, high-end Saint-Germain-des-Prés district of the city where many famous brands have a retail presence. The store's original concept was not merely as a sales outlet, but as a place where

¹⁵ Amitava Chattopadhyay, Betania Tanure and Nina Paavola. *Natura: Expanding Beyond Latin America*, INSEAD case study, No. 06/2007-5635, INSEAD, Fontainebleau, 2006.

¹⁶ Georgina Caldwell, "Natura – No Man is an Island", *Cosmetics Business*, November 2005.

Natura could market its value-based “well-being” lifestyle to passing consumers with a strong emphasis on its eco-friendly Brazilian roots.

Where an expansion foothold or public relations showcase, the Paris store took Natura out of its direct-sales model for the first time. The company had little choice, in fact, as direct selling is not a widespread market model in France. CEO Carlucci told the *Financial Times* newspaper in late 2006 that the Paris store was an “experiment” to test consumer response to Natura products in France and to benefit from the proximity to France’s R&D expertise in the industry. “We wanted to choose a sophisticated market where people understand cosmetics and have high expectations,” he said. “We wanted a test that was tough.”¹⁷

In June 2007, Carlucci seemed somewhat less optimistic about the French market, saying he would take a decision about the company’s strategy in France by the end of the year. “Either we will decide to roll out further, or....” he told *Cosmetic News*. The pause at the end of his sentence seemed to leave little doubt that results had been less than expected.¹⁸

Shortly after the Paris store opening, Seabra and his partners decided to assess the Russian market for possible entry. These plans were confirmed by Carlucci in an interview with the *Financial Times*. “We think there is a lot of space in the cosmetics industry to grow and we think we have good products that will appeal to consumers in other countries,” Carlucci told the newspaper, adding that he wanted to increase Natura’s revenues outside Brazil from 3% to 10% of total sales before 2011.¹⁹

A foray into Russia makes sense strategically: Russian women are relatively high per-capital consumers of cosmetics and beauty products (1.1% of GDP compared with 0.7% in France). In fact, the only region in the world where per-capital spending on cosmetics is higher than in Russia is Latin America. Also, Russia’s cosmetics and toiletries market is growing rapidly. What’s more, the direct-sales model has been gaining momentum in Russia – from a 5.4% share in 1999 to 18.7% five years later. On the downside, the Russian market is difficult to enter due to bureaucracy, poor product quality regulations, rampant brand counterfeiting, and a generally tough competitive environment. Russians moreover do not

¹⁷ Peter Marsh, “Natura aims to expand internationally”, *Financial Times*, 29 December 2007; and “Brazil’s Natura reviews its strategy in France”, *Cosmetic News*, 20 November 2006.

¹⁸ “Crunch time for Brazil’s Natura in France”, *Cosmetic News*, 18 June 2007.

generally share the eco-friendly values that are sweeping through many western countries where concern about the environment is growing.

In sum, Russia is not for the faint of heart. Natura has set 2008 as a targeted date for a market launch in Russia.²⁰

Looking Forward

Natura shares many Global Latina characteristics. Founded by a visionary individual with strong values, it has remained in the hands of a small group of controlling shareholders, faced domestic competition from foreign giants, and moved into international markets both to leverage existing competitive advantages and learn about global market dynamics. It is important to underscore in particular the quasi-ideological foundation of Natura's business model as an eco-friendly corporation exporting Brazil's biodiversity to the world – echoing Petrobras' drive into ethanol biofuels and Astrid & Gastón's exporting of its unique Peruvian cuisine.

There can be no doubt that, as a value-based company guided by an eco-friendly vision and corporate responsibility values, Natura has fostered an enviable corporate culture in which employees are motivated by a high level of material benefits and a vision. At the same time, one of the main impediments to Natura's internationalization, it would seem, is the weight of its Brazilian operations on its corporate culture. With the legacy of its direct-sales business model in Brazil, Natura still seems hesitant towards to the idea of a transformation into a global player.

Indeed, like other Latin American firms Natura has largely remained confined to its "natural" market – indeed, with more than 95% of its revenues coming from Brazil. The company consequently is overwhelmingly over-exposed domestically and needs to reduce its risk exposure through internationalization. Natura came to this realization at the end of the 1990s – three decades after the company was founded – hence its decision to publicly list its shares to raise capital. Still, the company's internationalization strategy has been late and somewhat improvised.

¹⁹ Marsh, Peter. "Natura looking for growth outside of Brazil", *Financial Times*, 2 October 2006.

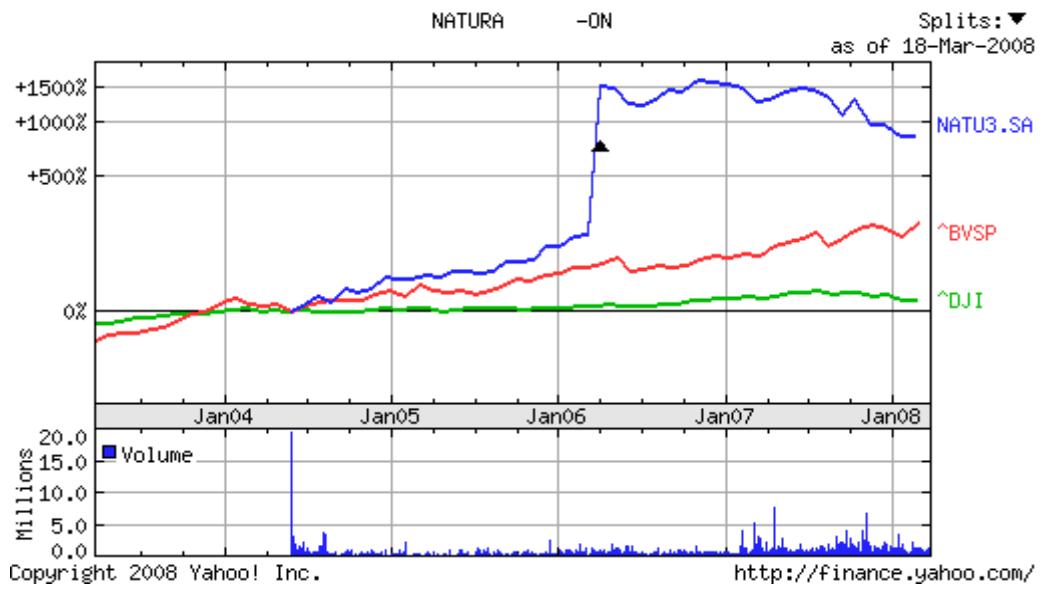
²⁰ Tabion, Mary . "Natura Challenges the Multinationals", *Latin Business Chronicle*, 9 April 2007.

Industry analysts have given Natura's internationalization strategy mixed reviews, citing its reluctance to make bold moves. It kicked the tires of The Body Shop, for example, but L'Oréal moved in and snapped up the well-branded chain of stores for US\$1.2-billion to buy volume in a market segment slightly down-market from its high-end brands. For Natura, this was a missed opportunity that could have had a transforming impact on the company. Some analysts wonder whether Natura can survive its own "idealism", while others have speculated that it could be the target of a corporate takeover by a global player looking to expand in Brazil.

It would appear, however, that in 2007 the company recognized that a concerted international strategy needed to be executed: the company was undergoing an internal reorganization and executives were being trained to adopt more aggressive business strategies. Going forward, Natura will have to make more substantial R&D investments if it hopes to compete globally with giants.

In April 2007, CEO Carlucci announced a capital investment plan to get Natura's international strategy back on track. Reiterating that Natura wants to earn 20% of its total revenues outside of Brazil by 2017, Carlucci admitted that the company was losing money in Chile, Argentina, Mexico and Venezuela, with only Peru breaking even. The lackluster performance of Natura products in the company's "natural" market was clearly pushing the company to look elsewhere for growth. Carlucci's challenge will be to prove that, this time, Natura is serious about its internationalization strategy.

Exhibit 1: Natura's Stock Performance vis-à-vis the Dow Jones and the São Paulo stock exchanges



NATU3 = Natura trading at the São Paulo Stock Exchange

[^]BVSP = Bolsa de Valores de São Paulo Index

[^]DJI = Dow Jones Index

Viña Concha y Toro¹

Chile's Global Wine

The demand shift from old world to new world wine has greatly benefited Concha and Toro's ambitious investment plan to increase and diversify its exports. With low per-capita consumption in domestic market, the developments of wine portfolios and innovative product branding have boosted their sales in foreign markets.

Introduction

"In an industry constantly facing new challenges and increasing competition in markets everywhere, a strong brand is more valuable than ever and indispensable for future growth."
- Eduardo Guilisasti, CEO Concha y Toro. 2007.

Chile's Viña Concha y Toro is Latin America's main wine exporter and one of the most recognized wine brands worldwide. The vertically integrated company is involved in every stage of the value chain -- from vineyards and production to distribution and marketing. Exporting to more than 115 countries, the company's consolidated revenues in 2007 exceeded US\$536-million. While Europe and the United States are its main export markets, it has been targeting Asia to boost growth. Exports represent about 75% of the company's revenues.

Its main wine brands are Concha y Toro, Don Melchor, Terrunyo, Marqués de Casa Concha, Casillero del Diablo, Trio, Sunrise and Frontera. Through its subsidiaries, it also markets brands such as Cono Sur, Isla Negra, Viña Maipo and Trivento. Its premium red wines are primarily made from Cabernet Sauvignon, Merlot, Carménère, Syrah, Pinot Noir and Malbec grapes.

According to *Intangible Business*, Concha y Toro ranks 3rd -- after Gallo and Hardy's -- among the world's most famous wine brands. In 2006, the influential American magazine, *Wine & Spirits*, named the company "Vineyard of the Year" for the twelfth time and included

¹ The authors are grateful to executives at Viña Concha y Toro for their cooperation with the preparation of this chapter. The authors are Francia Schürmann, Profesora Marketing, Constanza Sanchez, Ramón Molina Profesor Entrepreneurship, Director Ejecutivo & Director Programas MBA International Programme, Escuela de Negocios, Universidad Adolfo Ibáñez in Chile.

Concha y Toro in its Hall of Fame. The same year, the company's Don Melchor 2003 wine was awarded a record 96 points and ranked 4th in the "Wines of the Year" list published by *Wine Spectator*. The company's CEO, Eduardo Guilisasti, was named by *Decanter* magazine in 2005 as one of the "fifty most influential people" in the global wine industry. Concha y Toro was ranked 24th by the study "The Power 100: The world's most powerful spirits & wine brands 2007", which reviews more than 10,000 wine and spirits brands.

Wine Industry

The global wine industry generates annual revenues exceeding US\$100-billion.² Chile is the fifth-largest wine exporter, after France, Italy, Spain, and Australia in ranked order. Chilean wine exports totaled US\$962- million in 2006. According to the Chilean Wine Exporters Association, the country's bottled wine exports increased from 9.5-million cases in 1995 to 31.9-million cases in 2006, for an annual growth rate of roughly 12%. Chile's main export markets are the United Kingdom, United States, Canada, Germany, Brazil, Netherlands and Denmark.

Chile is recognized as one of the world's most favorable territories for viticulture production, thanks to the country's fertile soils, defined thermal amplitude, lack of rain in summer, and excellent environmental and sanitary conditions. Chilean wines, along with those of Australia, United States, South Africa and Argentina, are part of the New World Countries Group of wine exporters. Among Concha y Toro's main domestic competitors are other well-known brands such as Santa Rita, San Pedro, Santa Carolina, Undurraga, Errazuriz, Cousino Macul, and Tarapaca. Concha y Toro has a 35% share of Chilean wine exports.

Global Chilean wine exports grew in 2006 by 10.5% in value and 6.6% in volume. Concha y Toro beat the industry performance with a 17% increase in exports. Ironically, wine consumption in Chile – due to cultural habits and socio-economic realities – has been declining in a country whose inhabitants show a preference for beer. This challenge has put pressure on Concha y Toro to increase exports.

Concha y Toro: Past & Present

² Source: Euromonitor International, 2007.

The company was founded in 1883 by Don Melchor Concha y Toro, whose family had arrived in Chile in 1718. Its original vines were imported from the Bordeaux wine region of France. After being converted into a limited liability company in 1921, it went public in 1933 when shares were listed on the Santiago Stock Exchange. The same year, their first exports were shipped to the Netherlands.

In 1961, a group of investors led by Eduardo Guilisasti Tagle took control of the company. Today, its principal shareholder, the Guisasti family, holds a 26.69% stake. Other shareholders include Chilean and foreign mutual funds and insurance companies. Many regard Concha y Toro as a family business since the four Guisasti brothers work for the company.

Concha y Toro's passion for creating fine wines has led to steady international recognition. The excellence of Don Melchor and Amelia has been complemented by high rankings and extraordinary international reviews of its Terrunyo, Marqués de Casa Concha and Trio lines. In addition, growing preference for Casillero del Diablo -- a truly global brand - has translated into sales of two million cases worldwide

In October 1994, Concha y Toro was the first winery to trade shares on the New York Stock Exchange. Another milestone came in 1997 when the company created a joint venture, Viña Almaviva, with Baron Philippe de Rothschild to produce a category wine equivalent to the French Grands Crus Classés.

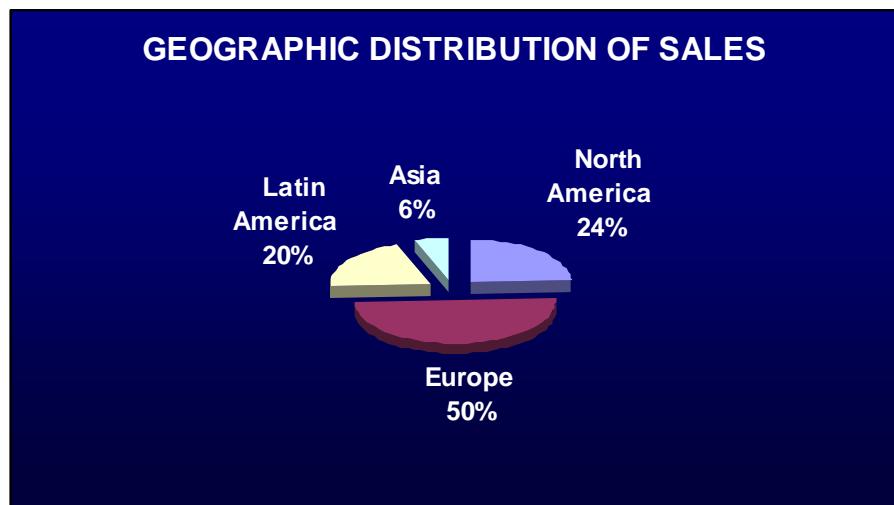
Since 2006 the company has been part of the "Consorcio Tecnológico Empresarial de la Vid y el Vino, Vinnova", comprised of others companies in the industry associated with "Viñas de Chile" and local universities, Universidad Católica de Chile (Santiago) and Universidad de Concepción. Through these institutions the company has channeled research into the fields of agriculture and enology. Also, the National Commission for Scientific and Technological Research of Chile (CONICYT) Fondef project "Water management technologies for sustainable intensive agriculture" remains up to date. The initiative aims to improve current irrigation practices by taking corrective measures to optimize water and energy usage and thus develop advanced, sustainable and efficient management of agriculture.

Company growth is based on the following fundamentals: development of a wine portfolio with very well-positioned brands in each price category, and strong past and

ongoing investment in brand construction. The Don Melchor and Marqués de Casa Concha brands are renowned for their outstanding quality while Casillero del Diablo global brand is widely recognized as a best value wine in the premium category.

In 1995, when Prudential Securities was initiating coverage of Concha y Toro as a publicly traded company, it noted that the Chilean winery, if it were not as small when measured by market capitalization, would be a member of the "nifty fifty" global companies that includes Coca-Cola, Gillette, and McDonald's. As Prudential observed: "The company's fundamentals encompass all of those requirements necessary to qualify as one of the 'nifty fifty'. A company's business has to be conducted on a worldwide basis and have a strong presence, both in terms of sales and profitability, in both *mature* and *emerging* markets. We believe that Concha y Toro's fundamentals are developing in a similar fashion to those of this elite group."³

Going Global



In the 1990s, the company made a strategic decision to increase its export revenues. An ambitious investment plan was implemented, including vineyard expansion, increasing operational capacity, and state-of-the-art winemaking technologies. Company growth was based on the development of a wine portfolio with well-positioned brands in each price category supported by strong ongoing investment in brand construction. The result was

³ Concha y Toro: Small Cap Research, Prudential Securities, 22 December 1995.

strong global brand awareness and high rankings for wines such as Don Melchor, Marqués de Casa Concha, Amelia, and Casillero del Diablo.

The export strategy has focused on market diversification. In 1990 the Company exported to 37 countries; today it is present in 115 countries with a clear leading position in highly competitive markets such as the United States, Britain, Canada and Japan. One of the company's main achievements in the recent past years was its growth in the European market, with shipments increasing over the previous year.

The company began operations in Argentina in 1996 by establishing Trivento Bodegas y Viñedos, which today is the country's second largest export winery in terms of volume. Investing in the premium wine category, Trivento launched Amado Sur, matured for eight months in oak barrels and then six months in bottles. The Trivento Golden Reserve 2003 was awarded the gold medal in the China Wine & Spirits Competition and was rated with 91 points by the U.S. magazine *Wine Enthusiast*. Trivento Reserve Syrah 2005 won a silver medal at the London International Wine Challenge 2006, while Trivento Reserve Cabernet Malbec 2004 and Trivento Reserve Syrah 2004 won gold and silver medals respectively at the China Wine & Spirits Competition. In 2006, Trivento sales were approximately US\$33-million, or 8% of the company's consolidated revenues.

Concha y Toro's exports to the United States totaled US\$48 million in 2007, a volume decline that could be attributed to price increase. The company's brands Marqués de Casa Concha, Don Melchor and Casillero del Diablo are particularly popular in the United States. Europe represents almost 50% of the company's total exports, amounting in 2006 to 5.5-million cases and generating roughly US\$125-million in revenues. Increasing revenues in Europe have been driven largely by growing demand in Scandinavian countries, Eastern Europe and Britain. While growth in the United Kingdom was 5.8%, on the continent, volume sales increased by 17.5%. In Russia, the company's Sunrise brand is a top seller. Finally, in Asia the company posted a 14.7% volume increase, especially in China and Singapore. In Japan, its Frontera brand is popular.

The company's market diversification strategy has been key to overcome specific obstacles that may appear in a given country. The company's strength in foreign markets is also the result of decades of work dedicated to building strong sales relationships with

distributors in each country. It has opened its own distribution office in Britain and sales offices in China and Brazil.

The company created the Viña Cono Sur subsidiary in 1993 as a response to increasing global demand. Sold in over 50 countries, it is one of the best-selling Chilean wine brands in Britain. Another subsidiary contributing to the company's growth, Viña Maipo, is well-positioned in Europe, Asia and Latin America.

Facing a highly competitive international environment, in 2006 Concha y Toro launched a worldwide campaign in over 21 countries of Europe, Latin America, the United States and Canada to sell the Casillero del Diablo Cabernet Sauvignon 2005. The British magazine, *Decanter*, ranked it as the world's "Best Value Cabernet Sauvignon". It also received the International Trophy for "Best Red Blend Under £10" at the 2006 Decanter World Wine Awards. This award marked Casillero del Diablo as the best competing Merlot in its category.

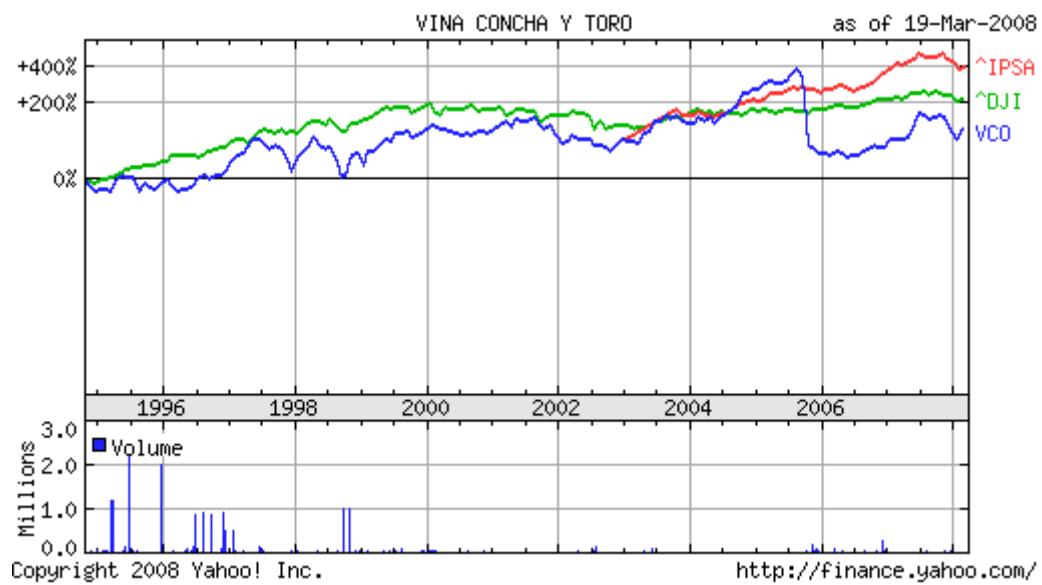
The success of the company's global growth strategy can be summed up with the following figures: since it began its internationalization in 1990, the company's exports have grown twenty-fold -- in 2006 totaling US\$251-million with a record 11.5-million cases.

Looking Forward

Going forward, Concha y Toro executives are betting on brand success. The company is seeking to sustain growth rates and achieve a greater brand penetration in its different markets by offering a wide range of products at competitive prices. In late 2007, investment analysts believed that Concha y Toro's growth would depend on its export business, especially by marketing its flagship brand "Casillero del Diablo".

The company's success has also been due to long-term vision, solid relationships with distributors, and a firm determination to compete with the best French, North American and Australian wines.

Exhibit 1: Concha y Toro's Stock Performance vis-à-vis the Dow Jones and the Chilean stock exchange indexes



VCO = Viña Concha y Toro trading at the New York Stock Exchange

[^]IPSA = Bolsa de Chile Index

[^]DJI = Dow Jones Index

Politec¹
Brazilian IT Services with Global Reach²

In a highly competitive environment, Politec has, transformed and, in some cases, reinvented itself in order to keep up with the rapid changes in the high tech sector from a local to a global services company. Seizing opportunities to expand and acquire new technologies as well as knowledge to drive revenue growth. The company offers lower prices, tailoring to fit products and services portfolio, own delivery global model and world-class technology to its clients.

Introduction

"Our ability to work fast, coupled with investments in technology and training, has allowed us to enter in the international market and maintain consistent growth."
-- Hélio Oliveira, CEO of Politec, 2007.³

Politec is the leading Brazilian Information Technology (IT) service provider with nearly 6,500 highly-skilled employees and 2007 revenues exceeding US\$270-million. The company's revenue growth averaged 10% to 15% from 2000 to 2007.

In 2006, *Business Week* ranked Politec second on Gartner's list of the world's top 15 "Emerging Outsourcing Players", which included companies from China, Russia, and Mexico⁴. In 2007, *Global Services* ranked Politec among the world's "100 Most Innovative Service Providers", 8th in the top 10 "Best Performing IT Services Providers", and 4th in its "South of the Border Leader" ranking.⁵ In addition, on September 2007 the World Economic Forum included Politec on its list of new "global growth" champions.

¹ The financial support of Orkestra, the Institute of Competitiveness of the Basque Country, for the development of this chapter, is gratefully acknowledged. The authors are grateful to executives at Politec for their cooperation with the preparation of this chapter.

² Carlos Arruda, Professor and Researcher on Innovation and Competitiveness, Erika Penido, Associate Researcher and André Almeida, Researcher at Fundação Dom Cabral, Brazil.

³ Interview with authors, June 2007.

⁴ *Business Week's* Emerging Outsourcing Players list for 2006 was, in ranked order: (1) Softtek - Mexico, (2) Politec - Brazil, (3) Bluem Inc. - China, (4) Neusoft Group Ltd. - China (5) BroadenGate Systems Inc. - China, (6) Freeborders - China, (7) Luxoft - Russia, (8) EPAM Systems, Inc. - Russia, (9) Ness Technologies Inc. - Israel, (10) ASCI S.A. de C.V. - Mexico, (11) Neoris - Mexico, (12) DataArt - Russia, (13) ITCI - Russia, (14) Venus Software Corporation - China, (15) DBAccess - Venezuela.

⁵ <http://www.globalservicesmedia.com>

Politec's products and services are focused on "system lifecycle" models -- from business analysis and requirement gathering to development, testing, integration, maintenance and transformation of solutions into client information systems. Politec has gained worldwide recognition for its innovative approach to developing, maintaining, and operating high-tech systems for large-scale clients in the banking and financial industries and public sector. The quality of Politec's work has been recognized by certificates such as the CMMI-5, ISO-9000, MPS-BR level A.⁶

The company has 16 technology centers and 20 branch offices in Brazil, as well as branch offices in the United States and Japan. Plans are under way for program management offices (PMOs) staffed by professionals representing the company in China, France, England, Germany, Belgium and India. Politec has expanded internationally in particular niches: biometrics, application maintenance, and integration services. It has also been expanding globally in other IT businesses such as offshore outsourcing, BPO and enterprise resource-planning (ERP) systems.

Still, Politec's international revenues represent less than 5% of its total sales. According to the company's strategic plan elaborated in 2007, its goal is to become a strongly-branded global firm with new products and services and total annual revenues of US\$500-million by 2012.

Global IT Services Industry

Most global IT service players provide consulting, data processing, technology outsourcing and systems integration solutions to business clients. More simply put, they help clients use their computer and communications systems and software more efficiently. IT companies recommend hardware and software systems and provide a variety of associated services, including business process outsourcing (BPO), data warehousing, systems planning, enterprise resource planning, and training.

The global IT outsourcing market is worth roughly US\$750-billion.⁷ In 2007 the top 10 global IT players, as measured by market capitalization, were in ranked order: Infosys Technologies (India) at US\$26.6-billion; Tata Consultancy Services (India) at US\$25.9-billion;

⁶ The company became CMMI Level 5 in 2005.

⁷ Gartner Dataquest, 2007. About 60% of revenues are generated by consulting and systems integration. Data processing and outsourcing contracts represent 40% of the outsourced market. Offshore outsourcing is a global trend that represents 10% of the

Automatic Data Processing (U.S.) at US\$24.7-billion; Accenture (U.S.) at \$23.5-billion; Mastercard Incorporated (U.S.) \$19.9-billion; Wipro (India) at US\$17.0-billion; Western Union (U.S.) at US\$16.5-billion; Paychex Inc (U.S.) at US\$15.2-billion; Redecard S.A. (Brazil) at US\$12.6-billion; and NTT Data Corp (Japan) at US\$12.4-billion. Some global players, such as U.S.-based Accenture, are pure consulting operations, while others provide outsourcing and data-processing functions.

The market is currently dominated by the United States, though the Asia-Pacific and European markets are rapidly growing. Emerging markets in Latin America, Eastern Europe, Middle East, and Africa are still relatively small but have achieved significant growth. India's IT services industry, in particular, has been experiencing surging growth – 27% in 2007 – with aggregate 2007 revenues (domestic and export) of roughly US\$48-billion⁸, or ten times revenues a decade earlier. India has produced some of the world's major players in the sector, including Infosys, Wipro, and Tata Consultancy Services (TCS).

Brazil's IT Industry

With some 280,000 employees and US\$11-billion in revenues, Brazil's IT industry compares favorably with India's US\$13-billion in domestic revenues. A comparison with India is pertinent, for Brazilian IT companies have been attempting to replicate India's success in the sector.⁹ This competitive emulation extends even to the anagram for Brazil's IT services industry association: BRASSCOM (Brazilian Association of Software & Services Export Companies) -- uncannily similar to India's NASSCOM (National Association of Software and Services Companies). Members of BRASSCOM, besides Politec, include CPM, Datasul, DBA, Itautec, and Stefanini. Another organization, Instituto Brasil para Covergência Digital (IBCD), is working to build Brazil's software and services export business. A number of major firms, including HSBC, Rhodia, and Motorola, have created captive development centers in Brazil to service themselves. Among the major global players in Brazil are IBM, Accenture, BearingPoint, EDS, Hewlett-Packard, and Unisys. IBM chose Brazil, along with China and India, as one of its top three global delivery hubs. Brazilian companies like Politec emphasize their creative approach as an important differentiating competitive advantage.¹⁰

outsourced IT services market and is growing by 40% annually. See also A. Bartels *Global IT Spending And Investment Forecast*, Forrester Research, Inc., 2006.

⁸ Roughly 80% of the revenues come from exports (and the US market counts for 80% of those exports) while the remaining 20% come from the domestic market. The sector employs 1.6 million people and represents about 5% of the Indian GDP.

⁹ The billing rates of Brazilian firms generally run higher than their Indian counterparts, though their labor inflation and attrition levels are lower than those of Indian firms.

¹⁰ N. Radjou, *Indian IT Providers Must Reinvent Their Innovation Strategies To Sustain Global Leadership*, Forrester Research, 2007.

The early development of Brazil's IT industry was partly facilitated in the 1970s and 1980s by soaring inflation, which forced banks to seek ways of processing large amounts of information quickly.¹¹ Besides being an attractive market for IT vendors, Brazil's other strengths are its political stability, telecommunications infrastructure, financial systems, extensive legacy skills, and competitive billing rates. Brazil also boasts competitive advantages from a cultural point of view. Corporate executives look for service providers from a similar cultural environment in order to improve results. Brazil, with its ethnically diverse population, is often seen as an attractive location because it offers cultural compatibility with various clients around the world. Compatibility with North American clients, for example, is facilitated by a common history of European colonization. Brazil's population of roughly 190 million moreover includes the largest Japanese community outside Japan, as well as large German and Italian communities. Brazil's central time zone location between the United States and Europe is also considered advantageous, while opposite time-zone from Japan reinforces the country's position as an adequate "night-shift" alternative for 24/7 activities with Asian partners. From a practical point of view, telephone and Web-conferencing between the United States and Brazil is more feasible due to time-zone compatibility.

Brazil also has gained considerable expertise in the global financial services industry. Most global banks are present in Brazil. The banking sector in Brazil is known for the sophistication of its transactional efficiency. For example, the vast majority of bank checks in Brazil are cleared electronically the same-day, while in the United States it takes one week on average. Brazil also enjoys the world's largest and most geographically dispersed ATM network with a higher number of functionalities.

There are nonetheless some negative factors. Brazil's IT sector, while robust, is still overwhelmingly domestic and exports of software and services remain minimal. Another competitive disadvantage, especially vis-à-vis Chinese and Indian firms, is Brazil's smaller scale in terms of qualified personnel and limited English-language competency. Also, the process and project competency of Brazilian IT firms lags behind that of competitors in other countries, as measured by the number and level of Capability Maturity Model (CMM) and

¹¹ W. Martorelli, *Brazil Emerges As An Offshore Destination*, Forrester Research, Inc, 2006; and D. Farrel, M. Laboissière, and B. Pietracci, "Assessing Brazil's Offshoring Prospects", *The McKinsey Quarterly*, Special edition: *Shaping a New Agenda for Latin America*, 2007.

Customer Operations Performance Center (COPC) certifications. Total certifications range in the dozens in India and China, while the number of CMMI Level 5-certified companies in Brazil can be counted on one hand. Local firms are expanding their CMM programs, and may get a boost from recent entry of Indian firms in the Brazilian market. Tata Consultancy Services, for example, is present in Brazil through a deal with global banking group, ABN AMRO, recently acquired by Spanish bank Santander. TCS is training more than 270 employees of ABN AMRO's local affiliate, Banco Real, in CMM disciplines; and after one year, the employees can join local Brazilian suppliers. Customers and suppliers are hoping that TCS process competencies will rub off on local suppliers and benefit the entire industry.

Another competitive disadvantage is relatively limited government support. The Brazilian government's support of domestic IT firms does not match the level of state backing from which India's IT exporters benefit. In Brazil, there are still high import duties on externally manufactured goods. Also, taxes in general are relatively high and export tax credits are not lavish compared with Indian levels.

Politec Past & Present

Founded in 1970 by current Chairman Carlos Alberto Barros, Politec began as a mainframe processor working on banking accounts, accounting systems and payroll data. That business vanished, however, when the advent of microcomputers allowed client companies to internalize these functions. Anticipating change in the market, Politec discovered an opportunity when large Brazilian banks, which were going through downsizing, began outsourcing data entry, digitalization and document scanning. The pool organized to service Brazil's banks included firms with a largely regional presence. Brazil's centre-west was Politec's target.

At that time, the company's three shareholders, Mr. Barros, Mr. Hélio Oliveira – current CEO – and Mr. Newton Alarcão – Politec's delivery model and technology expert on the Board of Directors – redefined business models, establishing new processes and facilities to cope with the challenges.

Politec also started looking for other regions to service. One of the first significant accomplishments in its southwest expansion was when the Brazilian FGTS¹² was migrating from paper to electronic control. Politec and three international firms were hired to meet a scanning demand of around 400 million forms. Politec allocated 600 people in a nine-story building in Rio de Janeiro, where the company had identified an advantage for hiring employees. After scanning and interpreting the documents, Politec managed to deliver the entire service in only 90 days, well ahead of the other companies. One of them, in fact, subcontracted its quota to Politec at the request of the client.

Another of the company's scalable niche service relies on the ability to work with huge amount of information, leading to achievements in the financial industry and also in census data. In Brazil, the company automated the country's demographic census in 2000, then the second-largest electronically processed census worldwide after the U.S., reducing the time needed for data collection and input processing from three years to three months.

When technology advances rendered digitalization services obsolete, Politec was forced to reinvent its business again. This time, its strategy focused on providing short-term IT services, which for corporate clients was a lower-cost solution than hiring in-house IT specialists. Politec's business of lending specialized human resources, initially a temporary business strategy, became more ambitious as contracts increasingly required continuity. As telecommunications improved, these services were transferred from the clients' premises to Politec's own facilities, which were spreading throughout Brazil. From that point, the company began offering a broad range of IT services such as software houses that predict diverse levels of CMM certification, with clients in all Brazilian states being serviced by the current 16 technology centers from North to South. Politec also learned to manage human resources in a differential and efficient manner, tapping specific talent pools in multiple parts of the country, and developed strong logistic capabilities which would become crucial to the firm's core competences.

"We have an excellent know-how in terms of logistics and talent management" said Humberto Ribeiro, Politec's executive vice-president. "We can quickly form a project team with the right profile for the service."¹³

¹² FGTS is the compulsory saving scheme which represents 8% of all employee salaries. The FGTS fund is centrally managed by the public bank Caixa Econômica Federal, but all commercial banks have the authority to collect payments made by employers.

¹³ Interview with authors, June 2007.

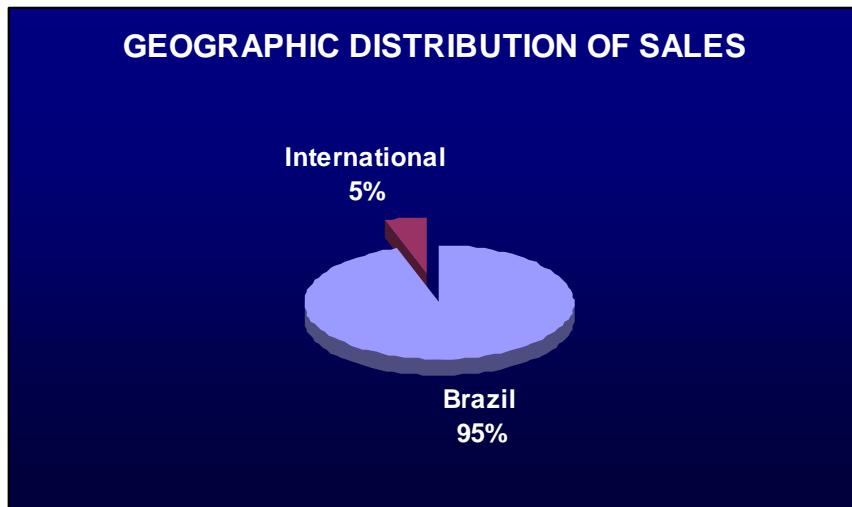
Politec has forged alliances with major technology providers and global IT companies to drive revenue growth. "Partnerships are in Politec's DNA," said Ribeiro. Partnerships involve commercial operations (representation and distribution) and production. In some cases, Politec searches for partners to complement its expertise and increase productivity. Some partnerships include know-how exchanges, while others help Politec penetrate new markets. A recent example highlights Politec's partnership strategy as a factor of differentiation: the national pilot project of electronic invoices developed in partnership with Oracle and the government of the Brazilian state of Goias.¹⁴ It hopes to revolutionize the way business is done in Brazil thanks to the use of e-invoices, which will speed transaction processing. Politec's partnerships today include leading technology providers such as AccesStage, CDI, Computer Associates, IBM, Iridian Technologies, IT Frontier, LG Electronics, MC1, Microsoft, Neusoft, Oracle, Panasonic, RCG, SAP, Staffware, Sun Microsystems, and TIS. One of its most recent partnerships was forged with an IT company from Israel to develop a sophisticated image-recognition system and optical character recognition (OCR) to be used by major banks worldwide.

Politec ultimately decided to focus strategically on building long-term relationships with a limited number of large-scale clients requiring a broad range of application lifecycle, ERP and BPO services. Politec today counts around 100 clients, including eight of the ten largest banks operating in Brazil. Among those, two institutions -- Banco do Brasil and Caixa Econômica Federal -- together accounted for more than 50% of Politec's revenues in 2006. ¹⁵ Politec is involved with more than 65% of all technology-related products and services used by these two banks.

¹⁴ Brazil is a federal system divided into 26 states plus a Federal District. The state of Goias is located in the centre-west. The Brazilian fiscal system is divided into municipal, state and federal taxes. B2B transactions involve federal (industrial taxes - IPI) and state taxes (VAT equivalent - ICMS). Services taxes are under municipal councils. Electronic invoices for full implementation will require the integration of databases and systems at all three levels as well as in each enterprise.

¹⁵ The 2006 adjusted net profits of the largest Brazilian banks were as follows: Banco do Brasil (US\$2.7-billion); Bradesco (US\$2.4-billion); Itaú (US\$1.3-billion); Unibanco (US\$771-million); Real (US\$724-million); Caixa Econômica Federal (US\$1-billion); Itaú BBA (US\$439-million); Votorantim (US\$432-million); Safra (US\$347-million); Santander Banespa (US\$333-million).

Going Global



"After 30 years, the Brazilian market became small for us."
– Hélio Oliveira, CEO Politec, 2007.¹⁶

Towards the end of the 1990s, when Politec was growing domestically by 15% to 20% a year, the company realized it would be difficult to maintain this growth rate if restricted to Brazil. In 1998, the company opened an office in the United States. Besides hoping to replicate its domestic success in North America, the company's main objective was to identify and access innovative technologies, as well as to gain knowledge in the world's most advanced IT market.

The overall context for this strategy was not favorable, however, especially after the Internet meltdown in 2000. The company's first years of expanding abroad were not easy. "It took us a long time to realize that the competition outside could not be based only on lower prices," recalled Oliveira. The market retraction meant that Politec had to tailor its product and service portfolio to U.S. market demand. The company therefore decided to offer customized solutions in the U.S. market by leveraging its expertise in information security, which it had acquired while servicing large Brazilian banks and public sector institutions.

Pursuing this strategy, Politec expanded into the United States through acquisitions. In 2000, it acquired Washington-based Sinergy, a pioneer in iris-recognition technologies.

¹⁶ Interview with authors, June 2007.

This acquisition brought new technologies into Politec's existing base and strengthened, by the database management systems of its partner Computer Associates, it won contracts to provide security solutions for U.S. government departments. In the U.S. health care industry, the company provided iris-recognition systems to Washington-area hospitals required by law to adopt privacy and security standards in order to protect individual health information.

The September 11th tragedy in 2001 created a business opportunity for Politec when demand soared in the United States for security services and systems. Politec's iris-recognition system, for example, was used at the Washington D.C. hospital, Children's National Medical Center, which was treating the victims from one of the hijacked planes that crashed into the Pentagon. The excellent performance of this technology led to the adoption of Politec's technology in all major hospitals in the Washington area. The company thus became an expert in the implementation of regulation-compliant solutions and established a partnership with Keyware, one of the world's leading providers of biometric and centralized authentication solutions. Also, Politec's technology was adopted by the FBI and 70 American embassies. The company was soon competing successfully in the United States in a high-tech niche with solid growth potential. Its U.S. office, counting some 50 employees who service 10 clients, generated roughly US\$2-million in revenues. Its foreign subsidiary, however, was not able to sell offshoring solutions to the market at the time. This gave Politec an incentive to expand beyond the United States.

When Brazil's federal government announced a new industrial development policy aimed at boosting IT and software exportation, Politec was well-positioned to take advantage of this initiative. In 2004, Hélio Oliveira invited former Politec partner Humberto Ribeiro, a young entrepreneur who in the 1990s had launched a successful e-procurement platform (www.superobra.com), to join the company as Chief International Officer with the mission to elaborate and implement the company's internationalization strategy. Ribeiro's "Global Reach" strategy was driven by quality improvement, productivity, visibility, and globally competitive pricing. Beyond traditional certifications -- like CMMi-5 -- the project involved initiatives for global diversity within a client-driven mindset.

After a careful analysis of market opportunities, Politec chose four target markets: United States, Japan, China, and Europe. As part of its global strategy, the company was present at all the main international IT industry events. According to Ribeiro, the main criteria for selecting a market were the company's ability to offer a significant cost reduction

to clients, affinity of the markets with the company's differential know-how in the banking and public sectors, and lack of local scale in terms of skilled human resources.

First, in the United States with its consolidated offshoring tradition, Politec planned to offer risk-mitigation to US clients already and only serviced by companies from India, adding-up the advantages of greater geographic and cultural proximity as well as banking and technological expertise. The company adjusted its approach to the U.S. market by amplifying its portfolio services beyond security solutions and incorporating "nearshore" outsourcing services, thus leveraging the advantages of Brazil for IT services and BPO. Second, in Japan the company aimed at leveraging cultural affinity derived from the large Japanese community in Brazil. From 2004 to 2006, the company targeted some of the largest Japanese corporate groups. Senior Politec executives flew from Brazil to Japan almost every month. Negotiations were slow, complex and rich in dinners and *sakes*. The result was an incrementally growing process of mutual trust and confidence building. Two of the potential clients -- Sumitomo and Mitsubishi -- signed small, but highly significant, contracts for systems for its SAP platforms and trading businesses. In 2005, Politec set up a Japanese office managed by a Brazilian executive with Japanese origins. Third, European cities were targeted, Frankfurt, London, Milan because of their highly sophisticated financial markets, and France because of the aerospace industry.

Finally, for its entry into China the company took into consideration the enormous influence of the Chinese state on both private and public institutions. China's membership in the WTO in 2001 required the country to make reforms and open up the financial and other key sectors. At that time, Chinese banks were using outdated IT technology that was 10 to 15 years behind the latest processes and practices deployed in Brazil. Politec's analysis also revealed that the Chinese government needed to make significant investments to update its IT systems in order to cope with high economic growth and the expansion and integration of its fiscal and governance systems. After making this assessment, Politec focused on China's four largest banks as well as some Chinese government departments.

"We can't stay out of the Chinese market, because the main movements of the industry are there, but the window of opportunities is short," said Ribeiro. "The players who don't establish themselves there in the next two or three years will be out. Just like in other

sectors, the Chinese people quickly assimilate technology and begin to compete in the same market and try to take our clients.”¹⁷

Politec’s portfolio is differentiated globally so it can respond to demand and requirements of each local market. However, each portfolio is based on solutions defined for Brazil and on the personalized delivery models that Politec adopts in all its activities. With a constant emphasis on innovation aimed at leveraging long-term client relationships, Politec’s portfolio additions include the creation of two companies within the Politec group: Governance Technology and Politec Consulting Services (or “Polics”).

Governance Technology, founded in 2006, is a vehicle for Politec’s expertise in assisting the financial sector to meet Basilea II risk management rules, and private sector clients with auditing and compliance solutions (like SOX compliance). Governance Technology is also emerging into international markets, including the United States and Japan, with services such as corporate governance, audit, internal controls, compliance and risk management.

Polics, created in 2005 to respond to market demand in Europe, where Ribeiro and his team made a number of visits to make contact with potential clients in the financial sector. After a first round of contacts it was clear that the European market had a specific need: support service for the implementation of SAP. Since this service was outside of Politec’s existing portfolio, the company decided to establish Polics totally in line with SAP in Germany. Polics’ market penetration in Europe meant that Politec’s expansion on the continent had to take a back seat while its subsidiary entered the market. In Brazil, Polics looked for opportunities among public and financial institutions already serviced by Politec. Polics’ success facilitated its expansion into the United States. In 2008, Politec was scheduled to open a Polics subsidiary in Atlanta to service the American market.

Politec has expanded opportunities for its more than 6,500 collaborators thanks to digital infrastructures such as its own Global Delivery Model, which allows fast and transparent relationships between its clients and collaborators worldwide. It can also consolidate the existing business knowledge spread throughout the organization within Politec’s knowledge-based corporate portal. These activities, along the ongoing technical,

¹⁷ Interview with authors, June 2007.

business and foreign-language education, empower Politec's talent base going forward and optimize the involvement of each professional in company projects.

Still, Politec's internationalization has not been easy. For one thing, the company has to struggle with the image of Brazil as a commodities exporter, not a high-tech powerhouse. There are moreover persisting doubts about a Brazilian company – whose national image is associated with notions related to its Carnaval and World Cup soccer matches – operating in a high-tech, high-value-added sector. Politec executives consequently have found it challenging to create a corporate culture with a truly global orientation. “When we began the Global Reach strategy, it was very difficult to convince our employees that they worked for a multinational company,” said Ribeiro “Politec’s human resources still need more tangible examples of successful talented people from the company who have reached outstanding success in foreign markets.”¹⁸

Indeed, by 2006 Politec’s international expansion fell short of what had been hoped. When the Global Reach strategy had been initiated in 2004, exchange rates (R\$3.40/US\$) were very favorable for Brazilian exporters. However, a significant appreciation of the Brazilian currency vis-à-vis the U.S. dollar began in 2005 -- reaching R\$1.73/US\$ as of November 2007 – and the result was negative for Politec’s cost competitiveness in international markets. In addition, structural problems in Brazil -- especially a lack of qualified people in the domestic IT industry -- erected barriers to Politec’s internationalization.

In order to compete with Indian-based IT companies, Politec has accelerated its internationalization process by opening branches in countries with cheaper costs. In 2006, it announced a joint venture with Chinese-based Neusoft to open a software house in China, planned for 2008. Politec predicts investments in China of US\$2-million in the first year of the joint venture beyond the \$3-million already invested. As one Politec executive put it: “We will transfer to China the knowledge that we generated in Brazil, especially in the banking sector.”

Crucial to Politec’s expansion plans in China is the recognition of its capacity to offer differentiated solutions for the populous country’s 2010 census. Using expertise developed in Brazilian census data-processing, the company impressed China’s National Bureau of

¹⁸ Interview with authors, June 2007.

Statistics despite legal restrictions that inhibit international companies from gaining access to, and working with, sensitive data in China. In order to win this contract, Politec and the Brazilian government must convince Chinese policymakers to remove this legal obstacle. The company hopes that the Brazilian government officials include this condition in the negotiation package as part of the Brazilian recognition of China as a market economy.

Looking Forward

Politec has elaborated an internationalization strategy to improve its investment capacity and reduce its overwhelming exposure to its domestic market – a common theme among Global Latinas. The company has also moved into foreign markets – either through joint ventures or acquisitions – to gain know-how and access technologies that have helped its own business growth.

Since 2005, Politec has been preparing itself either for an IPO to raise financing through public markets, or for a strategic investor to add this financial capacity as well as other market or technological access. Either way, the company would inevitably undergo a transformation imposed on all publicly traded companies. At the same time, its improved financial position would give Politec sufficient cash resources to make strategic acquisitions to acquire know-how, build its client base, and compete with global players from India, the United States and elsewhere.

Politec is emerging as an important player in a high-value-added sector with tremendous growth potential. Going forward, the strength of medium-sized players like Politec will be assessed according to how well they compete with much bigger companies from India and the United States. Indeed, Politec faces numerous challenges, especially in China, where opportunities are big but the non-technical barriers are even bigger. In Japan, too, it remains to be seen whether pilot initiatives grow to their full potential. Attention should also be paid to the domestic market, as more global competitors -- especially from India -- are making forays onto Politec's home turf. How will the market react to the growth in Brazil of Indian competitors? How will Politec adjust its flexibility, partnership and cost competencies to deal with international competitors in its dominant market? Finally, how will Politec sustain its international strategy as a public company? What are the potential implications of the changes in ownership and governance to the firm's Global Reach Strategy?

While Politec has yet to emerge as a Global Latina, it is definitely a Latin American firm to observe given its global ambitions and its strong positioning in the IT services sector.

Conclusion

This report began with three basic questions that inspired our research and findings. First, we asked: *Why have Latin American firms emerged and expanded beyond their own regional markets?* Our second question was: *What strategies did they adopt to expand their operations?* And finally, we asked: *What are Global Latinas' unique characteristics that differentiate them from multinationals corporations from developed economies?*

We have differentiated Global Latinas from "Multi-Latinas" or "Trans-Latinas", which have already been studied as firms with operations extended within Latin America. This report has focused on a sample of selected firms whose ambitions have gone beyond Latin American markets. As noted in the Introduction, we have largely relied on *qualitative* analysis using case studies. Our analysis has focused on firm internationalization, coinciding with the liberalization policies that were sweeping through the region during the 1990s.

In these concluding observations, we will attempt to summarize our findings by providing answers to the three questions we posed at the outset.

I. Why have Latin American firms emerged and expanded beyond their own regional markets?

On a macro level of analysis, Latin American firms that have emerged as Global Latinas, generally, were those which successfully reacted and adjusted to external pressures, both positive and negative, that tested their survival instincts and innovative capacities. Indeed, there was no shortage of political/economic volatility to test the mettle of these firms.

As we have seen, the region's industrial sectors historically benefited from direct state support and import substitution policies which in the short term produced high growth rates but, at the same time, maintained relatively closed and uncompetitive markets. High commodity prices, especially in the 1970s, further boosted domestic growth rates. This situation changed in the early 1980s when oil prices fell and Mexico's debt crisis provoked currency devaluation and forced the government to end import substitution. Further pressures towards liberalization came with the GATT agreement in 1985. Suddenly long-protected Mexican firms, faced the prospect of head-to-head competition with global giants, were forced to improve their operations.

The most severe challenge came in the 1990s with sweeping liberalization policies as Latin American governments responded to external pressures – notably from the IMF – to deal with economic crisis. The end of state protections, and the threat of competition from bigger global players on their home turf, meant that Latin American firms had to retool and adjust to a new competitive environment because their own backyard was under threat.

These lessons, while difficult, taught Latin American firms to navigate through turbulent waters as a matter of survival – and, as a result, learnt to manage risk and seize opportunities as opposed to foreign multinationals who often abandoned emerging markets during crisis. Some, as we have seen, shed their conglomerate baggage to focus on core competencies to exploit competitive advantages in a single sector, while most of them locked down a dominant position in their domestic markets to sandbag potential incursions by foreign multinationals. CEMEX, for example, made two strategic acquisitions in Mexico in the late 1980s out of fears that its major rivals Lafarge and Holcim would soon be invading the domestic market. CVRD followed a similar logic when it rolled up the Brazilian mining market at the beginning of the 21st century. When these firms began expanding throughout Latin America, they had the benefit of a deep understanding of markets dynamics in the region, and therefore possessed solid advantages against foreign multinationals with less experience selling to low-income consumers and dealing with complex regulatory environments in Latin American countries.

The same economic volatility also presented timely acquisition opportunities as foreign multinationals withdrew from a region which they regarded as too risky. Opportunistic buying of their assets left behind is a major theme for many of the firms studied in this report. The shrewdest among them have pounced quickly to pick up local assets sold off by American and other foreign corporations beating a retreat from a region in turmoil. América Móvil, most notably, has been a calculated acquirer of distressed assets of telecom giants like AT&T Latin America, MCIWorldcom (the long distance Brazilian Embratel), Verizon Dominicana and the Brazilian assets of BellSouth. Petrobras, too, has put together a network of retail gas stations in South America thanks to divestitures of giant corporations like Shell and Exxon. These examples show how a crisis, while challenging in some respects, can quickly become an opportunity for Latin American companies as they expand their operations armed with the benefit of know-how in facing similar market challenges.

Another macro factor that presented major challenges and opportunities was NAFTA, which in 1994 opened up international markets (especially the United States) to Mexican firms. It is no coincidence that Bimbo's expansion into the United States occurred in the years immediately following NAFTA in the last half of the 1990s. CEMEX, too, made major acquisitions in the United States – notably the Southdown deal in 2000 – during the same period following bitter pre-NAFTA experiences in the American market due to trade disputes. Extended liberalized trade with other Latin American countries, such as Chile, has similarly opened up the huge U.S. market to their products.

The over-arching context of economic turbulence in the 1980s and 1990s taught Latin American companies a valuable lesson: internationalizing their operations was a good hedge against economic and political uncertainties at home and reduce risks associated with domestic currency devaluations. This was particularly the case for companies like CEMEX, which needed stable cash flows and ready access to financing to drive its acquisition-based growth strategy. As we have seen, CEMEX structured all its non-Mexican assets under a Spanish-based subsidiary for reasons of fiscal and financing expediency. For such companies, generating revenues in US dollars protects them from holding cash in local currencies subject to hyper volatility.

Since 2002, high commodity prices combined with strong demand from emerging markets like China have triggered a surging economic boom in Latin America. Players such as Petrobras and CVRD have benefited from robust cash flows thanks to soaring prices for oil and minerals, while consumer firms like América Móvil have benefited from strong consumer demand in the region. Brazilian firms in our sample seem to have been quicker to take advantage of the “rising China” phenomenon than Mexican firms. This can be explained, obviously, by the fact that large-scale Brazilian firms are strongly positioned in the natural resources sector and therefore have a more global outlook in the extractive industries.

Indeed, beyond macro-level drivers we can also identify some *sector-level* factors. Large-scale firms in the extractive industries must internationalize their operations – often through global partnerships to reduce risk and leverage expertise – in order to explore for oil, gas, and minerals and to account for depletion. Energy and mining companies are, by definition, resource-seeking firms and consequently they must go to where the hydrocarbons and mineral deposits are located. This sectoral logic drives them to expand globally – though,

as we have seen with Petrobras, setbacks in the Middle East prompted the company to return to more familiar and less risky projects in Latin America and the Gulf of Mexico. Companies like CEMEX must also go to where its markets are located as it is too costly to export cement over long distances. Manufacturing firms like Embraer are also driven by a sectoral logic in an industry that is structured around global partnerships to offset risks in the production of aircrafts.

It might also be added that the overall Pan-Latin American market, when compared with the huge populations of Asian countries, is relatively small when social-economic factors like poverty levels are taken in to account. This has meant that, if Latin American companies seek to grow – with the possible exception of Brazilian firms with a larger domestic market – they have had little choice but to expand internationally.

II. Why have Latin American firms emerged and expanded beyond their own regional markets?

The major theme common to the firms studied in this report is their motivation to expand first into their “natural” markets in Latin America and the geographically proximate United States. This is particularly the case with mass consumer and service firms with products to sell directly to clients such as América Móvil, Bimbo, Concha y Toro, Pollo Campero and Astrid & Gastón, whereas firms in resource extraction (CVRD, Petrobras), heavy industry (CEMEX), industrial manufacturing (Embraer) and high-tech (Politec) have been driven, more by *resource-seeking* and *asset-seeking* strategies.

Therefore, where Latin American multinationals have been driven by *market-seeking* strategies, we can observe a clear preference to move into “natural” markets first. The “natural” market clearly has been a strategic stepping stone to and training ground for global expansion. However, there has been a tendency to establish a solid position in the “natural” market and not pursue global expansion with the same determination. In this latter category, we would include América Móvil and Bimbo, both of which have yet to establish a significant presence beyond the Americas. Natura, too, has mostly been contained in its domestic market in Brazil and a modest presence in other parts of Latin America.

Many of the firms studied have expanded internationally to *gain know-how*. Faced with a post-liberalization reality that they lacked competitive advantages, they actively sought to integrate know-how and expertise through acquisitions or partnerships. The process became a virtuous circle in which companies, when they expanded internationally,

learned, reintegrated their knowledge and replicated it through the company. A good example of this is Politec, which was forced to reinvent itself a number of times as the information technology business rapidly transformed. When the company bought an iris-recognition firm in the United States, it was not targeting a company whose operations could be merged into its own. On the contrary, Politec was buying a company with know-how and innovative expertise in a niche about which it knew nothing and opened up a new business opportunity for them. Likewise, Bimbo bought a candy factory in Germany to gain knowledge from the firm's expertise. And Embraer established partnerships in order to gain knowledge about plane manufacturing that it later used for its own operations. In short, the innovative capacities of these firms have sometimes been internal, but in other cases they have expanded internationally precisely to find and acquire innovative capacities.

III. What strategies did the Global Latinas adopt to expand their operations?

Concerning internationalization strategies, a major key to the success of many of the firms in this report has been a decision to focus on, and build competitive advantages in, a *single core business*. CEMEX, made a strategic decision to shed all its conglomerate baggage to transform itself into a cement colossus in the global construction industry. In Brazil, Embraer made a make-or-break decision to focus its manufacturing efforts on medium body business jets. Petrobras, too, brings recognized expertise in deep-water drilling to its international oil exploration partnerships; and CVRD, while diversified in mining, cornered the global market in iron ore extraction. The other companies studied (América Móvil, Astrid & Gastón, Bimbo, Concha y Toro, Natura, Politec, Pollo Campero) are all focused on a single line of business. They all do one thing exceptionally well, with a high premium on operational efficiency, and from the combination of focus and efficiency gain competitive advantages to compete globally.

Virtually all of the firms in this report expanded throughout their domestic markets *organically* through Greenfield activity, while international expansion has been driven largely by *acquisitions and/or joint ventures*. They moreover have frequently met with failure at the outset, and learned from their early unsuccessful attempts to internationalize. Also, expansion has tended to focus initially on "south-south" investments in neighboring countries ('natural markets'), before moving in to "south-north" expansion into developed economies.

Firms of the mass consumer and service sectors where, brand leveraging and a direct relationship with consumers are important – Natura, Bimbo, Pollo Campero, Astrid & Gastón, Politec, Concha y Toro - generally have not benefited from the same state backing and linkages to government preferment as the companies in mining (CVRD, Petrobras), heavy industry (CEMEX), and telecommunications (América Móvil) where business activities are more often related to national industrial goals.

The companies with the strongest global presence are those which have been prepared to pursue strategies based on deliberate takeovers of leading global players. CEMEX's purchase of the British firm RMC in 2005 and the Australian Rinker Group in 2007, as well as, CVRD's takeover of Canadian nickel giant Inco in 2006 were major acquisitions on a global scale that surprised the financial world and their respective sectors, who did not expect a Global Latina behind the deal. Bimbo has been less audacious in its acquisition strategy, which may explain why its international presence is not as diversified as that of CEMEX and CVRD. Bimbo is largely limited to Latin America and the United States, with only a minor presence in China. Likewise, Natura has missed opportunities to establish itself as a global player – notably, when it balked about a possible takeover of the Body Shop, and ended up watching L'oreal buy the company. América Móvil, too, failed in its attempt to buy a global player in Europe – Telecom Italia. One constraint that many of these firms will have to surmount is their fairly conservative attachment to liquidity, a persistent symptom of their long experience with volatile economic environments. To expand globally, they will have to show more willingness to deploy cash and buy major assets in order to consolidate market position globally.

Finally, the “emerging” Global Latinas in this report have shown a tendency to internationalize their operations quickly for medium-sized firms. Most of these companies did not wait to have dominant position in their domestic market before going abroad with their products; they tend to see the global marketplace as a natural extension of their expansion strategies. The only possible exception to this is Natura, which benefited from import substitution policies in Brazil and thus delayed its internationalization. Also, there is a strong tendency among these emerging Global Latinas to expand through Greenfield investments, unlike the acquisition expansion strategies that characterize much of the expansion moves of the bigger firms elsewhere in the report.

IV. What are Global Latinas' unique characteristics that differentiate them from multinationals corporations from developed economies?

Most of the large-scale firms from the region have emerged from the two most populous countries, Brazil and Mexico. These two countries, although similar in some respects, have cultural and geographical differences. Brazil is a Portuguese-speaking melting pot and occupies almost 50% of South America. Mexico is Spanish-speaking and shares a border with the United States that extends more than 3,000 kilometers. Not surprisingly, Mexican multinationals in our sample have shown a much stronger interest in the American market, encouraged by NAFTA, than Brazilian firms. The Brazilian cosmetics maker Natura, for example, has virtually no presence in the United States, though its U.S. competitor Avon is a major player in Brazil. Brazilian firms have generally preferred to expand into South American countries (Mercosur), Europe and Asia. Although an analysis of trade patterns were beyond the parameters of this report, it is interesting to note that, as of the end of 2006 while more than 85% of the Mexican exports go to the United States, Brazil has a more diversified pattern of exports. Only 20% of Brazilian exports go to the United States, 8.5% to Argentina, 4.5% to the Netherlands and 6% to China.

Brazil clearly has a more identifiable tradition of supporting state-backed "national champions" than Mexico. The major Brazilian firms examined in this report -- Embraer, Petrobras and CVRD -- have been vehicles of national champion industrial policies guided by state goals of independence and self-sufficiency. It can even be said that Brazil's current industrial focus on the burgeoning biofuel market is an extension the same legacy of government industrial policy. We would not wish to overstate this distinction, because indeed Mexican industrial conglomerates benefited from import-substitution policy and privatized firms in many respects show the characteristics of state-backed national champions.

Most of the firms studied in this report enjoy *dominant positions in their domestic markets* -- most notably, Bimbo, CEMEX, América Móvil, CVRD, Embraer, Petrobras, Natura, and Pollo Campero. As noted, market liberalization forced these firms to make aggressive takeovers to avoid becoming acquisition targets -- a sign of their "survival" instincts. One reason why they were driven to expand internationally was that they were operating in saturated home markets with little growth potential.

We also note in the firms studied a strong tendency towards *family-controlled conglomerates*. This is particularly the case in Mexico, where Carlos Slim, controlling shareholder in both América Móvil and Telmex, owns a massive conglomerate of industrial holdings. Also, CEMEX was organized as a conglomerate structure until CEO Lorenzo Zambrano decided in the mid-1980s to focus the company's strategy on a core business. In Guatemala, the Pollo Campero restaurant chain is part of a large, family-controlled conglomerate. Even those listed on stock markets (América Móvil, Bimbo, Natura, CEMEX, Concha y Toro) are nonetheless tightly controlled by a single family with a large, sometimes majority, block of shares. América Móvil stands out as unique in its sector, where most telephone and wireless private companies are widely-held, publicly traded corporations. América Móvil, however, is controlled by a single individual, Carlos Slim. Among the advantages of tight family control is that it can facilitate faster decision-making, more agility of action, and a longer-term vision -- as opposed to the slow, bureaucratic pace of many corporations with more cumbersome ownership structures as widely held companies. We have not analyzed in this report related issues, such as transparency, concentration of economic power and wealth, and the larger issue of distribution of wealth throughout Latin American society which could be linked to family controlled businesses.

Another factor relevant to the firms studied is *strong leadership*. In many cases, the CEOs of these companies - from Astrid & Gastón's CEO Gastón Acurio to billionaire Carlos Slim - are not only charismatic leaders, but driven towards international expansion by a personal mission. They are "can do" leaders and their ambitions have, in some cases, a quasi-historical dimension. CEMEX's Lorenzo Zambrano, for example, made milestone acquisitions in Spain in 1992 -- the 500th anniversary of that country's colonization of his home country, Mexico. In like manner, Carlos Slim has been keenly interested in the Spanish market, an ambition that is doubtless not unrelated to his competitive battles with América Móvil's nemesis, Spanish-based Telefónica. In the restaurant sector, both Gastón Acurio and Pollo Campero's Gutiérrez family have been driven by a mission to export Peruvian and Guatemalan "cuisine", respectively. In both cases, there is almost a hint of culinary counter-imperialism in their ambitions – especially for Pollo Campero, which competes with the American global brand, Kentucky Fried Chicken. For both restaurants, opening outlets in Madrid was a major milestone with an important emotional aspect. Likewise, Brazilian companies – such as Embraer – have made similar acquisitions in Portugal.

Strong leadership is reinforced with top-notch training, not only of the CEOs themselves but also of senior management. Latin American elites and many CEOs and senior executives of Latin American firms have been educated or trained in the United States and at prestigious MBA schools worldwide. Lorenzo Zambrano, for example, earned an MBA from Stanford. Cultural affinities with the United States have not only created business opportunities, but also fostered a corporate culture that puts an emphasis on first-rate executive training and recruitment. Indeed, a persistent problem for many of these corporations has been finding and retaining first-class executive talent, as many Latin American managers can take positions with major foreign multinationals. Some of the firms studied (CEMEX, CVRD, Embraer, Petrobras, Pollo Campero) have their own corporate universities or training centers which promote their corporate human resources goals. In the case of CEMEX, the company has a raft of executives with excellent M&A skills needed to manage its acquisition-driven global expansion strategy.

Finally, a major common characteristic shared by the firms studied is a capacity for *innovation* as both a survival instinct and a growth driver. This is especially surprising given the stereotype perception of Latin American companies as slow-moving and over-protected by a long history of state subsidies and barriers. It is often observed, indeed, that Latin American executives are driven to succeed in order to “prove” themselves and thus disqualify these stereotypes. They are also willing to learn from their mistakes, and often emerge from setbacks and failure in a much stronger position. In Latin America, companies have constantly faced severe challenges that enabled them to learn to navigate in troubled waters and embrace a strong innovative culture.

In some cases, such as Natura’s eco-friendly cosmetics, innovation is linked to traditional notions of research, product development and branding. Natura has exploited the “natural resource” of Brazil’s rich biodiversity not only for product development, but also for the brand’s marketing image linked to the timely issue of ecology. Similarly, Pollo Campero in Guatemala and Astrid & Gastón in Peru have used their local “natural resources” to produce unique culinary ingredients for export to foreign markets. In each case, the innovative capacity of these companies is associated with the country from which these firms originate. For other companies, the notion of innovation is linked not to product development, but to operations, logistics and business models. CEMEX is a classic example of how to innovate a business model and the operational standards in an industry. With regard to operations, the famous CEMEX Way and its heavy use of computer and satellite systems to

coordinate plant management and delivery of products is a highly innovative approach for an old, old economy cement company. Similarly, Bimbo's management of distribution systems, that reminds one of parcel service operations, is an innovative approach to conducting business. Finally, among the "emerging" Global Latina category we found a high degree of *entrepreneurial drive*, undoubtedly due to the fact that most of these firms are still managed by the founders. Also, these firms tend to operate in the service and mass consumer sectors where market-seeking and brand-leveraging are important strategies for internationalization. In fact, there is much to be learned about marketing from these firms operating in a region whose main export strengths have been based on unbranded commodities.

V. Looking Forward

What can we expect in the future from these Global or emerging Latinas? In the short term, there is every sign that the Latin American economies will continue to achieve relatively high growth rates – especially if commodity prices remain at their record levels. FDI outflows, as noted in the Introduction, are currently soaring and this trend should remain steady for the foreseeable future. Indeed, for the first time in decades Latin America is going through a continuous boom while other parts of the world – including the United States – are being hit by economic crises such as the contagion effect of the so-called "sub-prime" mortgage crisis. This has provided an excellent context for Latin American firms to rediscover their regional markets, much in the same way that Chinese firms are rediscovering Asian markets.

It can be expected that resource-based giants like CVRD and Petrobras will continue to build global scale and strengthen their global market position. Even with the lift from a high economic growth, strategic challenges face industrial and consumer-based firms like América Móvil, Bimbo, CEMEX, Embraer, and Natura. The international position of some of these firms will be determined by their capacity to integrate, manage and expand their worldwide operations in markets subject to overall macro-economic conditions; while for others, global growth clearly will depend on strategic acquisitions or alliances and if they fail they could possibly become takeover targets. For a high-tech firm like Politec, for example, its future will depend largely on its competitive position against market rivals, notably from India – and the inevitable logic of "eat or be eaten".

The general pattern we can observe from tracking the companies in this report is that large-scale resource-based and industrial firms from major markets like Brazil and Mexico have been the most prepared to internationalize. In the case of Brazil's "national champions" like CVRD and Petrobras, this has been because they have sought to reduce risk by forming global partnerships to explore for oil, gas and minerals worldwide and to secure markets and customers; moreover high commodity prices have given them huge cash flow resources to deploy to strategic acquisitions. Mexican firms, unlike Brazilian "national champions" have been more oriented towards the American market for reasons of geographical proximity and liberalized trade.

Beyond these major resource-based and industrial firms, we would not want to overstate the global scope of the firms in this report. Many of these firms have global ambitions, and are making serious attempts to establish a presence on other continents, but the overwhelming majority of their revenues still come from their domestic and regional markets. Perhaps most interesting will be tracking the future of emerging Global Latinas. We have seen in this report that the region is producing many ambitious firms with excellent products and a drive to export their brands globally. High levels of GDP and economic growth at home will allow them to leverage their domestic positions, but global growth will be a challenge – particularly in markets, such as restaurants, where growth generally is organic. For companies like Concha y Toro and Natura, the wine and cosmetics industries have been characterized by global merger activity and so the M&A strategy of these firms may have to come in to play at some time in the near future.

We have noted that most of the revenues of the firms studied are generated in the Latin American region, despite their global ambitions. We have seen how trade agreements, like NAFTA, have been positive triggers for economic growth. It might be suggested, therefore, that a similar trade agreement for Latin America as a whole would, in like manner, provide a stimulus for further firm expansion and, as a result, stimulate economic growth throughout the region while building a stronger foundation for international expansion. While the majority of firms have major stakes in their regional economy, there still lacks an overall regional framework in the form of a trade agreement or a supranational organization. Regional meetings have been held (Cumbre Iberoamericana and the General Assembly of the Inter-American Development Bank), multinational trade agreements signed (Mercosur, NAFTA, Andean Pact, CAFTA), bilateral trade agreements and regional funding agencies established (Corporación Andina de Fomento, Inter American Development Bank and the

recently created Banco del Sur). But still lacks solid institutions or agreements to provide a stable, legal framework and structural forum to resolve disputes and promote economic integration.

It should also be noted that Latin American markets, while small, still have growth potential if the effects of expansion contributes to increase general wealth levels and distributing purchasing power equitably. The current context presents a historical opportunity to resolve many longstanding issues associated with the region's struggles to make economic and social progress. It goes without saying that corporations have a role to play in this, notably as major contributors as employers, taxpayers, and generators of wealth and economic wellbeing.

Finally, the emergence of Global Latinas in an environment of soaring economic growth provides a timely context for international financing agencies like the World Bank's International Finance Corporation (IFC) and Inter-American Development Bank (IDB) to reassess their mission and activities. Indeed, these agencies are already seeking ways to remain relevant in a context of highly liquid capital markets. Even more troubling is the fact that there maybe a potential competition from state-backed financing entities such the Venezuelan and Brazilian-backed Banco del Sur, whose creation is regarded as a direct challenge to the IFC, IMF, and IDB.

We found in this report that funding agencies like the Brazilian Development Bank BNDES, IDB and IFC have played a role in providing financing for Latin American firms – for example, Bimbo (IFC and IDB) and Embraer and CVRD (by the Brazilian Development Bank BNDES and IDB). While in the past, funding agencies have tended to focus on state-managed infrastructure projects; there is a new impetus in favor of financing private actors to achieve social and economic goals. The IFC, for example, has been moving towards a lending policy directed at mid-sized banks, and the IDB has been shifting attention towards sub-national investments in both public and private sector companies – including a US\$120-million loan for an ethanol project in Brazil.

An approach favoring “micro-finance”, as opposed to the old state-based financing projects of the past, is perhaps a more appropriate and effective strategy in a context of high GDP and burgeoning economic activity that, if sustained, could produce the emerging Global Latinas of the future.

External Drivers (Macro Level)	Internal Drivers (Company Level)	Strategic Approach	Uniqueness	
 <i>(Telecommunications)</i>	<ul style="list-style-type: none"> Saturated domestic market Economic crises in the region Mobile growth 	<ul style="list-style-type: none"> Economies of scale Market seeking Risk reduction Asset seeking and exploitation 	<ul style="list-style-type: none"> Acquisition of controlling stakes in target companies High coverage in and focus on natural markets Leverage of market know-how in emerging markets Bypassing customer default risks to expand customer base Natural market 	<ul style="list-style-type: none"> Pioneering with prepaid cards Unique adjustment of serving a low income customer base Client outreach (men in yellow selling calling cards in strategic points) Marketing Leadership
 <i>(Restaurants)</i>	<ul style="list-style-type: none"> Rising demand for innovative restaurant concepts Shift to more exotic tastes 	<ul style="list-style-type: none"> CEO with a mission to position Peruvian cuisine among the best in the world Market seeking 	<ul style="list-style-type: none"> Greenfield operations in the high end market Franchise model for the mass market business models Establishment of flag ships in the high end markets of foreign countries Natural market 	<ul style="list-style-type: none"> Local resources from Peru Innovative combinations of different Peruvian cooking styles Country-rooted branding and marketing of Novo Andino cuisine concepts Visionary leadership
 <i>(Consumer Goods)</i>	<ul style="list-style-type: none"> Highly fragmented industry structure in consumer goods sector Off set economic risks and political volatility in its domestic market Trade agreements (NAFTA) 	<ul style="list-style-type: none"> Expertise in complex local complex logistics New markets needed for its branded products Market seeking 	<ul style="list-style-type: none"> Natural market Acquisitions and Joint ventures Marketing know-how in emerging markets 	<ul style="list-style-type: none"> Pioneering packaging and just in time delivery Foco Bimbo (intranet)
 <i>(Building Materials)</i>	<ul style="list-style-type: none"> Saturated home market US market tariffs forced expansion south of border Global cement industry consolidation trend Trade agreements Building booms 	<ul style="list-style-type: none"> Growth as defense towards possible takeover Expanded markets enable economies of scale in a commodity industry International exposure in order to lower cost of capital 	<ul style="list-style-type: none"> Focus on emerging markets with higher profit margins Pre-entry cement trading Fast acquisitions and integration of major local players with turnaround potential Natural market 	<ul style="list-style-type: none"> Integrated exposure to all elements of the value chain Business model innovation as global building materials solution provider Easy adjustment to serve both low-income customers (branding) and industrialized markets Visionary leadership

	External Drivers (Macro Level)	Internal Drivers (Company Level)	Strategic Approach	Uniqueness
	<ul style="list-style-type: none"> Demand shift from old world to new world wines 	<ul style="list-style-type: none"> Export diversification Increase export revenues Low per capita consumption in domestic market Market seeking 	<ul style="list-style-type: none"> Implementation of an ambitious investment plan Development of a wine portfolio Joint ventures Marketing 	<ul style="list-style-type: none"> Innovative branding Product innovation Geographical location
	<ul style="list-style-type: none"> Benefiting from state sponsorship Geographical location 	<ul style="list-style-type: none"> Achievement of economies of scale Offsetting development costs Risk reduction Asset and knowledge seeking Competitive advantage 	<ul style="list-style-type: none"> Direct sales contracts Risk sharing: manufacturing partnerships and alliances Leveraging operational expertise 	<ul style="list-style-type: none"> Niche player in the production of low-cost medium body business jets National champion Lowest labor cost in the world to develop prototypes
	<ul style="list-style-type: none"> High per-capita spending on cosmetics Growing demand for natural/green products 	<ul style="list-style-type: none"> Risk reduction Market seeking Learn about global market dynamics Looking for knowledge and competitive advantages 	<ul style="list-style-type: none"> Natural market Hybrid model that mixed retail outlets and direct sales Value-based "well-being" Eco-friendly Brazilian roots 	<ul style="list-style-type: none"> Eco-friendly products Country rooted branding
	<ul style="list-style-type: none"> Market liberalization: competition at home and privatization Expansion necessary to replace depleted resources High commodity prices (Chinese demand) Ethanol boom Economic crisis in the region 	<ul style="list-style-type: none"> Learn to compete Strengthen its downstream position in Latin America Risk reduction 	<ul style="list-style-type: none"> Opportunistic assets purchases from Western companies in retreat from Latin America Greenfield operations in worldwide exploration Joint Ventures Bidding for drilling rights Acquisitions 	<ul style="list-style-type: none"> Experts in deep-water drilling National Champion Semi-public status and successful privatization Excellence in Ethanol technology

External Drivers (Macro Level)	Internal Drivers (Company Level)	Strategic Approach	Uniqueness	
 <p>POLITEC IT Intelligence (Technology)</p>	<ul style="list-style-type: none"> Brazilian industrial policy Creation of Brasscom 	<ul style="list-style-type: none"> Drive revenue growth Market, technology and knowledge seeking Risk reduction Gain competitive advantages 	<ul style="list-style-type: none"> Alliances Tailor its product and service portfolio Acquisitions Global diversity within a client-driven mindset Opening branches in countries with cheaper costs 	<ul style="list-style-type: none"> Own delivery global model Iris recognition technology Near shoring Banking technology
 <p>POLLO CAMPERO (Restaurants)</p>	<ul style="list-style-type: none"> Small home market in Guatemala Large number of Latin immigrants opened new markets 	<ul style="list-style-type: none"> Respond to foreign competition in domestic market Market seeking Risk reduction Value chain integration and parenting advantage Looking for competitive advantage 	<ul style="list-style-type: none"> Franchise system Alliances with established market participants and experience investor groups Natural markets Differentiation strategy 	<ul style="list-style-type: none"> Superior flavoring adapted to a specific customer base Country-rooted branding Franchise model Tropicalization Leadership/entrepreneurship Family business
 <p>VALE (Metals & Mining)</p>	<ul style="list-style-type: none"> Market liberalization Anti-trust concerns in iron ore position Soaring demand for iron ore (Chinese demand) High commodity prices 	<ul style="list-style-type: none"> Diversify revenue base Risk reduction Scale advantages Expansion in its alumina refining business 	<ul style="list-style-type: none"> Geographic roll-up to keep foreign competition out of Brazil Securing markets abroad Securing resources through M&A, Greenfield and Brownfield investments Securing customers through JV and co-investments 	<ul style="list-style-type: none"> Integrated business model as one stop shop for the global steel industry High quality reserves with lower production cost Customized pelletizing operations National champion

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