Brazilian industries have been losing ground to competitors and seem to have lost the ability to expand markets. What can be done?

IS BRAZIL STILL COMPETITIVE? The share of manufacturing in the economy is now the lowest in history, just 10.9% compared to 35.9% in 1985. To try to find out why, and what can be done, Claudio Considera, research associate, and Juliana Carvalho, analyst, at the Brazilian Institute of Economics (IBRE) conducted a survey covering what has been happening in a number of sectors since 2000. Their results?

“The numbers show that Brazilian industry lost competitiveness as imports increased and exports declined for many manufactured products. ... The country has lost the ability to expand markets,” Considera says.

Goods manufactured for domestic use fell from 91.9% of total domestic production in
2000 to 82.7% in 2014. Meanwhile, imported manufactured goods went up from 13.4% of domestic demand to 17.3%.

“The government can give incentives,” Considera says, “but reindustrialization is unlikely. We have no innovation or cheap labor with which to recover markets from competitors.

All that can be done is to avoid an even greater reduction [in competitiveness]. For example, we are major exporters of iron ore, and we should have a strong steel industry. However, several steel plants are in difficulties or have closed.”

According to a study by the Brazil Steel Institute (IABR), steel is going through its worst crisis ever. With domestic consumption down to about 24 million tons a year and declining—and enough capacity to produce 48.9 million tons—crude steel production has only been relatively stable thanks to exports. The IABR study shows that, in August, 20 units in 29 steel mills were not producing, including two blast furnaces, four steelworks, and four rolling mills. With the domestic market shrinking and more competition from China, which now has about 460 million tons of capacity, there seems little hope for a surge in the Brazilian steel industry, at least in the short term.

In the metals sector, the IBRE survey found a steeply increasing foreign presence in the domestic market. Imports of metal products have quintupled, from 3.1% of domestic supply in 2000 to 15.6% in 2014. Meanwhile, exports have stagnated.

The increased foreign competition in both domestic and international markets has been partly caused by an excess supply of manufactured goods since 2008. “Slowdown in Europe and the United States, oversupply, fierce competition from China, and increased production costs in Brazil have buried the country’s manufacturing industry,” says Flávio Castelo Branco, executive manager of
“Our company [Dudalina] competes with major manufacturers, the big Asian networks. Constant innovation, commitment to high quality, and elimination of waste are what keep us competitive.”

Ilton Rogério Tarnovski

economic policy of the National Confederation of Industry (CNI).

Despite the discouraging environment, some companies have shown that a well-defined strategy of investments in innovation and management of brand attributes can still boost sales.

The role of innovation

Since it was founded 54 years ago Weg S.A. has become one of the biggest electric motor manufacturers in the world, with plants in China, Mexico, South Africa, India, Germany, Portugal, Austria, the U.S., Argentina, Colombia, and Spain as well as Brazil. In 2014 the company earned R$7.8 billion and in the first nine months of 2015 its revenues grew 24% to R$2.5 billion compared with the same period a year earlier, despite the economic crisis.

“The internationalization of Weg since the 1970s was not the result of a lucky business opportunity; it was a strategic move,” says André Luis Rodrigues, administrative and financial superintendent of Weg. Today, with the domestic market contracting, most of the company’s investments will be abroad: for instance, by 2020 it plans to invest US$210 million in Mexico and US$135 million in China. By then Weg expects that 60% of its revenues will come from exports.

“Today, we see that China is making the transition from an economy focused on exports to one more directed to the domestic market,” Rodrigues explains. In early November, Weg will open a new plant in China.

The manufacturing industry’s share in the Brazilian economy has been falling since 1985

Industry value-added as % of GDP at current prices

Source: IBRE.
Innovation explains much of the presence of Weg in foreign markets. Today, 50% of the company’s revenues are derived from products introduced in the last five years. Weg regularly invests 3% of its revenues in innovation and in training skilled workers, 200 of whom qualify as professionals every year.

Antonio Corrêa de Lacerda, professor and coordinator of the Graduate Program in Political Economy at Pontifical Catholic University of São Paulo, argues that “Brazil has important companies like Embraer, Weg, and Marcopolo. The country has conditions to multiply these examples. However, we face false dilemmas, such as what is our comparative advantage: agribusiness, services, or industry? Brazil is one of the few countries, like the US and China, that can be strong on all three fronts.”

Despite success stories like Weg, in general the IBRE survey results painted a gloomy picture. For instance, in the machinery sector, Brazilian companies lost domestic market share to foreign competitors. Imports of machinery more than doubled, from 16.6% in 2000 to 37.4% in 2014, and in 2011 machinery exports as a share of total domestic production fell from 7% in 2000 to 4.6%.

For clothing and textiles, once an important sector, the rapid loss of competitiveness is almost frightening. In 2000 imports supplied 2.5% of domestic clothing and textile consumption. By 2014 imports reached 17.5%.

**Exceptions to the rule**

One success story in the clothing sector is Dudalina, a shirt manufacturer founded in 1957. Today, the brand is present in nine cities abroad, from Milan to Stockholm. The company plans to open eight more stores in 2016 as franchises, mostly in South America but also possibly in South Africa, according to Ilton Rogério Tarnovski, company vice president. Sold last year to Restoque SA, Dudalina had the highest net income on equity in 2014, 59%, as ranked by Valor 1000, though the results are likely to be more modest this year.

“The crisis is inevitable and we are not immune. The difference is that in our case, the whole business strategy and revenues are based on brand assets. This gives us resilience to face the crisis,” Tarnovski explained. As the dollar appreciated, imports of fabric from abroad were
“To become more competitive, there is need for greater surveillance to combat fishing in the no-fishing season, improve fishermen’s working conditions, and invest in new technologies. We are lagging behind in this respect.”

Thiago De Luca

Reduced from 70% to 60%. But the company continues to buy machinery from suppliers in China, India, Turkey and some European countries because they have higher quality at a cheaper price. “Our company competes with major manufacturers, the big Asian networks. Constant innovation, commitment to high quality, and elimination of waste are what keep us competitive,” he said.

Despite a coastline of more than 8,000 kilometers and plenty of rivers, the outlook for the fishing industry is bleak. In 2011 fish product imports reached 38.9% of domestic consumption, while exports plummeted from 20.5% of domestic production in 2000 to only 5.8%. But even though the sector has been losing ground every year, the Frescatto company, founded by Italian Carmelo De Luca 70 years ago, is making its way back to international markets.

After nearly eight years without exporting, the company hopes to begin shipping its products to Spain, according to Thiago De Luca, commercial director and a member of the third generation of the the controlling family.

Frescatto’s sales this year should reach R$550 million, R$40 million more than in 2014. Today, 65% of the fish that is sold by the company is imported from China, Chile, Argentina, Uruguay, Canada and Vietnam because the cost of processing fish in Brazil is very high. Thiago De Luca cites an example: imported from China, a kilo of panga fish, which is similar to tilapia, can be sold in supermarkets for R$9 per kilo but local tilapia costs R$25.

“It’s all very expensive. The cost of labor, electricity, fuel, and financing has increased. To become more competitive, there is need for greater surveillance to combat fishing in the no-fishing season, improve fishermen’s working conditions, and invest in new technologies. We are lagging behind in this respect,” De Luca says.

Despite the current problems, Frescatto believes that domestic consumption should rise soon; Brazilians consume only 12 kilograms of fish a year, barely half the world average. This year Frescatto plans to open a shop in
Leblon in Rio de Janeiro to sell directly to consumers. In 2016, it will start operating a farm in Pernambuco state that will produce 100 tons of gray shrimp a month.

Another case of a company dodging the effects of its industry’s loss of competitiveness is Casa Valduga, a wine-maker in Bento Gonçalves, Rio Grande do Sul state. “We are rolling up our sleeves and working harder,” says Juciane Casagrande Doro, commercial director; she predicts 20% growth in gross revenue this year. She prefers not to risk projections for 2016, however, because of uncertainty about the effects of the higher IPI tax on beverages that goes into effect on December 1st this year.

Casa Valduga has diversified production and focused on building the domestic market—annually Brazilians consume 2 liters per capita of wine, far below Italy’s 45 liters and Argentina’s 30. The company already exports to 23 countries; England accounts for 35% of company sales. Casa Valduga will also enter the craft beer market. To survive, the industry cannot stop, Doro says, noting that Casa Valduga is betting on wine tourism, using hotels, restaurants, and inns for brand exposure, and has taken its first steps in the food business, producing juices and jellies under the Casa Madeira brand.

Not even coffee, the most emblematic Brazil’s product, has surmounted industry problems. Processed coffee exports, which accounted for 25.3% of total production in 2004, fell to 10% in 2011. Meanwhile, processed coffee imports grew from 0.1% of total domestic consumption in 2000 to 0.9% in 2011.

Apart from the successful trajectory of the Ambev group, overall the Brazilian beverage sector saw its exports plunge from 8.2% of production in 2000 to 1.7% in 2011. Meanwhile, imports steadily rose from 8% of total domestic consumption to 8.5% in 2011.

“Slowdown in Europe and the United States, oversupply, fierce competition from China, and increased production costs in Brazil have buried the country’s manufacturing industry.”

Flávio Castelo Branco

Dudalina store: The company’s goal is to expand the number of franchises abroad in 2016 and face down Asian competition.
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Loss of competitiveness
One of the sectors that lost foreign market share is office machinery and computer equipment. Imports, rising since 2005, reached 34.8% in 2011, the highest of all the goods IBRE studied. Foreign markets for these products manufactured in Brazil have virtually disappeared, with exports declining from 10.3% of domestic production in 2000 to 1.1% in 2011. “We have had a protectionist policy that led to a technological gap,” says the CNI’s Branco. “We did not do trade agreements, we are out of the international game, out of global supply chains. Now it is much more difficult to get back in the game.”

Despite all the recent incentives for the automotive industry, exports of vehicles and parts fell from 13.9% of total production to 7.6% in 2011. The loss of competition to Asian carmakers was decisive.

Brazilian appliances have been virtually wiped off the global map: Exports fell from 10.7% of total production in 2004 to just 1.6% in 2011.

In petroleum refining, exports fell from 5.1% of domestic production in 2008 to 3.8% in 2011. Imports, including ethanol, jumped from 3.4% in 2000 to an estimated 14.2% in 2014. Meanwhile, Brazil has become heavily dependent on imported oil products. Between 2007 and 2013, annual demand for oil products increased by 4.6% while domestic production grew only 2.3%.

Chemicals also lost ground: Imports rose from 11.4% of domestic demand in 2000 to 36.2% in 2014, while chemicals exports leveled off at 7% from 2000 to 2011.

Pharmaceuticals also saw foreign competition break into the domestic market: Last year, imports nearly tripled, from 12.3% of domestic
consumption in 2000 to 34.5% in 2014. Exports rose, but only slightly, from 1.8% of domestic production in 2000 to 2.5% in 2011.

The CNI study results agree with IBRE’s. CNI found that net manufacturing exports were a negative 0.9% in 2014—that is, Brazil imported more inputs but failed to turn them into final goods for exports, closing the year in the red. Brazil has been losing ground since 2005, when net manufacturing exports reached 9.8%. The situation is most severe in IT and electronic materials (−40.7%), printing and reproduction (−24.9%), petroleum products (−23.9%), chemicals (−19.1%), and pharmaceuticals (−10.8%).

“Devaluation of the exchange rate should bring positive effects for the industry this year,” in Branco’s opinion. “But only in 2016 will exports pick up strength. The exchange rate only solves part [of the competitiveness gap] and only for a time. To export it takes increased productivity and quality products and design.”

Market gains
Among products where Brazil has picked up market share in recent years is meat, mainly because demand has grown, Considera says. Exports of meat products such as beef rose from 6.5% of meat production in 2000 to 11.8% in 2011. Brazilian slaughterhouses—many with the support of the Brazilian Development Bank (BNDES)—have made their way to international markets. Meat imports are very small, about 1% of domestic consumption in 2011.

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Claudio Considera

Traditional maker of sparkling wine and red wine, Casa Valduga is now entering the market of craft beers under its own brand.
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Antonio Corrêa de Lacerda

The big challenge is to build the industry of the twenty-first century in Brazil. We are facing a great opportunity, but [much] depends on political will. The game is not lost, but I do not see this goal being pursued. There is no strategy,” says Professor Lacerda. He says that many Brazilian industries have eliminated production lines in Brazil and became representatives of Chinese and other Asian companies. “We need to focus on reducing red tape, improving the tax structure, and innovating. The artificially overvalued exchange rate ended this year. That has opened a possibility for industry to re-establish links in the chain supply and build an innovative environment, which should rely on a close partnership between companies and research universities,” he says.

of production in 2000 to 60.6% in 2014. Meanwhile, imports have fallen significantly, from 9.9% of domestic consumption in 2001 to 5.4% in 2014.

Transportation equipment, such as Embraer’s aircraft, is another important sector, though exports have been halved, from 38.1% of domestic production in 2000 to just 16.6% in 2011. Imports also increased from 28.9% of domestic demand in 2000 to an estimated 31.4% in 2014.