



# Brazilian Companies in China:

Presence and  
Experience



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### OFFICIAL SPONSOR OF THE STUDY:



## ABOUT THE CBBC STUDY

This publication is the second of a series of studies by the China-Brazil Business Council regarding issues relevant to Sino-Brazilian economic relations. The purpose is to furnish up-to-date information and analyses that can serve as elements for formulating policies and strategies by companies and government agencies. In doing so, the CBBC hopes, to contribute to a closer relationship between the business communities of the two nations, as well as to indicate directions and trends that could later be studied in greater detail by research institutes and think tanks.

## INTRODUCTION

Last year, after concluding the study on Chinese investments in Brazil, coordinated by Professor Barros de Castro, the China-Brazil Business Council now presents the results of its study regarding the presence of Brazilian companies in China, led by CBBC consultant Claudio Frischtak, supported by the Council's research team.

There is a significant difference between these two studies. With the rapid growth of the past several years, the stock of Chinese investments in Brazil has risen to around 20 billion dollars, while Brazilian investments in China remain stationary at around 500 million dollars.

It is true that the number of Brazilian companies in China (57) has grown significantly. They are concentrated in the services sector and are quite diversified. There are also examples of successful companies from the industrial sector that focus on the internal market.

On the other hand, Chinese companies in Brazil are distributed throughout various sectors. At first, investments were predominantly made in commodities and energy. Then, in infrastructure and, now, increasingly in products destined for the internal market, such as automobiles.

The CBBC study interviewed a significant number of companies. It showed the diverse nature of their experiences and results. While some of the companies owe their success to partnering with local Chinese companies or governments, others succeeded due to their own technological advantages. In some cases, the training of a local labor force was the crucial element.

This group of case studies is opportune and relevant. Gaining greater knowledge of the Chinese market is one of the necessary conditions for formulating successful policies and adding value to exports. The presence of Brazilian companies in China is essential for identifying niches for Brazilian exports and investments.

Regional integration in Asia is occurring at an increasingly accelerated pace. More than 50% of East Asian exports are intra-regional. Reciprocal investments have been significant, leading to a growing integration among the production chains in the region. When that integration process is consolidated, it will be even harder for other countries to export manufactured products to China and the rest of the region.

The Council hopes that this group of experiences, information and suggestions contributes to greater integration of the efforts of companies and the government, and to fostering a larger Brazilian presence in China.



**Ambassador Sergio Amaral**  
President  
China-Brazil Business Council

## MESSAGE FROM THE BANCO DO BRASIL

With support from the Banco do Brasil, the China-Brazil Business Council developed this study, based on extensive research that seeks to furnish information that will serve as an important source for those who want to be more involved in the Chinese market, by providing a detailed survey of the distribution of Brazilian investments in China. This is a complete set of materials, in which it is possible to identify opportunities and challenges for Brazilian companies that operate, or wish to set up, in China and, for that reason, it is in perfect harmony with the strategic actions adopted by the Banco do Brasil in its foreign presence. The international expansion strategy of the BB is founded on three aspects: the presence of Brazilian communities abroad, the internationalization of Brazilian companies, and Brazil's trade relations. And it is precisely the last two that make our sponsorship very natural for this important study,

As a pioneering institution, the Banco do Brasil began a movement in pursuing of space beyond our borders, at a time when few Brazilian companies, including those from the financial sector, had this strategy in mind. In November 2011, we completed 70 years of international presence, when we celebrated the anniversary of the opening of our first foreign branch, in Asunción, Paraguay. The BB is the largest financial institution in Latin America and now is present in 24 countries, with a foreign network formed by more than 40 points of dependence. And, with an attentive eye on the international economic movements and scenarios that have shaped a new mapa mundi, where emerging countries challenge the traditional leadership of other nations, the Banco do Brasil launches itself into the task of gaining global positioning. To that end, we acquired the Banco Patagonia, in Argentina, and the Eurobank, in the North American market. Currently, we are planning other acquisitions.

Historically, the BB has supported exporters and importers with credit lines and an extensive portfolio of solutions that are responsible for keeping us at the forefront of the Brazilian foreign exchange and trade market. And if the Nation has gradually been increasing its participation in world exports—from 1.36%, in 2010, to 1.44%, last year, according to a report released by the World Trade Organization (WTO)—we dare to state that the BB played a fundamental role for that to be made possible.

Brazil's balance of trade has also gained new configurations. The most obvious example of this phenomenon occurred at the beginning of 2009, when China, after 80 years of leadership of the United States (U.S.), began to be our Nation's main trade partner. In 2011, Brazilian exports to the Chinese reached a record volume of US\$ 44.3 billion, which is an increase of 43.9% over the total for 2010. In current figures, China receives at around 17% of Brazil's exports and the U.S., 10%.

This is a reality that absolutely no financial institution that traditionally supports national companies in their worldwide business dealings can ignore. The Banco do Brasil went to China to better capitalize on the trade flow between the two nations. Actually, this initiative occurred way before the classes in the Mandarin language began to be held in Brazil's corporate establishments. We planted our flag in Chinese territory in the mid-1980s.

After initially setting up in Beijing, our business office migrated to Shanghai, and it has functioned there, since 2004. Today, the Beijing branch has become the most profitable office outside Brazil. The BB brand is also present in Hong Kong, where Brazilians have another business office available to them. The next step in the strategy of being involved in the country consists of opening our first branch, and the process is well underway. This is an upgrade that we will give to the BB's activities in Shanghai, by transforming the office into a branch, in order to offer Brazilian companies installed in China, or that do business with the Asian giant, the financing, products and services that are most adequate to their needs, thus contributing to the internationalization of those companies and significantly boost their businesses. And better, yet: providing services with a "Brazilian accent".

Our involvement in China is part of the strategy for positioning the BB in Asia, where we can also highlight an intense presence in Japan, with a branch in Tokyo, and several sub-branches spread throughout the archipelago, and the activities of the business offices in Hong Kong (China) and Seoul (South Korea), as well as an emphasis on the capital market, with the recently created BB Securities Asia, in Singapore. These are triumphs already achieved and of which we are very proud. However, this does not lessen the responsibility and the big challenge of continuing to be a "BomPraTodos"(GoodForAll) bank, including for Brazilians and their enterprises throughout the world.

**Admilson Monteiro Garcia**  
Executive Director of the Banco do Brasil

# SUMÁRIO

<b>Executive Summary</b> .....	7
<b>Introduction</b> .....	26
Context and objectives of the study .....	26
Text structure .....	28
<b>1. Foreign Investments in China – History and Profile</b> .....	29
China as a receiver of direct foreign investments .....	29
Main countries investing in China .....	33
<b>2. The Presence of Brazilian companies in China</b> .....	36
Brazilian investments in China, in the context of the new bilateral relations phase .....	36
Overview of Brazilian companies in .....	38
Composition of Brazilian companies in China .....	38
Entry mode of Brazilian companies in China .....	39
Business activities of Brazilian companies in China .....	39
Geographical distribution of Brazilian companies in China .....	41
<b>3. The experience of Brazilian companies in China</b> .....	43
The entrance of Brazilian companies in China .....	43
The operation of Brazilian companies in China .....	45
Perspectives and suggestions from Brazilian companies for investing in China .....	47
<b>4. Strategic challenges for Brazilian investments in China</b> .....	49
Government position regarding Brazilian investments in China .....	49
Interview with Brazil’s Ambassador to China, Clodoaldo Huguency .....	51
CBBC Analysis – Strategic challenges for Brazilian investments in China .....	55
Initiatives on the national level .....	56
<b>Bibliography</b> .....	57
<b>News articles</b> .....	59
<b>Experience of Brazilian companies in China: Interviews</b> .....	60
<b>Interviews: CNI and Government</b> .....	81
<b>Appendix: About the catalogues for guiding direct foreign investments in China</b> .....	85

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## Figures

Figure 1 – Foreign investments entering during different periods of time .....	32
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## Graphs

Graph 1 – Flow and stock of DFIs in China - 1979-2011 (US\$ billion) .....	29
Graph 2 – Foreign investments in China, as (%) of GDP .....	30
Graph 3 – Main sector receiving DFIs in China (%) .....	31
Graph 4 – Investments in new sectors in China (US\$ million) .....	32
Graph 5 – Main countries investing in China, during different periods .....	33
Graph 6 – Inventory of Brazilian investments in China, according to official sources (US\$) .....	37
Graph 7 – Composition of Brazilian companies present in China (% of all companies) .....	38
Graph 8 – Company segments present in China (% of all companies) .....	38
Graph 9 – Entry mode of Brazilian companies (% of all companies) .....	39
Graph 10 – Business activities of Brazilian companies (% of all companies) .....	39
Graph 11 – Involvement of Brazilian manufacturing companies (% of all companies) .....	40
Graph 12 – Involvement of Brazilian processors of natural resources (% of all companies) .....	40
Graph 13 – Geographic location of Brazilian companies (n <sup>a</sup> of companies) .....	41
Graph 14 – Geographic location of Brazilian production plants (no. of companies) .....	42



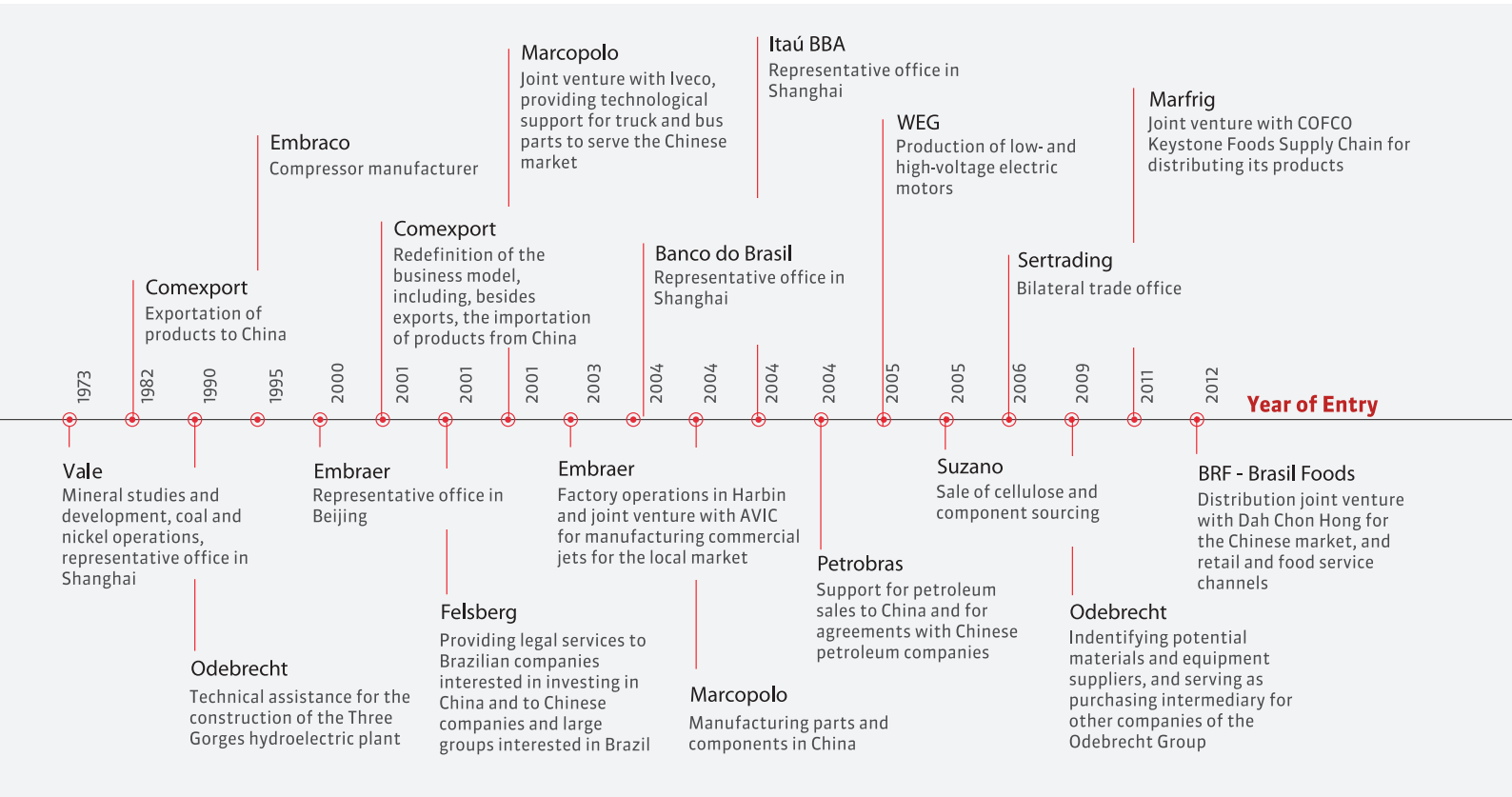
## EXECUTIVE SUMMARY

*This is a summary of the main data and conclusions of the study.*

# GEOGRAPHIC LOCATION OF THE MAIN BRAZILIAN COMPANIES IN CHINA (Nº. OF COMPANIES)



Source: Consolidated list | CBBC Preparation: CBBC



Source: Interviews held with companies and official information





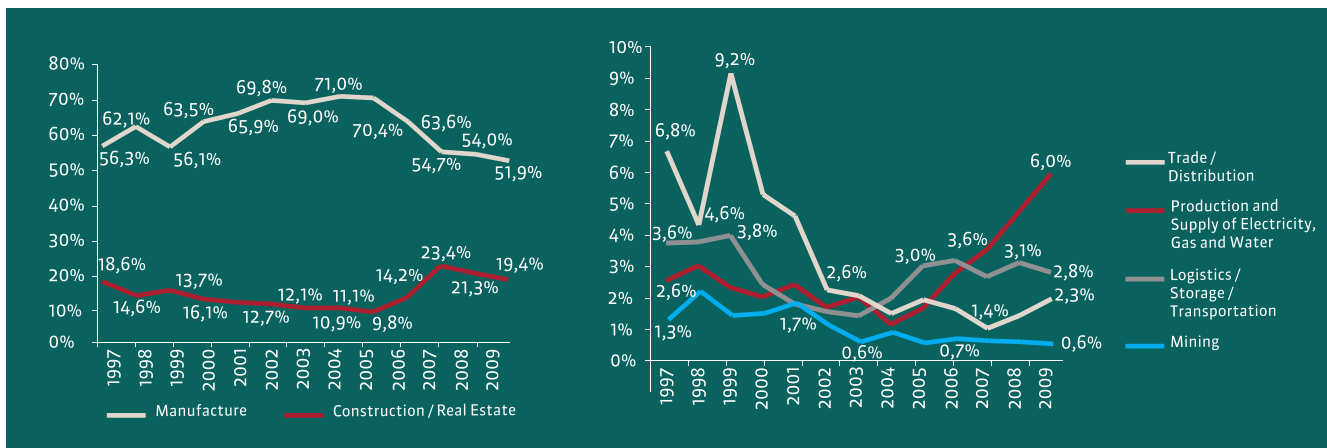
# PART 1 – FOREIGN INVESTMENTS IN CHINA – HISTORY AND PROFILE

China authorized the entrance of direct foreign investments (DFI) in 1978, constitutes one of the main strategies of the economic reform policies of the Deng Xiaoping era. At that time, besides the huge scarcity of capital, the nation suffered from industrial inefficiency, due to state-owned companies with technological deficits and limited production capacity.

Foreign investments played a central role in the model for economic development based on exports. The entrance of multinational companies to China’s special economic zones (SEZ), drawn by incentives offered for installing export platforms, made it possible for China to join the global production chain, combining the technological advantages and brands of foreign companies with the efficiency and low cost achieved by Chinese production factors. In 1994, the volume of investments came to 6% of the gross domestic product (GDP).

Another factor that boosted the influx of foreign investments was the opening of several sectors focusing on the domestic market.

**Main sectors receiving DFI in China (%)**

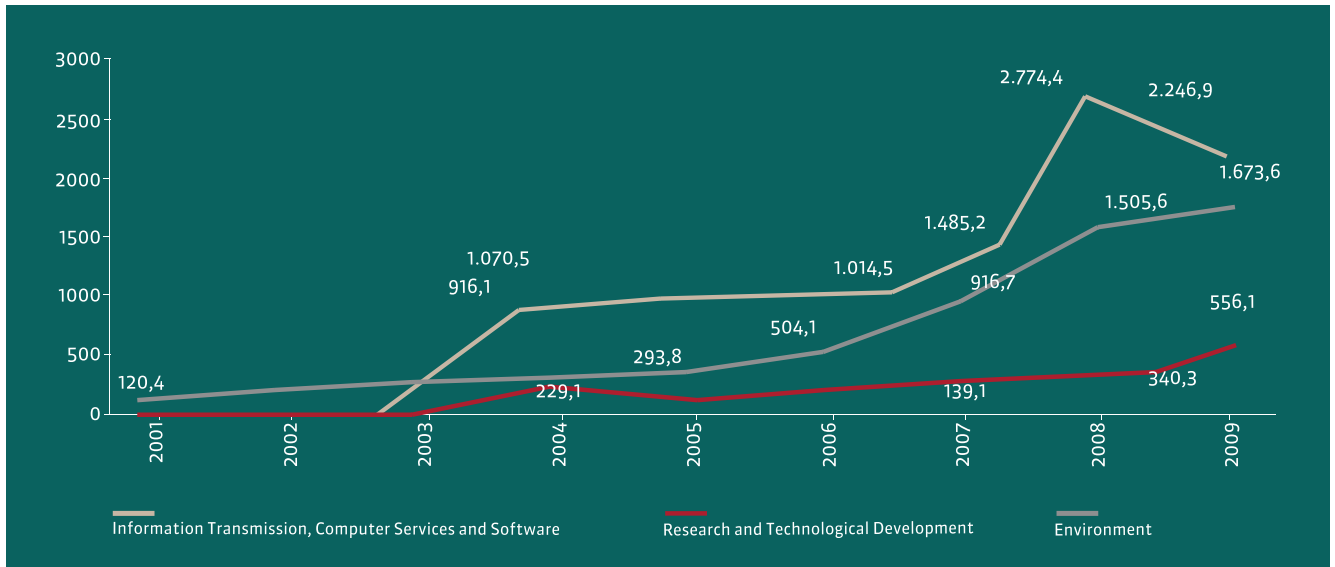


Source: NBS Preparation: CBBC

In 2001, China joined the World Trade Organization (WTO), but that did not inhibit the government from using mechanisms that gave orientation to investments within the new Chinese economic context. One example is the Investment Catalogue Guidebook that classifies the sectors of the economy under the following categories: encouraged, permitted, regulated, or prohibited for foreign investment. At that time, the Chinese were interested in reducing the gaps in the nation’s production capacity and infrastructure. The entrance of foreign companies depended on joining up with local partners, in order for Chinese companies to catch up technologically.

As of 2004, China became one of the world’s biggest receivers of foreign direct investment and began to witness a flow of investments to its interior. The coastal cities began to provide incentive to the entrance of foreign capital at the major stages of the productive chain, like the installation of research and development centers. Furthermore, sectors seen as strategic by the central government, such as renewable energy and new energy sources, began to be promoted, leading to the rapid expansion of recent years.

## Investments in new sectors in China (US\$ million)

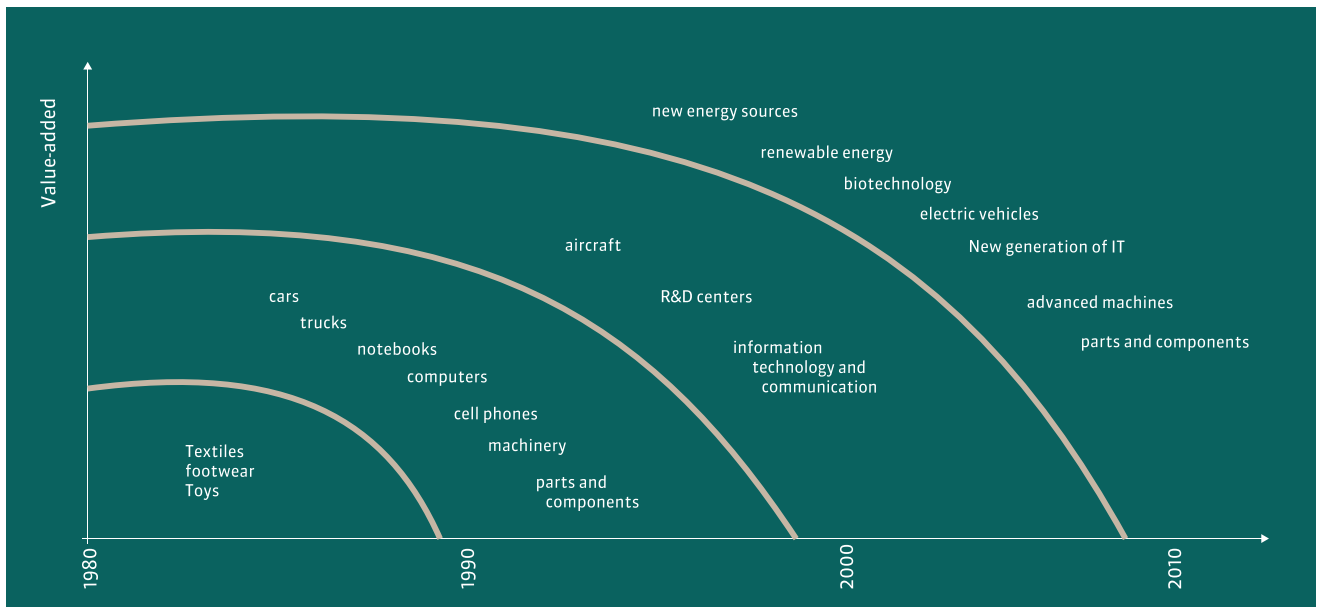


Source: NBS Preparation: CBBC

China then went through different phases in terms of attracting DFI. The first wave of DFI was destined for manufacturing products with low aggregate value, such as textiles, footwear and toys. In the 1990s, foreign capital was concentrated in the automotive and home appliance industries. In the 2000s, new investments in the aerospace, information technology (IT), and communications sectors appeared.

The new Investment Catalogue Guidebook, revised in 2011, that presents the strategic sectors recently included in the 12th Five-Year Plan, instructs the entrance of foreign capital for forming research and development centers and for sectors linked to the preservation of the environment, like new energy sources, renewable energy, new materials, and biotechnology. Other priority investments are suggested in machinery and equipment with advanced technologies, as well as the next generation IT.

## Different waves of incoming foreign investments



Source: Investment Catalogues: 1995, 2002, 2004, 2007, 2011, Naughton (2007), Brown (2008)

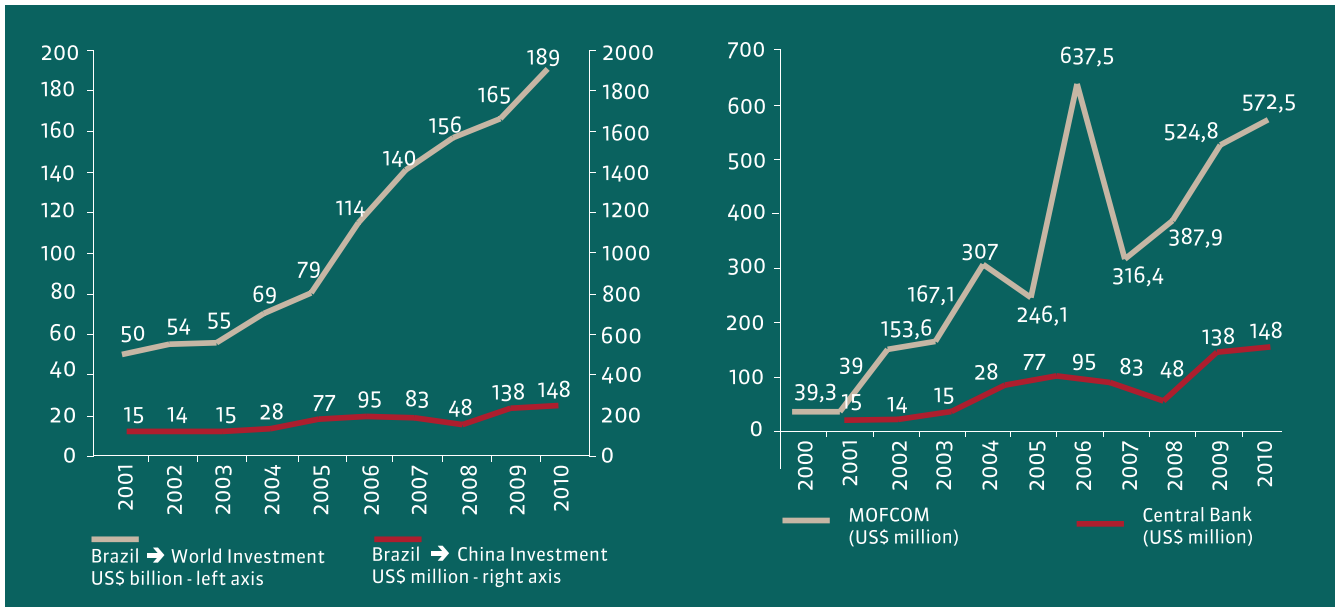
Preparation: CBBC



## PART 2 – THE PRESENCE OF BRAZILIAN COMPANIES IN CHINA

Brazilian investments in China have remained stationary over the past ten years. Data from the Ministry of Commerce (MOFCOM) of the People’s Republic of China show that, from 2000 to 2010, US\$ 572.5 million were invested by Brazilian companies, representing only 0.04% of the stock of FDIs in China.

**Inventory of Brazilian investments in China, according to official sources(US\$)**



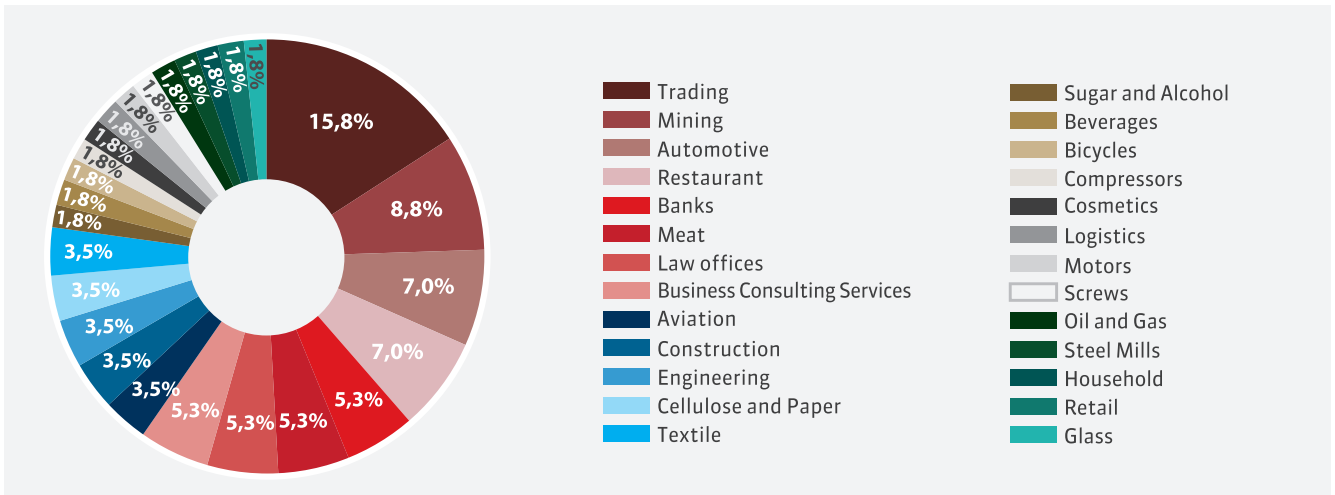
Source: Central Bank, MOFCOM Preparation: CBBC

It is widely agreed among multinational companies that a presence in China has become essential. However, we must not expect Brazilian investments in China to have the economic logic or timing similar to the flow of investments from China to Brazil. This is due, in part, to a certain inhibition on the part of Brazilian companies faced with the difficulties of serving the Chinese domestic market, in comparison to the facility of serving the Brazilian market and relatively easy access to the Latin American market. Recently, a new issue has been drawing the interest of several possible investors: urgent need of reducing costs, due to Chinese competition in Brazil’s own domestic market.

Due to the limited volume of Brazilian investments in China, the CBBC chose to focus this study on an analysis of the presence and experience of Brazilian companies in the Chinese market. Taking advantage of information gathered from associated companies, embassies, company forums, and Brazilian professionals, such as the Foro Brasil and Brazilian Professionals in China, the Council identified 57 Brazilian companies present in the Chinese market. Among them are service providers (50.9%); manufacturers (28.1%), like EMBRACO, Embraer, and WEG; and processors of natural resources (21%), like BRF – Brasil Foods, Marfrig, Petrobras, and VALE, among others.

One point worthy of note is the diversity of sectors of involvement in the Chinese market: Brazilian companies are found in 26 different sectors.

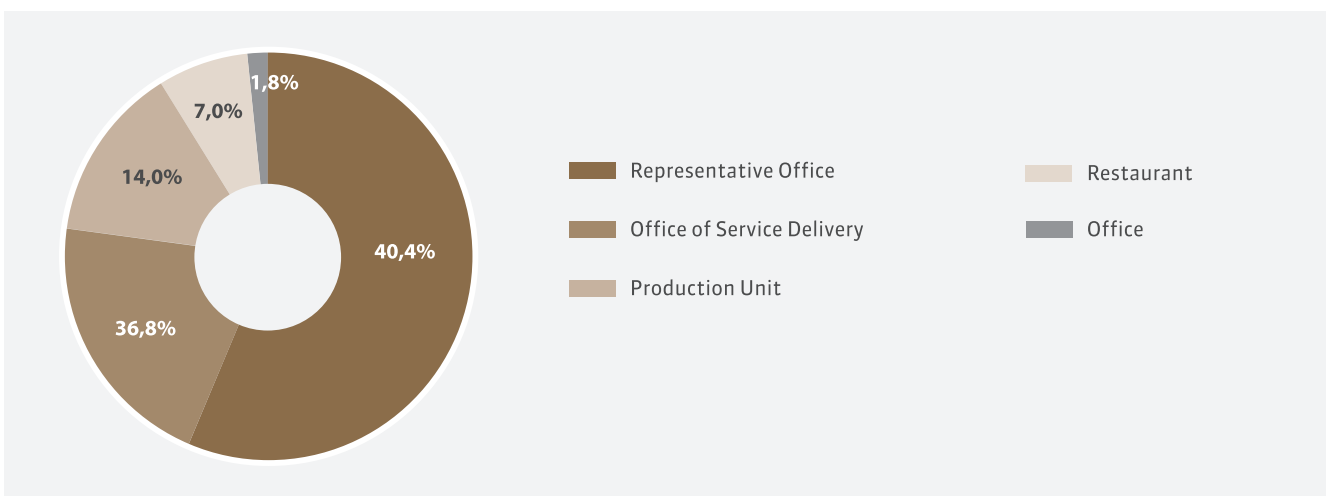
## Company segments present in China (% of all companies) <sup>1</sup>



Source: Consolidated list | CBBC Preparation: CBBC

No matter how diversified Brazilian investments might be in China, there are still no Brazilian companies involved in such sectors considered to be strategic by the Chinese government as new energy, renewable energy, advanced machinery, new generation information technologies, and communications. Given the composition of Brazilian companies in China, it is natural that the main way of setting up operations is via representative offices and providing services.

## Entry mode of Brazilian companies (% of all companies)



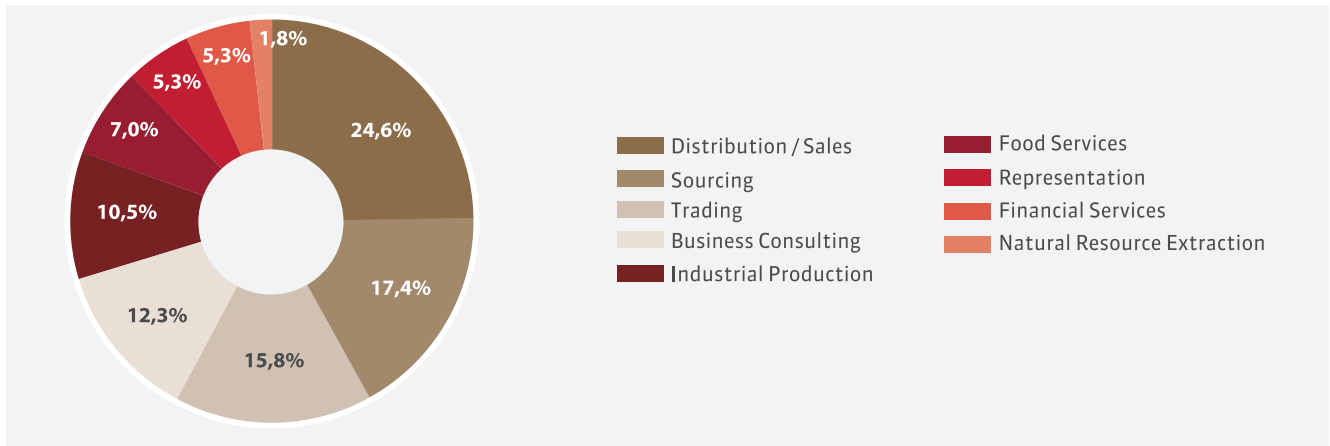
Source: Consolidated list | CBBC Preparation: CBBC

More than 70% of the business activities carried out by Brazilian companies in China are focused on business consulting, trading, distribution and sales, and sourcing (purchasing products or components).

<sup>1</sup> We must add that was impossible to obtain data regarding the Brazilian footwear sector in China. It is known that a group of small and medium industries from the sector migrated to South China. However, it is possible, given the rise in production costs in the region that part of these companies have moved to other countries in Asia.

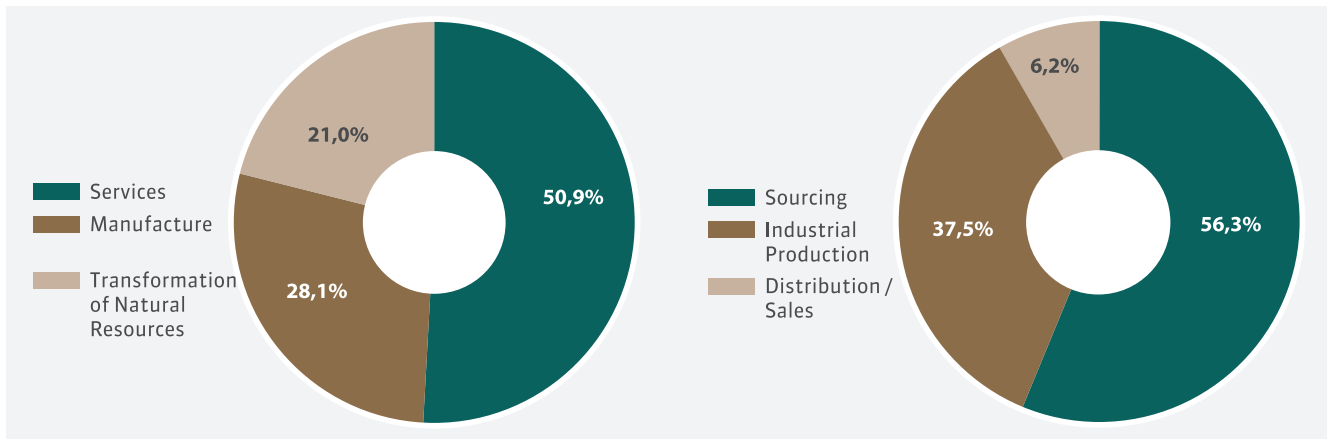


### Business activities of Brazilian companies (% of all companies)



Source: Consolidated list | CBBC Preparation: CBBC

### Involvement of Brazilian manufacturing companies (% of all companies)

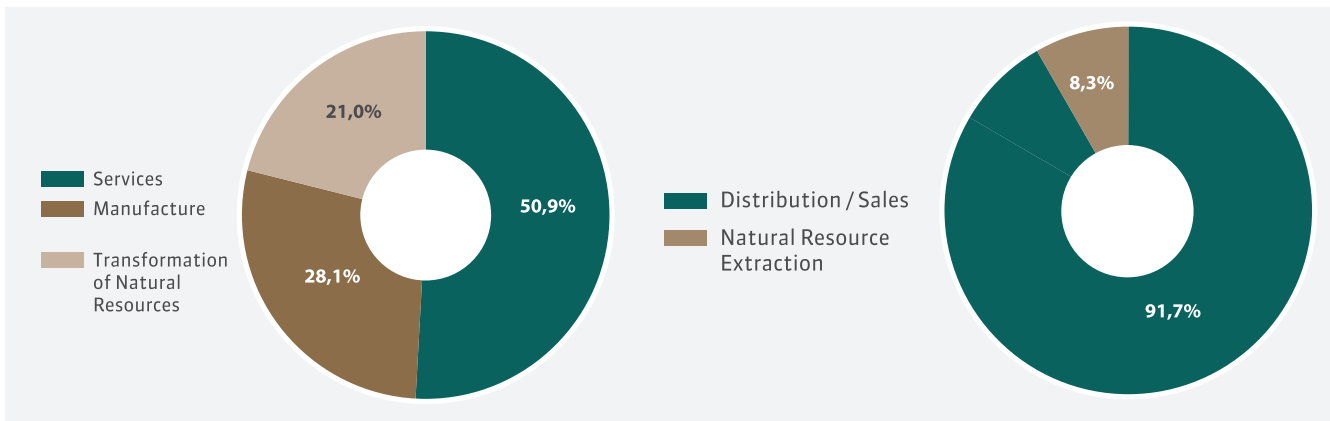


Source: Consolidated list | CBBC Preparation: CBBC

More than half of the 17 Brazilian manufacturing companies in China purchase (source) products and components, raising the volume of Brazilian imports from this Asian nation.

Regarding the involvement of companies that process natural resources in the Chinese market, more than 80% are present in China to sell and distribute their products.

### Involvement of Brazilian processors of natural resources (% of all companies)



Source: Consolidated list | CBBC Preparation: CBBC

As for location, the cities on the east coast of China have most of the Brazilian companies, with Nantong being the main city receiving Brazilian manufacturers.

## PART 3 – THE EXPERIENCE OF BRAZILIAN COMPANIES IN CHINA

To better understand the experience of Brazilian companies, the Council interviewed 12 executives from key companies that are present in different sectors of the country's business community. The structure of the interviews followed similar lines, so as to bring an understanding, as much as possible, that is based on the way the company entered the market in China, and the operations and perspectives for the Chinese market, always with an eye to identifying the primary barriers faced by Brazilian companies, regarding their continuance and the expansion of their activities in China, and the business practices followed by the executives to effectively compete in the Chinese marketplace.

With respect to companies entering China, the following obstacles were observed:

- physical and cultural distance between Brazil and China; the Chinese business scene is replete with peculiarities;
- the lack of accumulated information and knowledge regarding how to enter China and handle the various levels of the Chinese government;
- authorization and approval processes from the Chinese government for projects in regulated sectors;
- lack of alignment between the strategic objectives of Brazilian companies and their Chinese partners; and
- non-recognition of internationally accepted practices by the legal system, regarding intellectual property, which ends up favoring the Chinese.

In order to handle these obstacles, the companies adopted such initiatives as:

- establishing a “guanxi” network;
- associating with a Chinese company;
- offering technology-intensive products, and products near or on the technological frontiers; and
- consulting service providers and such government agencies as the Embassy and the Brazilian Trade and Investment Promotion Agency (APEX).



Regarding the operations of Brazilian companies in China, the main obstacles were:

- the formation of a reliable supply chain;
- establishing and maintaining a sales channel for serving the local market;
- limits imposed by the Chinese government on direct trade, demanding the participation of local companies and making it hard to create independent export platforms;
- the low level of qualification and training of the Chinese labor force;
- high employee turnover;
- the significantly lower production level of Chinese partners, compared to that of Brazilian companies; and
- the low number of Brazilian companies carrying out innovation and technological partnership activities in China.

To deal with these barriers, Brazilian companies invested in:

- forming a network of reliable suppliers, preferably international. If that was not possible, they contracted Chinese suppliers, and the solution for avoiding the risk of violating intellectual property rights was to reduce the volume of information regarding product specifications. Another strategy was to establish long-term contracts with local suppliers, with the assistance of the “guanxi”.
- establishing sales channels with the presence of a leader from the Brazilian company and building long-term relationships based on trust.
- offering customized and distinctive products with quality and high technology, in order to gain space in the local marketplace.
- holding an intense series of training classes with local employees, in order to reduce the big difference in the qualifications of the labor force.
- differentiating salaries and benefits, in order to correct, as much as possible, the high worker turnover rate in the factory. Furthermore, key managers of the operation in Brazil are often transferred to China, thus ensuring closer supervision on the part of the Brazilian headquarters.
- implementing changes in the planning system in China, so as to balance the performance of the operations in Brazil with those in China.



There is a massive difference between Chinese investments in Brazil and Brazilian investments in China. The latter are relatively stationary, with an inventory of less than US\$ 1 billion, while Chinese investments in Brazil are growing and were estimated at US\$ 12.669 billion in 2010. With this scenario in mind, the CBBC asked the interviewed companies to give suggestions on how to boost investments in China, some of which included:

- the need for the Brazilian government not only to name China as a priority, but to treat it as such.
- the mobilization of government institutions in dealing with the different aspects that related to business dealings with China.
- the pursuit of greater parity in the rules and practices that describe the investment, due to the fact that Chinese companies have more freedom to invest in Brazil than Brazilians do in China.
- the urgency of formulating a strategy and a policy on the bilateral level for guiding the discussions between Brazilian and Chinese companies and the Chinese government.
- the need for effective dialog, for the purpose of building relations not only between Brazilian companies and the Chinese government, but also between those same companies and the Brazilian government, so as to increase the alignment between entre the public and private sectors. From this would come a coherent positioning and effective action plans for promoting Brazilian investments in China, thus serving the nation's interests.
- greater coordination between government agencies.





## PART 4 – STRATEGIC CHALLENGES FOR BRAZILIAN INVESTMENTS IN CHINA

Given the scenario of Brazil's presence in China and the challenges that Brazilian companies face, specially in the area of the mutual investments that bring a new dimension to bilateral relations, the CBBC interviewed key players from the government, touching on possible points of intersection, in terms of the main issues raised by Brazilian companies.

According to the interviews, there has been unprecedented progress, from the qualitative standpoint, in the relations between the two nations, due to the complementary nature of the Brazilian and Chinese economies. China became Brazil's leading economic player and the dynamics of its economy began to be highly relevant to the movements of the Brazilian economy.

Chinese investments in Brazil have rapidly increased, in recent years, and we perceived that their focus has been changing. While, in 2010, Chinese investments were primarily related to seeking for natural resources, like iron ore, petroleum and soy, in 2011, there was a shift towards investments in the manufacturing sector.

The government recognizes that Brazilian investments in China can become more significant and that the entrance of Brazilian companies should be treated as a relevant issue for domestic industry. However, since the establishment of Brazilian companies abroad implies the creation of jobs outside the country, there is—on the part of some government agencies—a certain amount of caution regarding initiatives that promote the internationalization of Brazilian companies.

When compared to companies from other countries, Brazilian companies arrived in China relatively late. The low presence of Brazilian companies in China is associated to Brazil's delayed entrance. When it was no longer possible to ignore the Chinese market, the Brazilian companies encountered an environment where, in several sectors, American and European companies had already established themselves, and the Chinese were already able to compete as equals.

The challenges that Brazilian companies face when entering China go beyond regulatory restrictions and issues related to economic policy. The high degree of integration of production chains in Asia is an important factor in making this process more difficult. To overcome this obstacle, Brazilian companies depend on low costs, resulting from perfected production technologies in scale-intensive segments (as is the case of parts, components and other materials and supplies) or on a large capacity for establishing ab initio an efficient chain, with the Brazilian entrant the integrating element.

The government reinforces that it has acted in conjunction with the Chinese government in issues regarding approvals and licenses, and points out that there are very clear rules for foreign investments entering China. We would mention that despite the fact that the Chinese government has accepted the rules and limits imposed by Brazil, eventual discriminatory measures imposed by our government against Chinese interests could slow down the progress of negotiations for Brazilian companies to enter China.

Until recently, the lack of a Brazilian bank established in China to support the financing of the initiatives of Brazilian investments was another aspect raised by the government, as being a limiting factor. Therefore, the entrance of the Banco do Brasil to China was an important landmark in facilitating Brazilian companies entering the Chinese market.

The government understands that specific action plans must be prepared for Brazilian investments in China and that this area still lacks better-defined strategies and policies. However, it must be remembered that in the area of bilateral relations, the Joint Action Plan was signed by the governments

of both countries, in 2010, for the period up to 2014. The Plan highlights such sectors as energy, mining, and agriculture for reciprocal investments, as well as providing for the formation of a working group, to exchange information and also cooperate, in terms of bilateral investments and new opportunities.

It should be pointed out that the coordination between the government agencies responsible for different stages of the internationalization process of Brazilian companies could be improved. China has a deliberate policy for attracting, filtering and qualifying foreign investments. The first big strategic challenge for expanding Brazilian investments is to promote partnerships within the scope of sectors that receive incentive for foreign capital to enter China, that is:

1. new generation of information technologies;
2. products that save on energy and protect the environment;
3. clean and renewable energies;
4. bio-agriculture;
5. high-performance machinery and equipment;
6. new energies;
7. new materials and composites; and
8. vehicles powered by new energies.

The Chinese government is not interested in attracting opportunistic investments, or even those with relatively short payback periods. This represents an additional challenge for Brazilian companies: investments must be “patient”, and strive for the medium and long range projects.

In fact, there is a set of obstacles for establishing a production and distribution base and accessing the Chinese market. For example, using China as an export platform to third-party countries is possible, but the Chinese government increasingly provides incentive to its own companies to help position themselves as integrating and intermediary elements for foreign clients.

It is interesting that the Chinese government feels that initiatives and policies of a nationalistic nature are legitimate, whether for the defense of the domestic Brazilian market, for regulating foreign investments, or for supporting national companies, as well as foreign investors. It is the responsibility of each country to structure itself in the best way possible and to position itself competently on the playing field of the global economy. Brazil—while a strategic partner of China on issues regarding international policies, both in the G-20 or BRICS—has a certain political “credit”. However, it is not enough to change the policy for attracting investments from China and give it a bias in favor of Brazilian companies.

The CBBC concluded that there are three initiatives that depend on the national players and that would signal the priority given by Brazil to relations between the two countries.

First, raise the visibility of these relations in the government’s plan, allocating more resources for forming, designing and carrying out the policies, so as to reflect the true importance of China for Brazil, now and in the near future.

Second, improve inter-agency coordination. It is possible that the sharpest contrast between the stance and the actions of the two governments is not found in the competence or effectiveness of a specific institution, but, rather, in the limited degree of coordination between them.

Finally, the design of an effective strategy, in light of the challenges and opportunities imposed by the rise of China will depend on stimulating the debate, generating knowledge, and mobilizing the resources of society, for the ultimate purpose of bringing greater balance and sustainability to the Brazil-China economic relations.



# INTERVIEW HIGHLIGHTS

## COMPANIES

### BANCO DO BRASIL

“ We took nearly five years to understand how we could do business in China. It was not an easy learning process, especially for a Latin American bank, since western culture is completely different from eastern culture. Besides the cultural factor, at that time, there was not such a profusion of Brazilian companies in China.

We will begin with the relations with Chinese banks. One of the first difficulties was the fact that the Chinese banks do not engage without having a signed memorandum of understanding in place. Usually, we only sign memoranda of understanding when we already have a specific project. In China, however, this had to be the first step.

Since this was the rule of the game, the BB signed memoranda with the greatest possible number of Chinese banks and, thus, business began to flow much better. We learned, with some difficulty, that in China it is not so important what the bank has to offer, but rather, the “guanxi”.

With reference to China, we noticed a tendency for growth, which might not be 10%, but that will come to 7% or 8%, which is still a very strong growth rate. For some years, now, China has seen people transferring from rural areas to urban centers.

In this context, there is an increasing demand for food supplies, while local production has dropped. To a certain extent, this benefits the Brazilian situation, which will probably continue to focus on natural resources and agribusiness. Another important point is the growing need for Brazilian iron ore, because of the rebuilding of China—with steep growth rates and increasing dependency. China is Brazil’s largest trade partner, and this degree of dependency will tend to climb. The U.S. will gradually lose its relevance and China will become more prominent.

**Admilson Monteiro Garcia – Executive Director of the Banco do Brasil**

### EMBRACO

“ EMBRACO’s investment decision was made almost naturally, because we had already been present in the Chinese market since the mid-1980s, exporting products to China, via traders in Hong Kong, who facilitated our connection with clients.

Over the years, our position in the market rose to such a level that, in 1995, we took advantage of an opportunity to associate with a local compressor company that belonged to the Beijing government. Thus, we began to supply the market with local products, and have maintained, until today, the exports of some specific products from Brazil, as well as from Slovakia.

The company with which we associated was already in existence before the mid-1980s, but, as time went by, it lost its competitiveness, due to a lack up technological updating. They saw EMBRACO as an opportunity to bring in technologies, initially for products and manufacturing and, later, for administrative and managerial competence.

Since that time, and yet today, we are recognized as technology leaders in China, as is the case, fortunately, in the rest of the world.

**Lainor Driessen – EMBRACO Vice President, Operations, Management and Sustainability**

## COMEXPORT

“ Our history in China is much older than most Brazilian companies. At the beginning of the 1980s, our mission was to export large volumes of textile raw materials that were produced by several multinational companies installed in Brazil. The Brazilian market was still relatively immature for the consumption of those fibers, resulting in a significant amount of material left over during the offseason consumer periods. We noticed that we could not sell the product to just any country, on the spot market, that is, during a short period of the year and in large volumes, except to countries with very significant consumption levels. It was at that time the China arose as an alternative for these exports.

In 2004, President Lula made his famous trip to China, and, the day after the trip, an interesting thing happened: Brazil discovered China. Therefore, a huge number of business people from a broad range of sectors sought to do business with China. They went to the consulates and trade offices that Brazil had at that time—very few Brazilian companies were located there. So, we decided to try and absorb a little of the new demand that arrived in the country.

Most of the items that we bring to Brazil are developed here and produced in China. We purchase production space or lease small industries. Then, Comexport produces, controls production, loads the shipment, brings it to Brazil, and distributes it or delivers it to the specific client.

Every year, or even every month, we watch the Chinese become more competitive, aggressive, and less bureaucratic regarding the export of their products. China now has all of the infrastructure, capability, and intelligence for exporting. The nation became a niche exporter and it is amazing how they have been able to achieve such a level of excellence. Actually, competitiveness is not only in production, but in operations and logistics.

Roberto Milani – Vice President Comexport

## FELSBERG E ASSOCIADOS

“ It is not viable to negotiate with Chinese companies in the same way we negotiate with companies from other countries, that is, in a market-driven fashion. It is necessary to establish a strategy, have clear objectives, and negotiate them.

I believe that Brazilian companies are at a disadvantage when they go to China, unassisted by the Government. Discovering China should be a part of a project for relations with the country. Therefore, the involvement of the China-Brazil Business Council in straitening the dialogue regarding the position of companies and the Government and about their commercial and business interests has been important.

A broader strategy that truly took into account the interests of the Nation and of Brazilian companies that want to expand their businesses to China would work well. This is needed, since the countries do not have the same interests.

Thomas Felsberg – Founding Partner of Felsberg e Associados



## PETROBRAS

“ Petrobras set up its office in China in May 2004. This was the result of the company “discovering” China during that year. We noticed that the country was a huge consumer of energy, especially petroleum. At the time, China was the third largest petroleum buyer in the world. Today, it is the second, after the U.S. So, we saw that we couldn’t ignore it. We launched the office in Beijing with the presence of President Lula.

Since Petrobras decided to open the representative office in Beijing, to prospect possible business opportunities there, the company’s petroleum sales to that country have increased significantly. Today, it is one of the main destinations of our sales of the Nation’s petroleum. First, we seek to serve the country, especially business relations: which companies buy and which do not buy, what is the relationship with the government, and other factors. This was a very important learning process. We began to sell, in 2005, and, since then, our presence has grown solidly. In 2005, we sold US\$ 300 million and we closed out last year with a sales volume of US\$ 4.6 billion.

By law, in China, only five large state-owned companies are authorized to import petroleum. We had quite a job finding out who were the key people of the companies, making the decisions to buy petroleum. China buys four million barrels of petroleum per day, but, if there is no personal contact, it is impossible to finalize the sale. We can count on the support of the Embassy, and even the President, but if the key person of the purchaser does not trust you, not a single barrel of oil will be sold in China. It took us a year to gain this access, until we signed our first contract.

[Marcelo Castilho – General Manager of the Petrobras office in China](#)

## SERTRADING

“ Early in 2006, we found a market niche to justify our presence in China: the home appliance and electronics market. We opened a trade representative office in Shenzhen, in the south of continental China, next to Hong Kong. This region is considered to be a scientific and technological hub with a high concentration of companies from the home appliances, electronics, and telecommunications areas. We visited more than 100 industries, established a few partnerships, created a brand, got a distributor from Brazil, and began operating as intermediaries, developing products and bringing them to Brazil, always with a focus on the home appliance and electronics sector. That initial work was very good and was basically focused on developing suppliers and products, with no government participation.

We are banking heavily on China. Our focus is on straitening China-Brazil business relations. To that end, we are forming a team to identify and develop new types of distribution representatives in Brazil. The other path would be exports. Furthermore, we are investing in expanding the knowledge of our personnel regarding China.

[Alfredo de Goeye – President of Sertrading](#)

## SUZANO

“ The Chinese market for cellulose is number-one in the world, and it is our trade policy to not sell through trading companies. So, just as we have a direct presence in Europe and the U.S., we chose to open an office in China. We have trade representatives all over the world, and we deal directly with our clients. I would point out that having a direct channel in China is of primary importance, because they tend to have very personal relations. Contrary to what many people think, the Chinese market is not characterized as a wholesale market, where you buy things without knowing the client, even in the case of commodities. We must exercise special care in our relations with Chinese clients.

Suzano has a representative office in China, with a staff of around 11 people that tends to grow. We don't only sell cellulose, there, but also source raw materials. We have a research operation, independent from this office—a company that Suzano bought in 2010, called FuturaGene, that is setting up a very complete laboratory.

The tendency in China is toward growth. The country, which is one of our target markets, is the one that most invests in producing paper, and has very ambitious growth projects—approximately five million tons of paper to be produced over the next 20 months.

In our China office, we work with Chinese professionals, because we believe that a local executive who is fluent in Mandarin is of great importance in contact with clients. We also arrange executive interchanges between China and Brazil, by bringing Chinese executives to train in our country and taking Brazilians to be enabled in China. In this way, we pursue a deepening of our trade relations and a greater understanding of the Chinese market.

So far, we haven't had significant difficulties in our business with China. On the contrary, it has been quite easy to do business with them.

Alexandre Yambanis – Director of the Cellulose Business Unit of Suzano

## WEG

“ In 2004, we did a study to assess the opportunities in the Asian market and to decide where we should establish a production unit. WEG needed a local plant, since services provided from Brazil involved very high logistics costs and transfer time. In 2004, after a study of thousands of Chinese manufacturers, we chose the city of Nantong, in Jiangsu Province. The provincial government offered to sell a local state-owned company to WEG, including all of its assets. The Nantong factory has about 30,000 m<sup>2</sup> of building space on some 67,000 m<sup>2</sup> of land. At that time, the government was preparing to sell many state-owned companies—some are still Chinese, but are no longer under public control, while others were offered to foreign companies, like WEG. Our case is an example of how the Chinese government looks for alternatives for those who want to invest in the country.

The government is dedicated to pursuing opportunities on a global level, mapping the interest of companies and of other governments in making investments in China. This relationship is fundamental in China. Right from the beginning, during the implementation phase of the factory, the relationship between the company and the government is very positive, so that solid bases can be built for future opportunities for growth.

“Guanxi” is pure relationship, based on the ethics and principles of mutual trust between people. There is nothing unethical about this. It is merely based on trust. It is a relationship where directors and clients talk sincerely and openly about strategies, growth and opportunities. If the client, who is on the other side of the table, feels that the company communicates trust, the deal will go forward; and the opposite can also happen. There's nothing more than that. It is earning trust at the highest levels.

In business meetings, there is a little dealing with trade subjects, but the main thing are the generalities and personal subjects. It is a very interesting ritual. There are protocols: a way of talking and of celebrating. “Ganbei”(gift) is essential to the Chinese, as a means of showing gratitude. It is a sign of trust.



If we hadn't established a good relationship, difficulties would most certainly arise. Fortunately, "guanxi" helps us in this respect, like speedily obtaining certain licenses. It is essential that there be "guanxi". This trust relationship is built up over a period of time.

In our strategic plan, Nantong should become a large industrial hub for that market. We have a growth plan and, over the next seven years, we hope to grow five times larger than we are, today. We will not do this merely via organic growth. At this speed, we will also have to grow through acquisitions. Looking back on the past six years, we are investing much energy and are confident that we will grow.

Siegfried Kreuzfeld – Director-Superintendent of WEG Motores

## NATIONAL INDUSTRY CONFEDERATION (CONFEDERAÇÃO NACIONAL DA INDÚSTRIA - CNI)

“ “ Today, any company that wants to develop a survival strategy should consider China in its analyses, diagnose the existing chains, and pursue ways of being distinctively different in this scenario. For example, if the company chooses specialized automation, its chances of success increase. If the decision is to produce a generic system, then, losses to the Chinese are certain. Competing with Chinese products as equals is aggravated by all of the cost issues in Brazil, which do not exist in China, such as labor costs, taxes, and exchange rate.

Therefore, in order to deal with this issue, we must first understand China, investing in knowledge. Here, the Council has an important role to play. We must study their operating logic, where they are headed, and what are the dilemmas that their economy will face.

Furthermore, we need to think about our global competitiveness. There are enormous difficulties in changing some of the factors in Brazil, like the tax burden and social charges. However, in the medium range, we must advance, in terms of infrastructure, thus improving our capacity to compete on the international level. Important private projects exist, along this line. Our connection with China, for example, is made via the Atlantic Ocean and not the Pacific, as it will possibly be done in the future, which is the most efficient option. So, if we invest in the waterway projects and highway and railway connections proposed for the North of Brazil, will gain a cost reduction of around 25% to Shanghai. These projects are identified in a CNI study that lists the investments, rates of return (some between 3 and 5 years) that could significantly reduce the cost of placing products in China.

Besides this, we need to be aligned with China's economic reforms. And, at this point, it seems like the strongest short-term gains are still associated with agribusiness. There was an advance, last year, with reference to pork, but I believe that Brazil should deal more seriously with its agenda of phytosanitary negotiations, as a way to open the market to its products. I think

that we would see good returns on this type of measure. To that end, however, it is important to set up a dedicated staff for the area, in order to resolve existing problems, and give it clear result-oriented goals, while providing the resources needed for achieving the objectives.

José Augusto Coelho Fernandes – Director of Policies and Strategy of CNI

Brazil missed the first wave of foreign investments entering China. When Brazilian companies decided to enter the Chinese market, they already found thousands of multinational companies—all of the large companies of the world are represented in China. Furthermore, they found Chinese companies evolving and becoming competitive.

Clodoaldo Hugueneu – Ambassador of Brazil to China

## BRAZILIAN EMBASSY IN CHINA

“ The growth of trade relations between Brazil and China, in recent years, has been so significant that one could apply the dialectical principle: quantity transitions into quality. Spectacular growth in such a short period of time has led China to be Brazil’s biggest trade partner.

The future of the relations depends on how we will be able to handle the present moment, find solutions for the problems. Protectionist measures might be necessary, however they will be merely palliative, if they are not accompanied by programs for promoting competitiveness. We enjoy good relations with the Chinese and we must not let them deteriorate. Although the Chinese seek retaliations against the Americans and Europeans, so far they have behaved differently toward Brazil.

I think that the complementary nature of the relations will continue. China is moving more and more towards a demand for sophisticated products and services. Therefore, we must be alert to this change in Chinese consumer standard, in order to take advantage of the new windows of opportunity that this economic transition will make possible.

One Chinese peculiarity is the fact that the investment project demands great efforts, as well as a series of trips and contacts with local partners. The process is tiring and even discouraging. The Brazilian company is entering a distant country, with a legal system that is very different, a specific way of organizing the industrial sector, and very distinct regulations.

Another point that can be raised is the fact that

## MINISTRY OF DEVELOPMENT, INDUSTRY AND TRADE (MDIC)

“ There was a big first influx of Brazilian companies to China, which began in the second half of the ‘90s and ran until 2005/2006. At that time, such companies as EMBRACO, VALE, WEG and Embraer invested in the Chinese market. Our companies took advantage of China’s period of great economic growth, at rates of over 10%, to enter the Asian country.

What we now see could be considered as a second moment of the entrance of Brazilian companies, for example, when Brazilian companies open franchises in China, or when they form a distribution strategy in the Chinese market. Another example would be Brazil’s financial sector that, through the BM&F, is beginning to draw closer to China. And, finally, in sectors with more technology, with EMBRAPA studying the possibility of opening laboratories in the Chinese market.

Brazil enjoys a relatively large degree of complementary elements with China, or practically 50% of what Brazil exports, in terms of products, China imports. This is an important percentage, when talking of a market that nearly doubled, in size, between 2005 and 2010. In 2010, Chinese imports were nearly one trillion 400 billion dollars.

Therefore, given this degree of complementariness, Brazil has a potential for entering other sectors more heavily, whether investing in manufacturing for the local market, or with actions for promoting their image, linked to distribution strategies in China. There are a number of sectors where Brazil has the potential for a stronger involvement in the Chinese market.





We have done a study with data that shows, for example, that we have opportunities in the food supplies, beverage and agribusiness, house and construction, and machinery and equipment sectors. Despite thinking that we are unable to compete, we have room to work. For example, the entire complex involving fashion, and medical and dental equipment. So, we have room to enter China. We are clearly experiencing a time of much growth in Brazil and, obviously, business people are much more concerned about serving the domestic market, than exporting, but we are trying to stimulate business people. We see that the strategy must work on two levels: we need to care for the domestic market, but we also need to be competitive, abroad. And when we talk of competition outside of Brazil, we most certainly need to look at China.

Ricardo Schaefer – Adjunct Executive Secretary of the MDIC



# Introduction

## CONTEXT AND OBJECTIVES OF THE STUDY

Claudio Frischtak - CBBC Consultant  
André Soares – CBBC Research and Analysis Coordinator

This publication is the second in a series that are part of the study program developed by the China-Brazil Business Council (CBBC), whose main objective is to bring to the table a discussion of relevant issues for forming policies and strategies in Brazil-China relations, whether on the part of companies or of government agencies.

The subjects dealt with in these studies constitute a preliminary survey for the purpose of calling attention to new facts or possible trends. The observations made here may be taken deeper, at a later time, with greater energy and resources by research institutions, companies, and think tanks.

The first topic developed by the CBBC was the leap in volume of investments announced in 2010, by Chinese companies interested in entering Brazil. In May 2011, the CBBC launched the study called “Chinese investments in Brazil: a new phase in bilateral relations.

The study sought to call attention to the rise of a new phase in the relations between Brazil and China. As has been widely announced, China has been Brazil’s largest trade partner since 2009 and trade relations with the Asian nation have been intensifying. In 2011, China was responsible for 40% of the Brazilian balance of trade.

In 2010, the presence of China as a big investor in the country stood out as a distinctive difference for the Brazilian economy. Chinese investments in Brazil became a new and relevant bilateral relations component, which the CBBC gave special attention, in order to understand some of the peculiarities and outworkings that were noted.

The CBBC attempted to estimate the volume of Chinese investments in 2010 and to describe Chinese interest in Brazil. In one of the main results of the study, the CBBC estimated investments of US\$ 12.669 billion for that year, with two predominant entrance standards.



First, for several years, now, China has been consolidating an international base of raw material suppliers from Australia, Indonesia, and African nations, keeping in mind the explosive demand for natural resources. The phase is characterized, in part, by the inclusion of Brazil in the international base for supplying these resources.

Second, for some years, now, Chinese investments of significant amounts have been multiplying in the manufacturing sphere, with the recent dynamism of the Brazilian consumer market—highlighting the entrance of Chinese automobile companies to the Brazilian market.

Continuing the work done in 2010, the Council maintained the monitoring of the announcements of projects for Chinese investments in Brazil, in 2011. During that year, Chinese companies announced a volume of investments estimated at US\$ 10.890 billion. The characteristics of the investments reinforced the second standard presented in 2010—more than half of the 19 projects were destined for manufacturing, as in the automobile, home appliance and electronics sectors.

After the conclusion of the study on Chinese investments in Brazil, the CBBC focused its efforts on another topic of special relevance for a deeper understanding of the bilateral relations—the presence of Brazilian companies in China.

A fundamental part of this study concentrated on interviewing top executives of large Brazilian companies present in China. In all, 12 were interviewed, making it possible to gain a very unique picture of the entrance and permanence of Brazilian companies in that market.

Contrasting with the significant interest and participation of Chinese companies in Brazil, as confirmed by the big increase in investments announced in 2009 and 2010, the presence of Brazilian companies in China is still timid, and has remained stagnated in recent years. As readers will see, however, this presence is quite diversified in terms of segments.

This study has attempted to raise critical points regarding the presence of Brazilian companies in their respective markets. Such issues are dealt with as the difficulties for entering the country, the importance of relations with the Chinese government and companies, and certain peculiarities of operating in China. Finally, the study lays out the main strategic challenges to expanding the flow of Brazilian investments to China and ensuring that both countries come together in less disproportionate investment environments.

## STRUCTURE OF THE TEXT

This document is divided into four parts. The first informs readers of the policies that guide foreign investments in China, and in which Brazilian companies are present. Emphasis was given to the country's opening to foreign capital and to the main sectors that receive investments, as well as comments on the entrance of companies from other countries to the Chinese market. One of the critical points raised by the study indicates that, over the past several years, China has been receiving the main companies of the world in different sectors. This implies that changes in worldwide competitiveness will be increasingly established in China, thus urging the presence of Brazilian companies interested in learning about the Chinese market but, above all, about the global market.

The second part of the study presents the volume of accumulated investments in recent years and assessment of the presence of Brazilian companies in the Chinese market. Readers will find the main characteristics of the group of Brazilian companies that are now in China. Based on the study of what is considered to be the state-of-the-art literature on investments, analyses were performed that point out the reasons, manner of setting up, location of companies, and the main business activities in the Chinese market.

Due to the limited volume of Brazilian investments in China in the past, this study is based on the hypothesis that certain barriers faced by companies—including cultural differences in how to do business, and the information gap regarding how to work in the Chinese market—make it difficult to have a greater presence of Brazilian companies in the Asian nation.

In order to furnish information lacking about the experience of Brazilian companies in China, the Council interviewed 12 executives from key companies that are present in different sectors of the country. The third part of the study consolidates these experiences, with an eye to identifying the primary barriers faced by Brazilian companies, regarding their continuance in China and how they were overcome.

The fourth, and last, part of this study deals with the strategic challenges, not only of the companies, but also of the Brazilian government, regarding investments in China. This stage presents the results of the interviews with agencies of the Brazilian government that have attempted to line out possible ways for expanding the presence of Brazilian companies in the country.



# 1. Foreign Investments in China – History and Profile

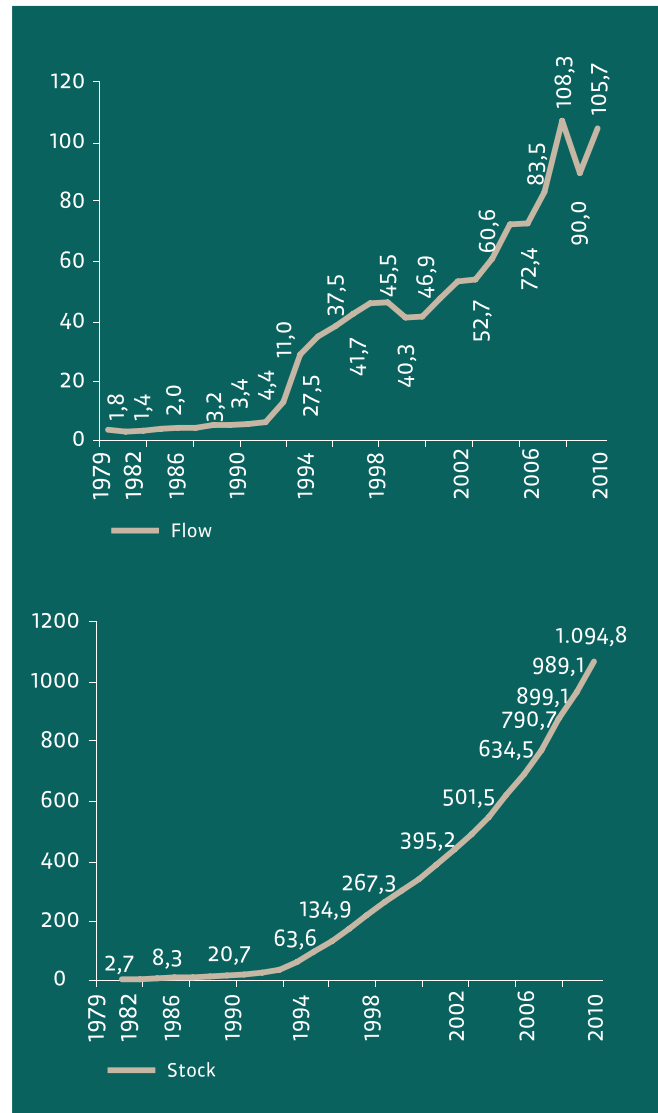
## CHINA AS A RECEIVER OF DIRECT FOREIGN INVESTMENTS

The entrance of direct foreign investments (DFI) to China was authorized in 1978 and was one of the main points in the policy of economic reform promoted by the Deng Xiaoping government. A summary of the guidelines for the entrance of investments can be seen in this article by Deng:

*“We welcome foreign investment and advanced techniques. Will they undermine our socialism? Not likely, because the socialist sector is the mainstay of our economy. Our socialist economic base is so huge that it can absorb tens and hundreds of billions of dollars’ worth of foreign funds without being shaken. Foreign investment will doubtless serve as a major supplement in the building of socialism in our country. And as things stand now, that supplement is indispensable. Naturally, some problems will arise in the wake of foreign investment. But its negative impact will be far less significant than the positive use we can make of it to accelerate our development. It may entail a slight risk, but not much.”<sup>2</sup>*

At that time, besides the huge scarcity of capital, the nation suffered from industrial inefficiency, formed by state-owned companies with technological deficits and limited production capacity. In light of this scenario, the Chinese government sought to use foreign investments as one of the ways to get around the restraints to the country’s economic development. The result was an accentuated increase in the flow of investments, which marked the decade of the 1990s. (Graph 1)

**Graph 1 – Flow and stock of DFIs in China - 1979-2011 (US\$ billion)**



Source: China FDI Preparation: CBBC

<sup>2</sup> DENG, X. ‘Building Socialism with a Specifically Chinese Character.’ in *The People’s Daily*. Beijing, 1984.

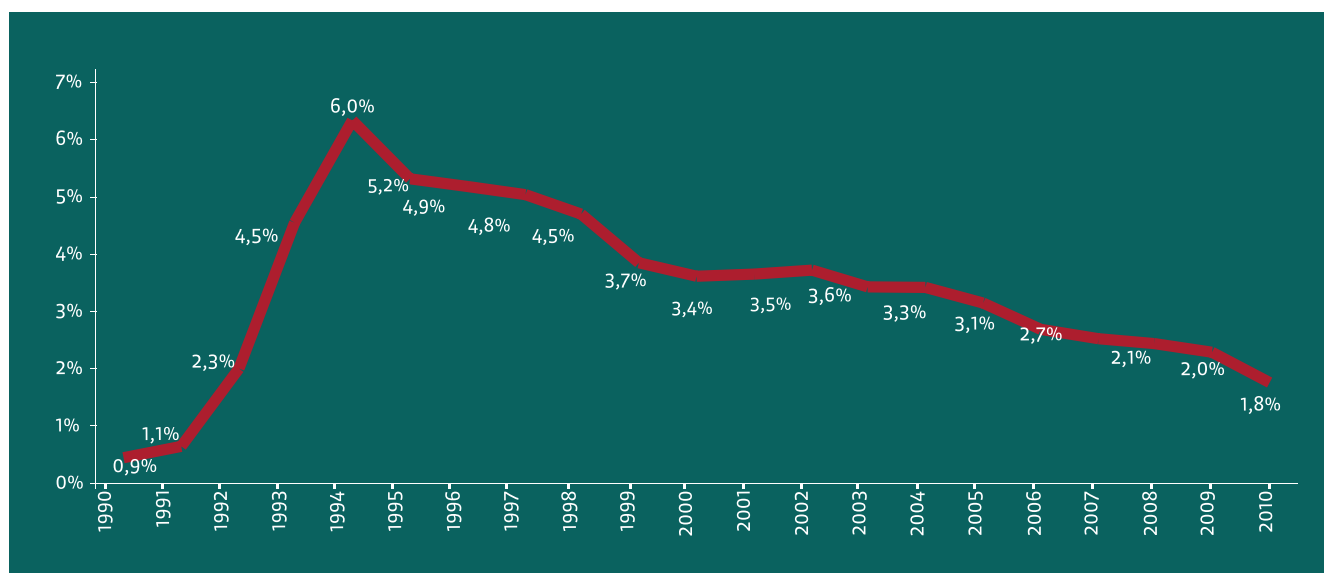
In the 1980s, the government attempted to implement policies and promote cautious institutional changes for expanding the entrance of foreign capital. Therefore, Special Economic Zones (SEZ) were created, in regions where investments would be encouraged with preferred fiscal treatment, simplified bureaucracy, and, especially, customs incentives, such as importing tax-free parts and components. In 1980, four special zones were created in the regions of Shenzhen, Zhuhai, and Shantou, in Guangdong Province; and Xiamen, Fujian Province. These zones were experiments for the entrance of investments, and constituted the first basis for forming an export-driven economy.

Foreign investments played a key role in developing the model for the export-driven economy. The lack of capital, technology, distribution channels, and brands made it hard to increase Chinese exports, especially to industrialized markets. Nevertheless, with the entrance of multinational companies, attracted by the incentives offered for installing export platforms, China was able to join the global

production chain, combining the technological advantages and brands of foreign companies with the efficiency and low costs achieved by Chinese production factors.

With the positive experience of the SEZs, starting in 1984, the government began a process of opening the costal cities to foreign investments, significantly increasing the entrance of capital. At first, fourteen cities were chosen, including Shanghai, and another SEZ was created, in Hainan. This process intensified dramatically in the 1990s, so that by the beginning of 2000, China had more than 100 zones open to foreign investments. In 1994, the volume of investments came to 6% of the Gross Domestic Product (GDP), which was significant enough to transform the Chinese economy (Graph 2).

**Graph 2 – Foreign investments in China, as (%) of the GDP**



Source: Dragonomics      Preparation: CBBC



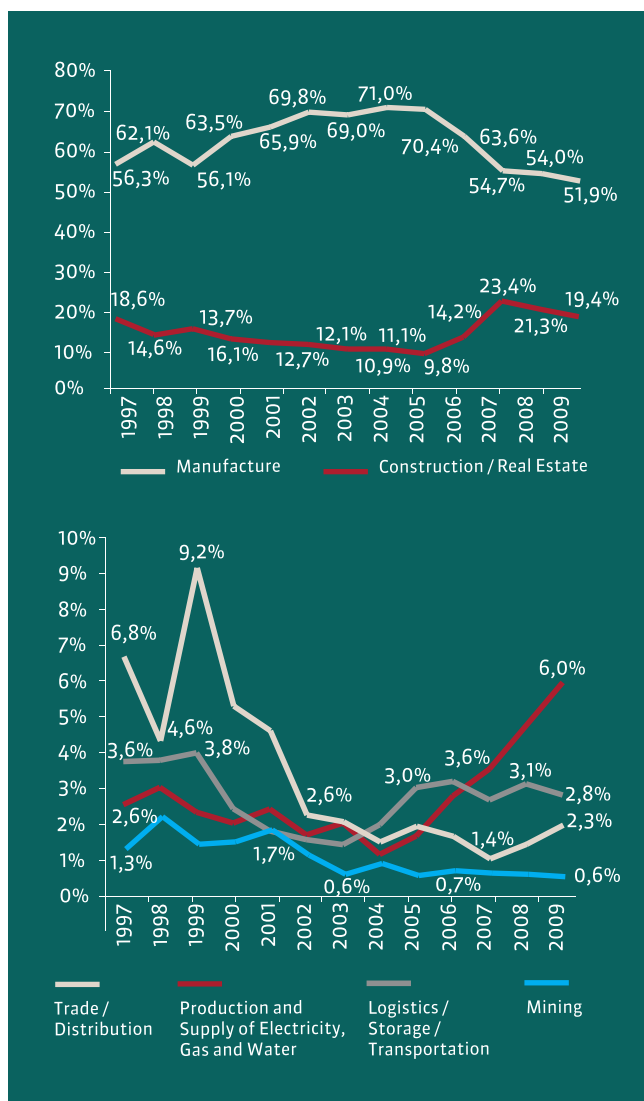
Another factor that boosted the influx of foreign investments was the opening of several sectors focusing on the domestic market, like construction and real estate; production and supply of electricity, water and natural gas; logistics, storage and transportation; mining; and, more recently, sales and distribution (Graph 3).

The process of opening new sectors to foreign investments, for all practical purposes, became irreversible in 2001, when China joined the World Trade Organization (WTO). The WTO membership, however, did not keep the government from using different mechanisms for guiding investments, within the new Chinese economic context. This

includes the Investment Catalogue Guidebook, which distributes the sectors of the economy according to categories: encouraged, permitted, regulated, or prohibited for foreign investments.

At that time, Chinese interest was focused on reducing the gaps in the country's production capacity and infrastructure. The government attempted to regulate the entrance of foreign companies to sectors like automotive and aerospace, by imposing the need for a local partner for entering the market. Through these partnerships, Chinese companies would be able to catch up, technologically, while the foreign partner would gain access to the Chinese domestic market.

**Graph 3 – Main sectors receiving DFIs in China (%)**



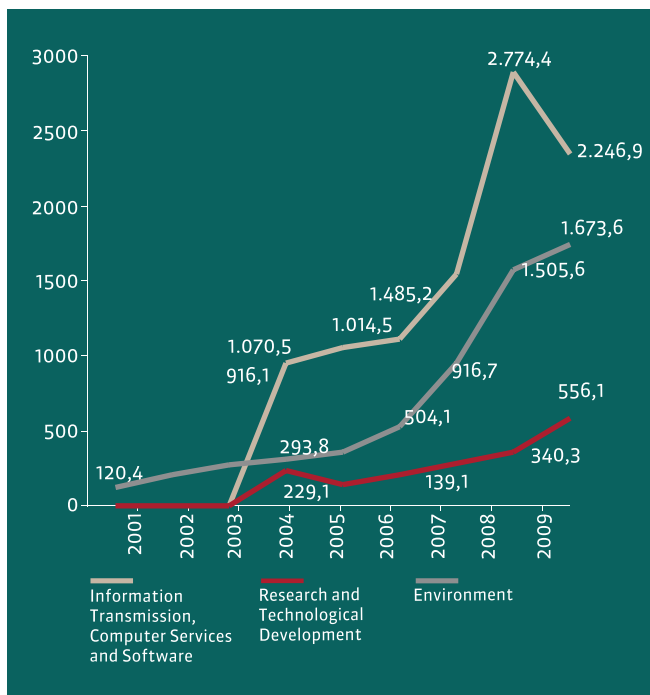
Source: NBS Preparation: CBBC

As of 2004, one sees investment flows of more than US\$ 60 billion dollars per year, thus establishing China as one of the biggest receivers of global investments. Today, the investment regime is well-defined, the level of taxation is moderate, the legal procedures are mapped out, and there are promotion centers in all of the country's provinces. At the same time, there are discretionary and particular elements that affect foreign investors.

One also notes that investments are beginning to flow to the interior of China. Companies that set up in SEZs and coastal cities, in the 1980s, in search of efficiency, and with the increased production costs in those regions, are now shifting to the interior and to countries that border on China. This phenomenon is related to integrating the production chains in Asia, and is characterized by the formation of a production network where materials and supplies from different countries are brought to China. One of the main implications of integrating these chains is in the increased barriers to the entrance of foreign products to the Asian market.

With this shift in investments, the coastal cities began to give incentive to foreign capital entering at stages of greater value in the production chain, such as installing research and development centers. Furthermore, such strategic sectors for the central government, as renewable energy and new energy sources, began to be promoted, which has led to their rapid expansion in recent years (Graph 4).

**Graph 4 – Investments in new sectors in China (US\$ million)**



Source: Investment Catalogues: 1995, 2002, 2004, 2007, 2011, Naughton (2007), Brown (2008)

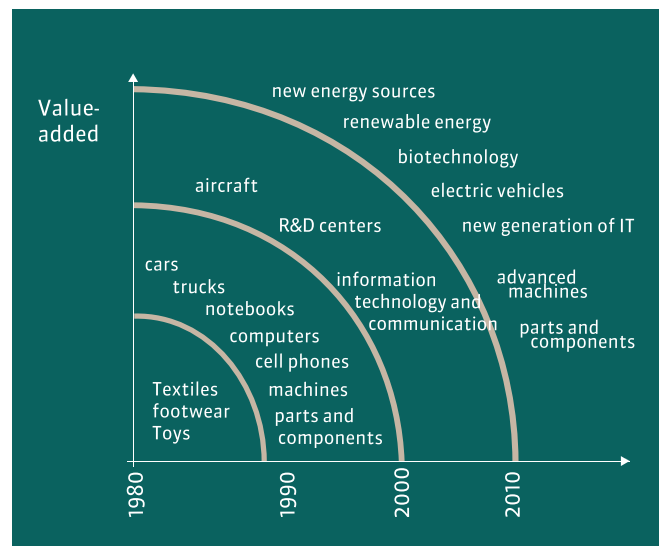
Preparation: CBBC

In fact, China has gone through different phases in attracting direct foreign investments. A first wave focused on manufacturing low aggregate value manufactured products and simply on production, such as textiles, footwear, and toys. In the 1990s, foreign capital concentrated on the automobile and home appliance and electronics industries. In the first decade of 2000, new investments in the aerospace, information technology (IT), and communications areas entered the Chinese market.

The new Investment Catalogue Guidebook, revised in 2011, which presents the new strategic sectors covered by the 12th Five-Year Plan, guides the entrance of foreign capital to form research

and development centers and for sectors connected with the preservation of the environment, like new energy sources, renewable energy, new materials, and biotechnology. Other priority investments are in machinery and equipment with advanced technology, as well as next-generation IT (Figure 1).

**Figure 1 – Different waves of incoming foreign investments**



Source: NBS Preparation: CBBC

The main objective of the 12<sup>th</sup> Chinese five-year plan, endorsed in October 2010 by the Central Committee of the Central Committee of the Chinese Communist Party, is to set the guidelines for the nation's economic and social development for the next five years. It is not merely a single document, since it combines a series of others that are produced at the regional and local levels, as well as the specific plans for sectors and technologies. This is a set of proposals, an ecosystem of policies and programs. Its immense political importance lies in the fact of its being an indication of how the Chinese economy and society are desired to grow and be transformed in the coming years. Although furnishing parameters for decision making, the plans, as currently prepared, allow for considerable flexibility: two years after the announcement, they go through detailed revisions that serve as input for producing a new five-year plan.

The Chinese five-year plan can be understood as the hub of a network of interlocking plans. They are open to adaptations, and increasingly receive the collaboration of universities and international institutions.



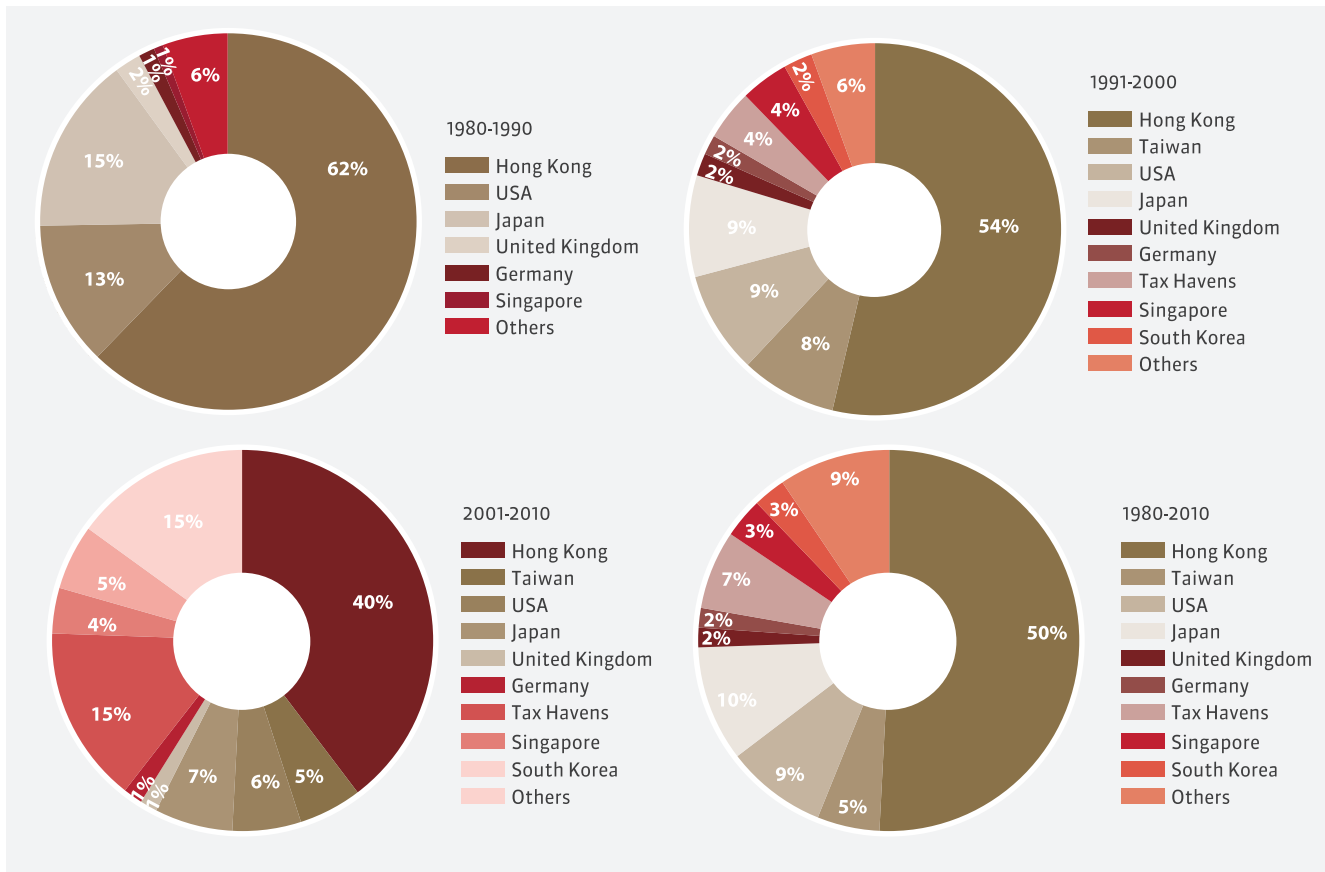


## MAIN COUNTRIES INVESTING IN CHINA

According to official data of the Chinese government, eight countries have historically been responsible for over 70% of the direct foreign investments in China: Hong Kong, Taiwan, U.S., Japan, England, Germany, Singapore, and South Korea. In Graph 5, we see that these countries held significant shares, over the past decades.

Starting in the decade of the 1990s, due to its historical relations with England and the fact of its administrative system separate from China, Hong Kong became the destination of numerous western subsidiaries interested in entering the Chinese market. At that time, Hong Kong began to play the role of a platform for the investments from these countries to enter the South of China.

**Graph 5 – Main countries investing in China, during different periods**



Source: FDI.gov Preparation: CBBC

Since the economic reform began, Hong Kong has figured as the main investor in China. During the 1980s, the island’s economy was based on manufacturing and exporting cheaply produced goods, like textiles and footwear, to the West. At first, the interest of Hong Kong business people in China was motivated by lower production costs. The geographical and cultural proximity of the Guangdong Special Economic Zone attracted investments, and several manufacturing industries were relocated from the island to the South of China.

In the first decade of the century, with the establishment of the financial market and Hong Kong stock market, it was the turn of Chinese companies to set up subsidiaries on the island. The objective was to go public and attract investments that, in the future, would be directed to its operations on the continent. Those companies also began to use Hong Kong as part of a tripod for reinvesting in the interior of China. This phenomenon, called round-tripping, consists of sending investments from the headquarters of Chinese companies located in the interior of China to Hong Kong, for the purpose of returning to China with the status of

foreign investments, thus, taking advantage of fiscal incentives.

Taiwan's investments in China have similar characteristics to those from Hong Kong. During the accelerated development of the 1980s, Taiwan began to face strong pressure on its production costs, mainly for the appliance/electronics production clusters. As a means of maintaining the competitiveness of its companies, the Taiwanese government launched policies for giving incentive to internationalization, supporting the companies in making investments abroad. The main destination was Fujian Province, in China, with which Taiwan has close linguistic and cultural ties. Therefore, the operations of Taiwanese companies, which produced computers, hardware, and components moved to the interior of China. One of the main examples is the company Foxconn that, since 1989, has maintained its production base in Shenzhen, employing more than 400,000 workers and producing electronic equipment for such companies as Apple, Microsoft, Dell, HP, Acer, Nokia, Motorola, and CISCO.

While the purpose of investments from Hong Kong and Taiwan is to establish export operations for manufactured goods, North American investments were the first to focus on serving the Chinese domestic market. Since 1979, when the Carter administration normalized relations with China, American companies, like Coca-Cola, Ford, and GM, have set up in the country in the interest of producing and selling their products to the emerging Chinese market.

As of the 1990s, a new wave of American investments entered China, represented, this time, by such companies as McDonalds, KFC, Walmart, and Nike. These companies created distribution networks covering all of the East Coast cities, and consolidated their brands with local consumers.

During the first decade of the century, we see the entrance of high-tech manufacturing companies, like GE, HP, and Apple, which also offered their products to a more developed consumer market.

One of the critical points related to American investments in China is the issue of intellectual property. A number of companies, including GM and Ford, say that their Chinese partners took advantage of their technology, copied their products, and began to offer them under their own brands on the domestic market. On the other hand, one sees an increasing interest on the part of American companies in investing in technological development in conjunction with the Chinese. The most outstanding example is GE, which reformulated its business strategy, placing China as the center for technological development and innovation.

European investments in China are led by England and Germany. The English have an historic trade link with the country. Such companies as Shell and Standard Chartered have been present in China since the end of the Qing Dynasty, in 1911. Investments from England have a diversified profile. There are large projects by companies like British Petroleum, HSBC, and Tesco, and a big variety—around 5,000—of small projects spread throughout China's entire coastal and central regions.

German investments are concentrated on high-tech manufactured items, in the automotive and electrical, mechanical and chemical engineering areas. The factories are found in Shanghai, in the delta formed by the Yangtze and Pearl rivers. Like the English, German companies have been in China since the end of the Empire. The most representative case is Siemens, which has been in the country since the end of the 19th century, and played an important role during World War II, in supporting the population of Nanjing against the Japanese invasion. Recently, when reformulating its business strategy, Siemens also positioned China as its base for technological development. The company's strategic areas of involvement, like renewable energy and new energy sources, are aligned with the new emerging industries indicated by the Chinese government in the 12th Five-Year Plan.

Finally, Eastern Asia countries, like Japan, Singapore, and South Korea, also represent a significant percentage of all foreign investments in China. The



Japanese and Korean investments are focused on high-tech manufactured products, in such sectors as automotive, home appliances, and electronics. Japanese companies, like Toyota, Honda, and Sony, and Koreans, like Hyundai, Kia, Samsung, and LG, have factories in China to serve the local market. On the other hand, more than 90% of the investments by Singapore are concentrated in financial services and insurance.

Today, 400 of the Fortune 500 companies have already made direct investments in the country. These companies, which entered the Chinese market ten years ago in search of consumers, now shift over to China the core activities of their businesses, like technological research and development centers.

The implications of the technological concentration in a region by different companies that are leaders of their sectors still cannot be measured, but they begin to generate new conditions for worldwide competitiveness. A company that wants to compete on a global level, or even in its own country, will increasingly need to be present in China, at the risk of breaking step with the technological development in their sector.

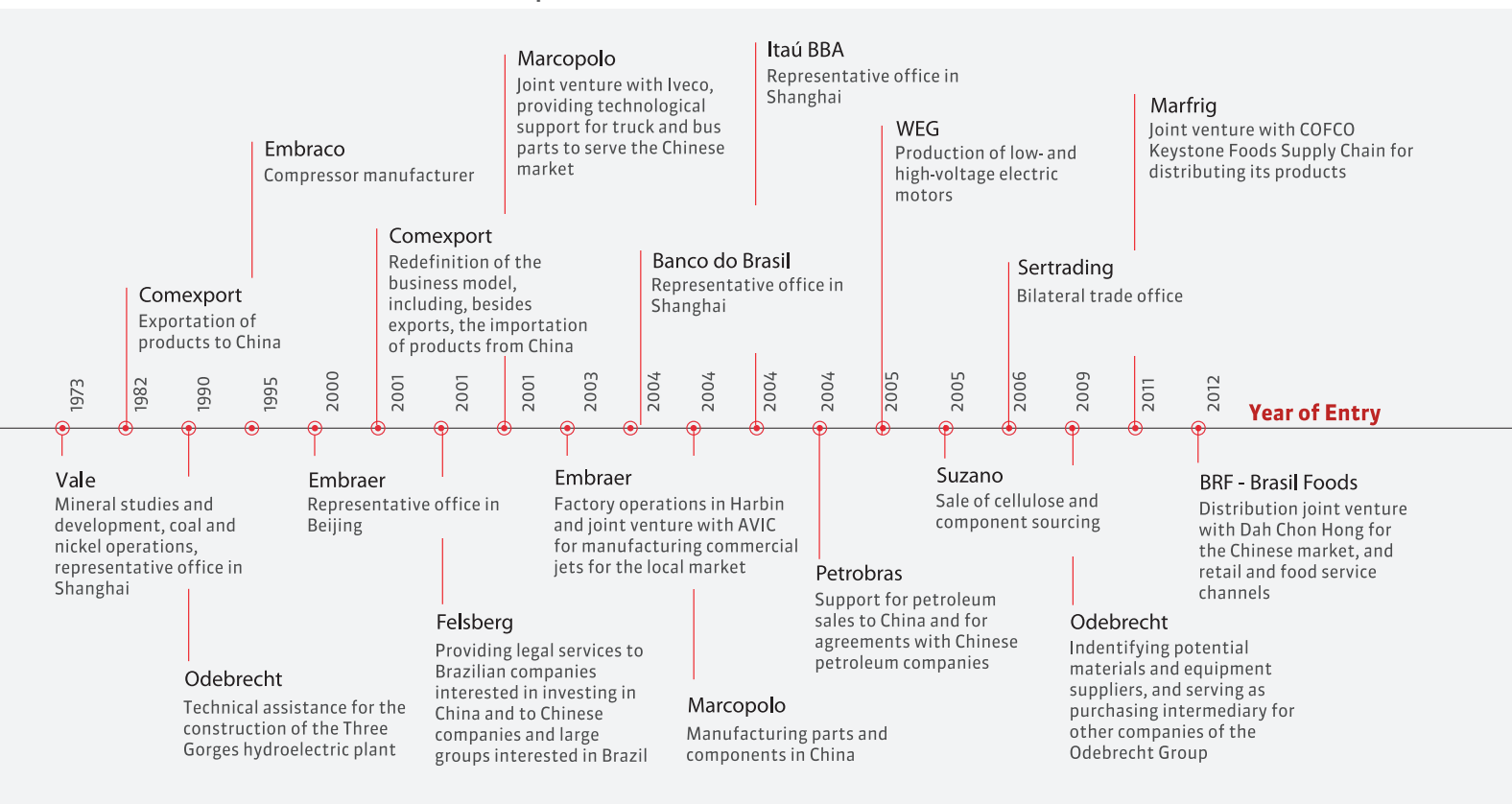
## 2. The Presence of Brazilian Companies in China

### BRAZILIAN INVESTMENTS IN CHINA, IN THE CONTEXT OF THE NEW PHASE OF BILATERAL RELATIONS<sup>3</sup>

There is no evidence, or even indications, that Brazilian investments in China have recently entered a new and accelerated expansion phase. This is one of the most significant differences from Chinese investments in Brazil. While the previous study was motivated by a leap in Chinese investments in Brazil, the Brazilian investments have remained stationary over the last ten years (Graph 6). In fact, in neither volume or type of investment, were any differences perceived in the flow of Brazilian investments to China. The entrance of such large Brazilian companies as EMBRACO, Embraer, Petrobras, and WEG was spread out over the years, starting with VALE, in 1973.

Data from China's Ministry of Commerce (MOFCOM) indicate that from 2000 to 2010, Brazilian companies invested US\$ 572.5 million in China, representing only 0.04% of the stock of foreign investments in the Asian nation. Few characteristics of Brazilian investments in China are disclosed by the MOFCOM. In conversations and presentations made by technicians from the Chinese Ministry, it was possible to note aspects of the investments, such as the concentration of approximately 80% in 12 provinces and municipalities of the East Coast of China. As everyone knows, the main ones are Jiangsu, Zhejiang, Shandong, Heilongjiang, Shanghai, and Beijing. More than 90% of the Brazilian investments in China consist of joint ventures with Chinese partners.

#### Year that the main Brazilian companies entered China

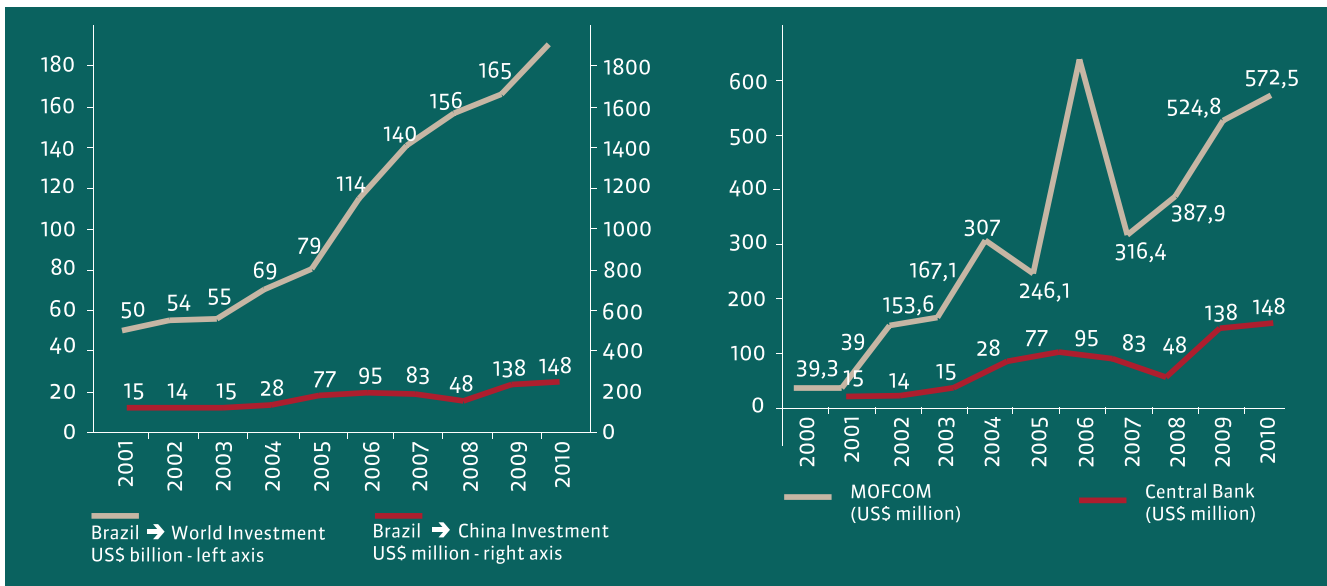


Source: Interviews held with companies and official information

<sup>3</sup> The volume of Brazilian investments in China was based on official statistical sources disclosed by both the Central Bank of Brazil and the Ministry of Commerce of China. However, it is necessary to raise an alert regarding official data, intrinsic to the methods used for generating them. Those primary sources are affected by deviations, due to different factors, like the use of fiscal havens, the investments that come from offshore operations and, specifically in the case of China, the phenomenon known as round-tripping—that is, the round trip of funds to Hong Kong. For more information regarding the method for measuring DFIs, as well as the factors that influence the data, see Appendix 1 of the Study of Chinese Investments in Brazil: A New Phase in Bilateral Relations.



**Graph 6 – Inventory of Brazilian investments in China, according to official sources (US\$)**



Source: Banco Central, MOFCOM Preparation: CBBC

Besides being small, the investments in China seem to suggest that, even the majority of large Brazilian companies have not awakened to the fact, which is widely recognized by multinationals from other countries, that being in China has become essential. Therefore, we must not expect Brazilian investments in China to have the economic logic or timing similar to the flow of investments from China to Brazil. In other words, while China “reaches out” to Brazil, Brazil does not reciprocate, whether due to the inhibition of companies faced with the difficulties of serving the Chinese domestic market, as against the attractiveness of the Brazilian market (and, to a certain point, the relative ease of access to the Latin American market), or to the fact that the companies do not have—for now—clear policies for creating and consolidating brands on the global market (see the interview and comments of CBBC’s staff regarding the Chery in the study released in May 2011).

The reasons for the direct investments in China by Brazilian companies can be classified—as per Dunning (1993) — as efficiency-seeking, resource-seeking, market-seeking, and strategic asset-seeking.

Recently, an issue has dominated the interest of a number of possible investors: the urgent need of reducing costs, in order to face off with China in the dispute for Brazil’s own domestic market. Such

is the case of textile companies that import their winter collections directly from China, since the production cost in the country is about 80% lower than that of Brazil. For the other collections, the advantages are around 30% to 40%<sup>4</sup>. Obviously, this argument applies equally well to the dispute for third markets, as is the case of Latin America.

One difference, with regard to the classic Dunning paradigm (1993), has to do with the fact that, in certain sectors, technological changes occur and will occur in China. Thus, the presence of the companies in the Asian nation has become necessary, in order to accompany the changes and to make it possible to learn them. The case of America’s GE is an example of this type of movement. The company developed innovations for equipment and devices destined for preliminary diagnostics (with low costs), making them portable and thus possible for use at home. The innovation was inspired by the advances achieved in China, and the company has already taken new products to other markets (IMMELT, GOVINDARAJAN & TRIMBLE, 2009). The same could happen, now, in the wind and solar energy sectors, in which advances have systematically reduced equipment prices.

## OVERVIEW OF BRAZILIAN COMPANIES IN

<sup>4</sup> Data obtained through an interview with a former VP of a large Brazilian textile firm.

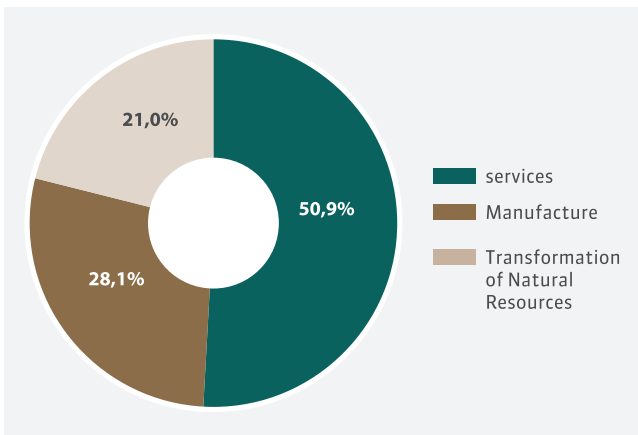
## CHINA

Given the limited volume of Brazilian investments in China, the CBBC chose to focus the study on the presence and experience of Brazilian companies in the Chinese market. The object of the study gained a new dimension, and began to take into consideration not only the companies that invest in production in China, but, also, those that are present and carrying out specific business activities, like legal firms, trading companies and banks.

### Composition of Brazilian Companies in China

The CBBC took advantage of information gathered from member companies, embassies, and Brazilian company- and professional-organized forums, like Foro Brasil and Brazilian Professionals in China (BPC), and arrived at 57 Brazilian companies present in the Chinese market. In this setting, it is possible to identify three different types of companies (Graph 7). The first consists of service providers, including legal firms, business consultants, trading

**Graph 7 - Composition of Brazilian companies present in China (% of all companies)**

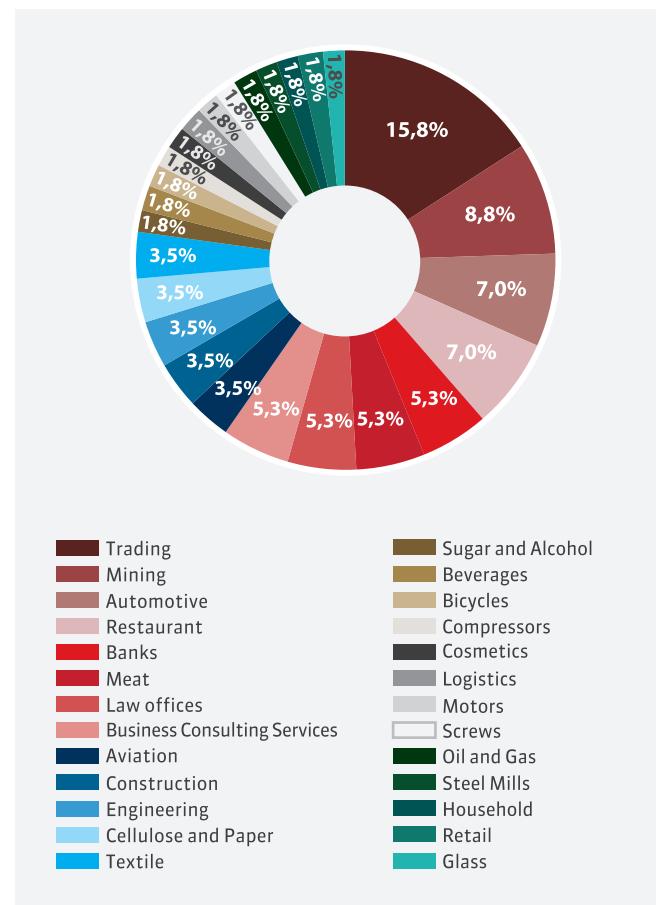


Source: Consolidated list | CBBC Preparation: CBBC

companies, and banks. Second, manufacturing companies, like Embraer, EMBRACO, and WEG. And, last, companies that process natural resources—this group takes in companies that deal directly with the primary sector, like BR Foods, Marfrig, Petrobras, and VALE, among others.

The number of Brazilian companies present in China is relatively low, compared to other countries. The U.S.-China Business Council, alone, has 240 member companies, while the Europe-China Chamber of Commerce has 1,600 members. One point we should highlight about Brazilian investments is the diversity of sectors in which they are involved in the Chinese market, with Brazilian companies from 26 different segments (Graph 8).

**Graph 8 – Company segments present in China (% of all companies)<sup>5</sup>**



Source: Consolidated list | CBBC Preparation: CBBC

<sup>5</sup> We would add that it was not possible to obtain data for the Brazilian footwear sector in China. It is known that a group of small and medium industries from the sector migrated to the South of China. However, it is possible, given the steep increases in production costs in the region, that part of these companies have shifted to other countries in Asia.

On the other hand, we would stress that there is no clear strategic alignment between the sectors in which Brazilian companies are present and the guidelines and new strategic sectors



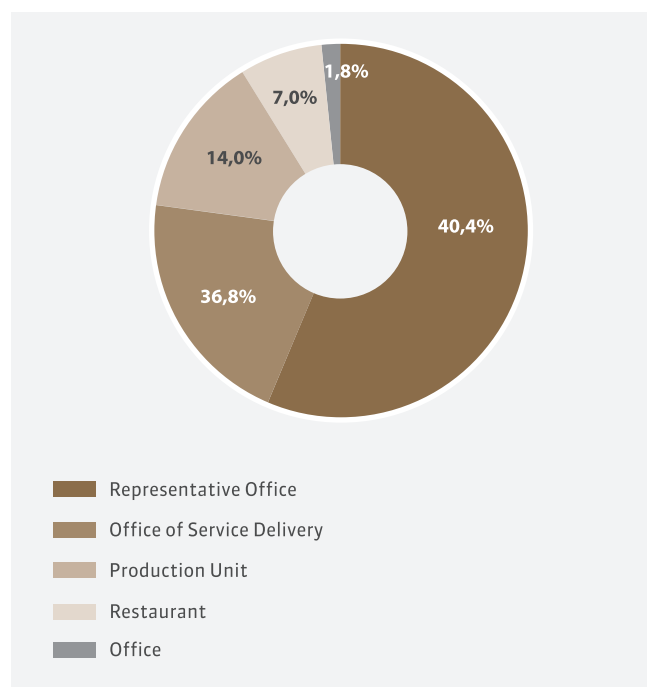
indicated by the Chinese government. As nearly as we were able to map this out, there are still no Brazilian companies present in such segments as new energies, renewable energy, advanced machinery, and new generation of information and communication technologies.

### Entry mode of Brazilian companies in China

Given the composition of Brazilian companies in China, it is natural that the main form of setting up companies would be through representative offices and providing services (Graph 9). Also, we would point out the reduced number of production units: only eight companies with industrial plants were identified. While companies from other countries move their manufacturing bases to China, in search of greater production efficiency or, more recently, technological development platforms, Brazilian companies remained and continue their inertia regarding this movement.

We must highlight that some Brazilian companies interviewed by CBBC's staff declared they were broadly satisfied with going into China and they plan for heavy expansion over the coming years. WEG, for example, intends to multiply its size

**Graph 9 - Entry mode of Brazilian companies (% of all companies)**



Source: Consolidated list | CBBC Preparation: CBBC

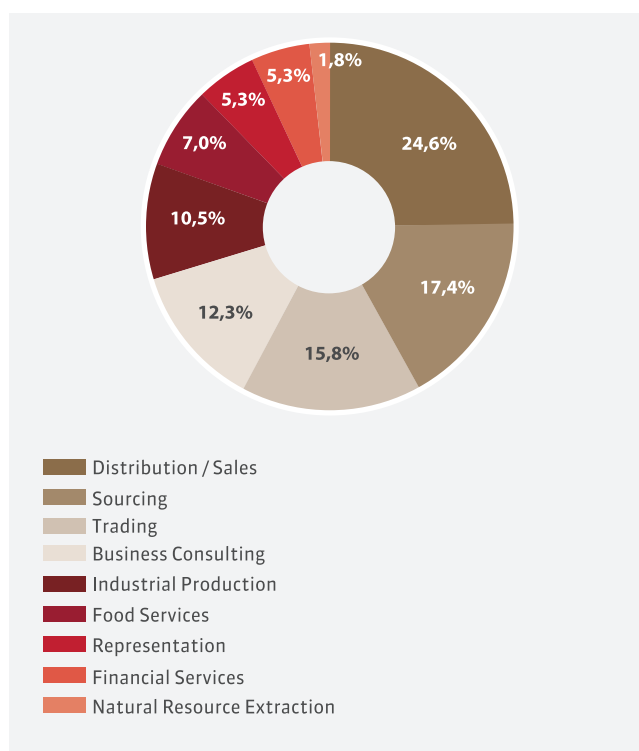
by five, over the next seven years, according to the Director-Superintendent of WEG Motores, Siegfried Kreutzfeld.<sup>6</sup>

### Business activities of Brazilian companies in China

Within the activities that comprise providing services (Graph 10), we can safely say that more than 70% of the business activities of Brazilian companies in China are focused on business consulting, trading companies, distribution/sales, and sourcing (purchasing parts or components).

At the same time, when listing data about the nature of Brazilian companies present in China, with information about the business activities they carry out, it is possible to learn one of the factors that is behind the present imbalance of the commercial agenda between Brazil

**Graph 10 – Business activities of Brazilian companies (% of all companies)**



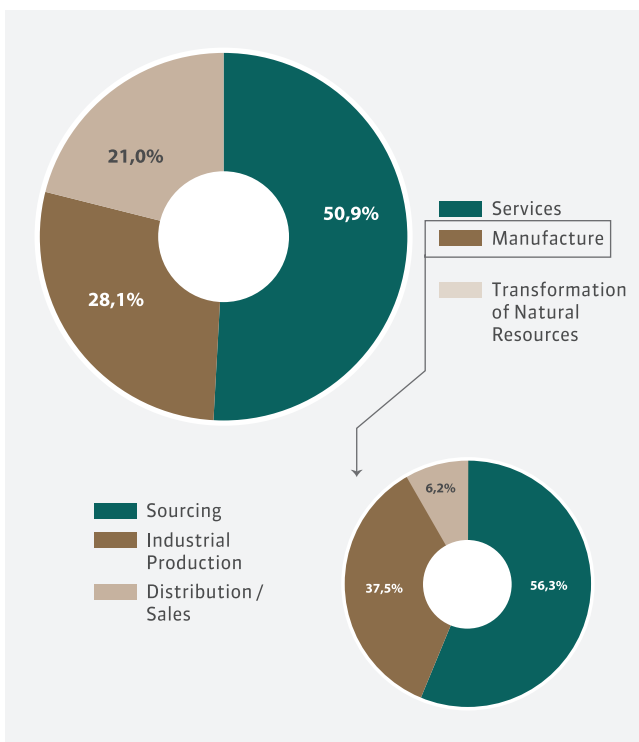
Source: Consolidated list | CBBC Preparation: CBBC

<sup>6</sup> Para maiores informações sobre o caso da WEG, ver Carta Brasil-China (Ed.2 Disponível em: <http://www.cbcc.org.br/sites/500/521/00001791.pdf>)

and China. Among the 17 Brazilian companies manufacturing products in China, more than half of them are sourcing products and components, raising the volume of Brazilian exports to the Asian nation (Graph 11).

If, on the one hand, the manufacturing companies are present in China (among other reasons) to purchase products and components, on the other hand, the companies processing natural resources are present in

**Graph 11 - Involvement of Brazilian manufacturing companies (% of all companies)**

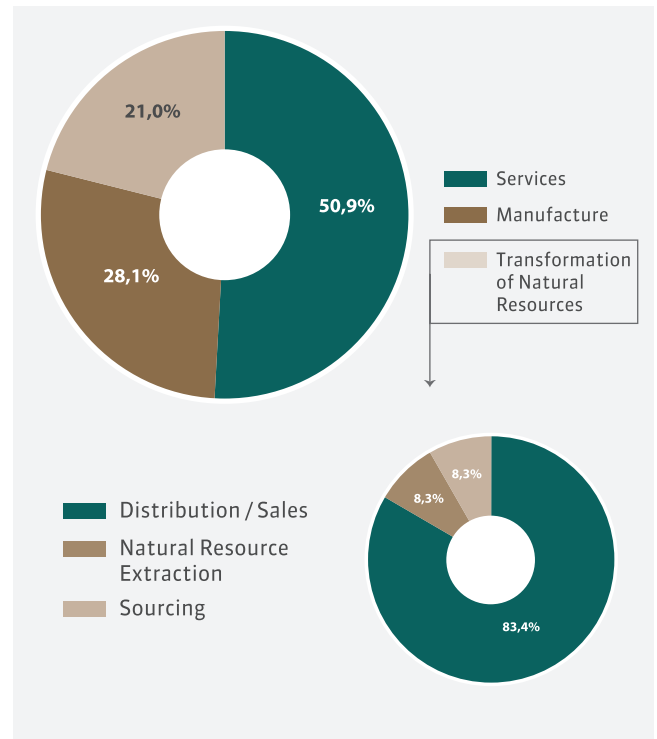


Source: Consolidated list | CBBC Preparation: CBBC

the Chinese market in search of buyers for their final products, ranging from iron ore to soy and meat. Among the 12 companies identified as processors of natural resources, more than 80% are present in China to sell and distribute their products (Graph 12).

Marfrig is an important example of this type of activity. In an official communiqué, the company disclosed that, through its subsidiary in China, it will set up two joint ventures, for the

**Graph 12 – Involvement of Brazilian processors of natural resources (% of all companies)**



Source: Consolidated list | CBBC Preparation: CBBC

purpose of increasing its involvement with food supplies, meeting the growing demand of the Chinese market. According to what was officially announced by the company, in 2011, the project is expected to go into operation in 2012, and provides for building six distribution centers, a transportation fleet, and an information technology support platform in Chinese cities, including the capital Beijing, Chengdu, Shanghai, Shenyang, Shenzhen and Wuhan.



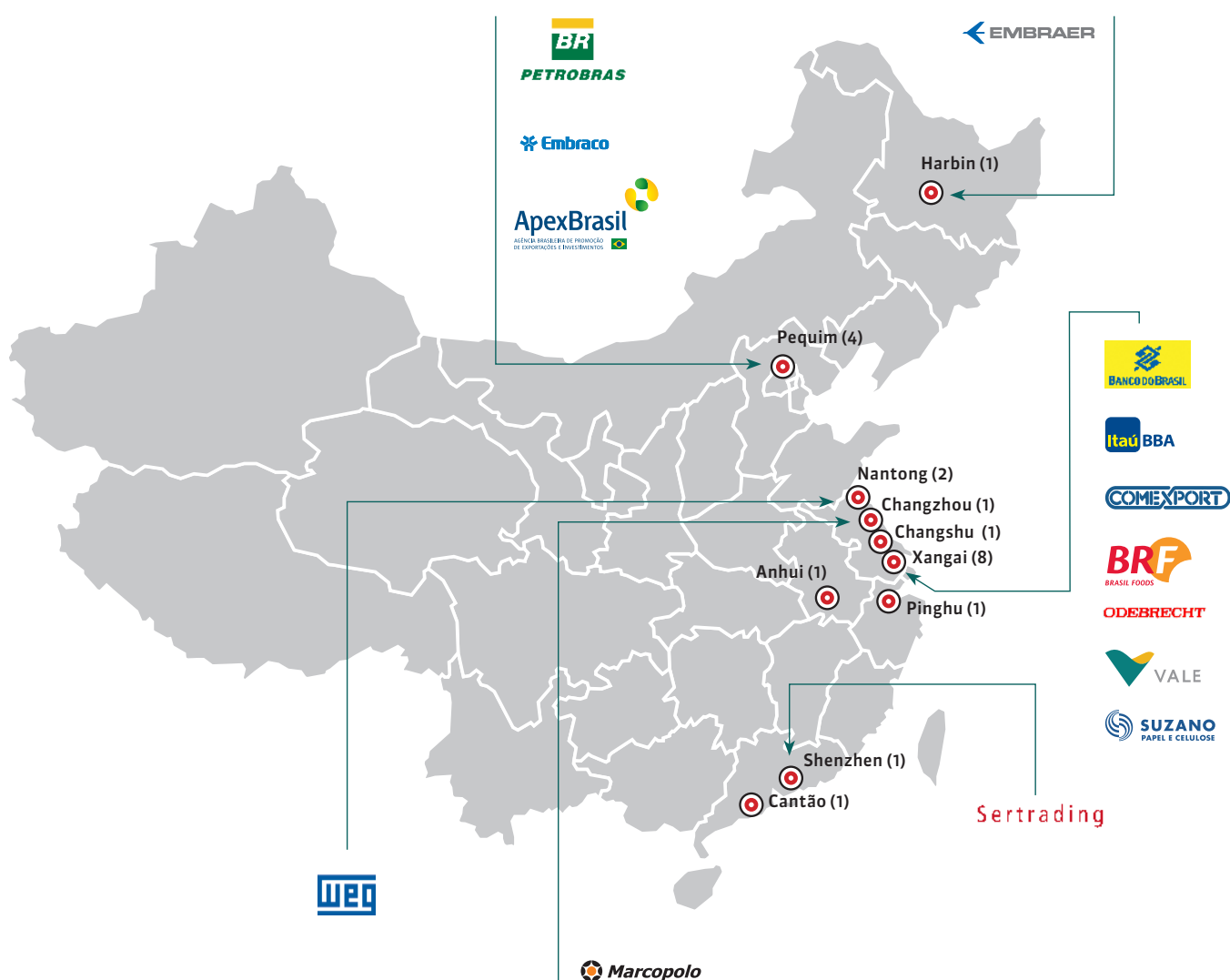


## Geographical location of the main Brazilian companies in China

The provinces and municipalities on China's east coast, where the nation's large commercial centers are located, are home to most of the Brazilian

companies (Graph 13). This fact is consistent with the overwhelming presence of Brazilian service providers in China.

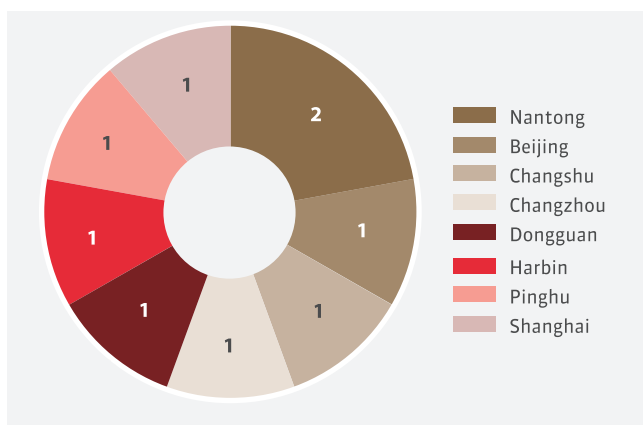
**Graph 13 – Geographical location of the main Brazilian companies in China (No. of companies)**



Source: Consolidated list | CBBC Preparation: CBBC

As for the production plants of Brazilian companies, one sees a more balanced distribution, with Nantong<sup>7</sup> being the main city receiving Brazilian manufactured goods, such as WEG and Maxion (Graph 14). The few Brazilian production plants in China are also present on the East Coast, where the production cost factors, like land and labor, have been growing in recent years. These companies are expected to relocate, geographically, as time goes by, following the flow to the interior, which is now occurring with companies from other countries.

**Graph 14 – Geographical location of Brazilian production plants (No. of companies)**



Source: Consolidated list | CBBC      Preparation: CBBC

<sup>7</sup> Nantong is a city in Jiangsu Province, on China's East Coast. It is located in the north of the province, on the north side of the Yangtze River, and has about seven million inhabitants.



## 3. The experience of Brazilian companies in China

This chapter presents an overview of the challenges and answers found by Brazilian companies in China. Based on the main characteristics of the companies, the study advances the analysis of bilateral relations by pointing out difficulties, solutions and perspectives of the companies in a country whose affirmative action in the world economy comes second only to that of the U.S. The discussion of the experience of Brazilian companies and the solutions they found for re-inventing themselves in the Chinese market provides a new and demystified view of the difficulties and possibilities for growth in the Asian nation.

For the purpose of better understanding the experience of Brazilian companies, the Council interviewed 12 executives of key companies present in different sectors of the country. The structure of the questions followed a similar logic, so as to provide a more balanced understanding of how to enter the country, the operations and perspectives for the Chinese market, always seeking to identify the main barriers faced by Brazilian companies regarding their continuation, the expansion of their activities in China, and the business practices followed by executives to compete effectively in the Chinese market.

### BRAZILIAN COMPANIES ENTER CHINA

From the interviews, there initially emerges the obstacle presented by the physical and cultural distance between Brazil and the Asian nation. And, at the moment of formulating the investment project, the companies come up against a geographical barrier that becomes a financial obstacle: moving resources to China implies high transaction costs that, depending on the situation, can make the initiative unviable. However, it is the distance involving mentalities and practices that alarms Brazilian business people. Cultural and institutional strangeness, and the fact that the Chinese business environment is replete with its own peculiarities constitute the first significant obstacle to be overcome by Brazilian companies.

In this context, there is the additional difficulty that China is an economy where the State plays a more decisive role in allocating resources: there are laws that serve as references and institutions that filter and approve investment projects. The decision-making process is cloudy and the bureaucratic meanderings bring delays, when they do not make restrictions, to entering the Chinese market. Depending on the size of the project and the sector, the decision varies between the three government levels: municipal, provincial and

central. The National Development and Reform Commission comes into the picture, here, with its central role in the process of approving investment projects in China. Cases that are tougher to approve occur when the company intends to enter sectors that are regulated or restricted by the government. Projects in such sectors as transportation, aerospace, and food supplies, which are heavily regulated, are subject to a wide variety of demands for authorizations and approvals from the Chinese government.

The lack of accumulated information and knowledge regarding how to enter China and on how to deal with the numerous levels of approval of the Chinese government bring difficulties that reinforce the cultural and institutional distance as an obstacle to the entrance of companies. We would point out that this distance is a common problem for companies from different countries that plan on investing in the Chinese market. However, different from Brazilian companies, those already have channels in place for accessing information and knowledge, like the research institutes, think tanks, and business associations that have dealings in the Asian nation.

Another highlight consists of the intense competition imposed on companies that decide to enter the Chinese market. As reported in one of the interviews, when a new and interesting market appears, the proliferation of players rises exponentially. Since any province or large city has the autonomy for allocating funds, when initiatives arise that are directed and coordinated by the Chinese government, the number of Chinese companies that choose to enter that market quickly multiplies. The central government presents the overarching guidelines and the provinces add funding to companies aligned with their interests, which means the companies may not necessarily have financial return as a main objective. In these cases, one sees that the strategic objectives of the companies are related to generating jobs and production knowledge, as well as market

share, implying more competitive offers to final consumers, and constituting a significant barrier to the entrance of non-Chinese companies.

The intellectual property issue also becomes an obstacle to the entrance of Brazilian companies. In this case, the problem can be described in two distinct aspects. The first refers to Chinese competitors that, by reverse engineering and secondary innovations, seek to upgrade themselves technologically and end up disrespecting ownership rights. The second, and most relevant, consists of the Chinese government launching a national development plan for a given technology or product. In that case, the government facilitates and, sometimes, gives incentives to incoming foreign companies, but, in contrast, it requires that technology be transferred to the Chinese partners. The intellectual property issue is aggravated by a judiciary system that often does not recognize international practices and ends up favoring the Chinese side.

In this scenario, the interviewed companies pointed out a series of initiatives that assisted them as they entered China.

First, there is a consensus among Brazilians regarding the importance of establishing a “guanxi” network, for the purpose of shortening the cultural and institutional distance separating the two countries. The term can be translated as “relationship”, and consists of informal interpersonal relationships that implicitly presupposes ties of mutual commitment and trust. As time goes by, the relationships evolve into a feeling of obligation between the parties, in terms of exchanging favors. An important step for entering China is in establishing a “guanxi” network that supports the Brazilian companies in accessing information regarding the markets, and how to navigate through the different levels of approval of the Chinese government. The term also refers to the professional who performs this function—it is common in Brazilian companies



that a Chinese, or a Brazilian of Chinese descent, be responsible for “guanxi”.

One thing that is often of fundamental importance is associating with a Chinese company in order to enter the country. Basically, the partnership can be positive, since the local partner knows the market and has established a “guanxi” network. However, the interviews show that the choice of a partner can be the determining factor for a Brazilian company to successfully enter the Chinese market. This decision must take into consideration that the partners can have different strategic objectives. Although the Brazilian company gives priority to generating economic results, at least in the medium term, followed by acquiring knowledge, actual market share, and making jobs, the Chinese party might give less relevance to such issues as profitability and financial sustainability. This is because the provinces and municipalities usually are the owners or controllers of the Chinese partner, and they tend to not close a company, even if it is not profitable, in order to avoid unemployment and the resulting social tension. If, on the one hand, having a Chinese partner is positive for assisting with entering China, on the other, the different interests make it hard to choose adequately and could lead to growing tensions, over time, in the relations between the partners.

To overcome the barrier of the lack of information regarding the market and the sectors for involvement in China, the Brazilian companies reported that they count on the support of several institutions. As mentioned in Part 2, a Brazilian company interested in entering the Chinese market has access to service providers, like legal firms, consultants, and Brazilian banks that are already established in China. Furthermore, they can also fall back on such government institutions as the Brazilian Trade and Investment Promotion Agency (APEX), Consulates and the Embassy. The latter is worthy of special mention; throughout the interviews it was referred to for its outstanding support of the initiatives for Brazilian investments in the Asian nation. Also mentioned were such associations as Foro Brasil, which organize

meetings and exchanges of information between the Brazilian companies established in China.

The initiative adopted by most Brazilian companies for dealing with the intense competition and dynamics of the Chinese market was to offer technology-intensive products. The option for such items as these comes from two factors: the evolution of the market and the intense competition, which forces them to enter the market with products near to or on the frontier of technology. This type of strategy has its risks, mainly in light of the problems regarding intellectual property. Once the technology is sold, it will be subject to possible assimilation and reproduction by Chinese competitors, and with a limited level of legal protection, as discussed earlier.

## THE OPERATIONS OF BRAZILIAN COMPANIES IN CHINA

The second large topic dealt with in the interviews has to do with the operations of Brazilian companies in China. The interest was in revealing the modus operandi of the companies, particularly the relations with Chinese suppliers and with the local consumer market, and the aspects of day-to-day operations.

One of the first barriers faced consists of the formation of a reliable supply chain. The Brazilian companies tend to give preference to international suppliers that are also established in China, in detriment to Chinese factories, whose product supply and quality standards are often questionable. Another factor that influences this choice is the possibility of calling on suppliers from other jurisdictions, for example, the case of information leaks to Chinese competitors. We must remember that the technology of a product is built in not only to its design and critical elements, but also to the components and parts that come from suppliers, and to the way they are integrated. The worldwide trend is that suppliers join together in pyramid fashion,

so that systems and subsystems administrators must know strategic information regarding products, and those at the bottom of the pyramid are excluded.

When there are no international suppliers and the supplying is done by Chinese companies, protection is even more restricted and the solution is to reduce the volume of information regarding product specifications. Even at that, according to some reports, around 15 days after the launch of a new product, it can already be found being manufactured by another company. One way to remedy this type of situation is to establish long-term contracts with the local suppliers. Once again, this is where “guanxi” gains relevance, which rules the relations between the parties, thus forming implicit contracts that seek to benefit both companies.

Regarding relations with the consumer market, as shown in Part 2, the Brazilian companies enter China with the objective of serving the local market, as well as establishing export platforms. To that end, it is necessary that they have control over the sales channel. As we observed, during the interviews, there are several success stories, in which the Brazilian companies spend years exchanging positions of leadership in their markets. This was obtained by offering customized and distinctively different products for a demand profile with low flexibility, in terms of prices. The practice adopted by Brazilian companies for serving this type of market was to offer quality, high-tech products, and ignoring the common feeling that associates the Chinese with consumers having no criteria.

We see that to establish a channel with sales networks in China or with corporate clients, the presence of the leadership of the Brazilian company is an important differential. In the interviews, agreements between the top leaders were considered to be more relevant than the contacts between sales teams. The same type of relationship, based on trust and long-term

arrangements that the companies have with their suppliers is also required for establishing and maintaining the sales channels.

As for creating export platforms, the Chinese government guided the policy, over the years, in terms of expanding the direct or indirect participation of Chinese companies. Therefore, cases have been reported where the companies are unable to set up an independent export platform, since the Chinese government imposes limits on direct sales, demanding the participation of domestic companies. In this way, it relegates to Brazilian companies the role of supplying the essential manufacturing elements but, in fact, it blocks the interface with clients.

Several points were highlighted, regarding day-to-day operations. The first refers to the Chinese labor force. Despite the cost being 30% to 50% lower, compared to a Brazilian worker, the Chinese still have a qualification and instruction level that is also much lower than the Brazilian average. This occurs because, generally, migrant workers are hired—peasants from the interior of China and with a low educational level. Here, the first step for a Brazilian company to set up its operations in China is to hold an intense training series with local employees.

The practice of hiring migrant workers is considerably risky for the operations, due to its sensitivity to salary levels. Generally, an opportunity for being paid more than they are currently receiving is enough for them to change jobs. This implies high turn-over rates, which certainly compromises the training investment on the part of the Brazilian company. Add to this the fact that, every year, more companies are moving to the interior of China, increasing the job offerings in the region and diminishing migration in search of work. Furthermore, there could be constant pressure, on the part of the remaining workers, for wage increases.

In this context, the Brazilian companies comment that it is impossible to retain the labor force, but they say that there are ways



of creating attractive differentials via wages and benefits, that go beyond what is required by the unions. However, it that is not enough, the companies give priority to efforts to retain key people, like trainees and managers. Among these, the outstanding ones are often brought to Brazil to learn the company's culture and management philosophy.

The high turnover rate also implies the need for closer supervision by the Brazilian headquarters. To that end, the company is forced to transfer to China the key managers of operations in such strategic areas as Engineering, Human Resources, and Controllershship. Promoting Chinese managers trained in Brazil to positions of greater responsibility is also frequently done. Finally, the presence of the top management of the Brazilian company, closely accompanying the results of the China operations makes a significant contribution to its success.

These initiatives also help breakdown the stigma of the hierarchical relationship between boss and subordinates in China. Brazilian companies have a more participative management system, where employees are able to interfere and propose improvements in the business. Under the influence of Brazilian management, the management model can be adapted, giving greater responsibility to Chinese employees.

Another highlight has to do with the productivity of the China operation. Brazilian companies say that their Chinese partners have a much lower production level than their operations in Brazil. Changes in the production planning system in China needed to be made, in order to balance the performance of both operations. According to their reports, planning with Chinese partners was based on relatively inflexible goals, in terms of production level, even though the result was kept in stock, afterwards. This mentality is credited to a lack of knowledge of modern management systems on the part of local companies. The learning involved, here, is ongoing, but several years will possibly be needed to fully implement

these systems. In other words, there is still a lot to be done, in this respect, in China.

Finally, with regard to innovation, there are still very few Brazilian companies that have this type of activity in China. Some of the companies reported the creation of centers for adapting their products to the needs of Chinese consumers. However, more recently, new partnerships are being established with Chinese research institutes. One highlight is the case of FuturaGene, a company from Suzano, which is involved with universities, in the area of cellulose, and has a signed agreement with South China University of Technology for an exchange program involving research and development of the use of eucalyptus cellulose in paper produced in China.

## PERSPECTIVES AND SUGGESTIONS FROM BRAZILIAN COMPANIES FOR INVESTMENTS IN CHINA

As we saw in previous chapters, there is an asymmetrical relationship between Chinese investments in Brazil and Brazilian investments in China. While the Asian nation reaches out to Brazil, announcing growing volumes of investments, estimated at US\$ 12.669 billion, in 2010, and projected to be US\$ 10.890 billion in 2011, the flow of Brazilian investments to China is relatively stationary, with the stock of investments being no more than US\$ 1 billion. Given this scenario, the companies were asked about their perspectives and what suggestions they had for boosting the flow of Brazilian investments to China.

Most of the companies feel that the Brazilian government should not only choose, but also treat, China as a priority. Since 2009, the country has been Brazil's main trading partner and, in recent years, it has become one of its main investors, as well. Brazil is positioned among the 10 biggest trading partners of the Asian nation. The status

of the bilateral relations has been changing quickly, and this requires a new positioning by the government. In this context, it was suggested that government institutions be mobilized for dealing with the different aspects that permeate business with China, such as trade and investment opportunities, mapping barriers and rising tariffs, and support for financing internationalization, among others.

The need for greater parity in the rules and practices surrounding investments was also noted, since the Chinese have more freedom to invest in Brazil, than Brazilian companies that intend to enter the Chinese market. There is asymmetry, not only in the trade programs, but also in investment rights, which is accentuated by the series of incentives that Chinese companies receive for investing abroad. The government needs to think about how it intends to position itself, in light of this asymmetry, and move to reestablish balance (even if only partially) in the rules of the game of the two countries.

To that end, it was suggested that both a technical and a political agenda be created. According to the Brazilian companies, it is essential to have a strategy and a policy for the bilateral relations between China and Brazil that focus, or at least guide, the discussions between Brazilian and Chinese companies and the Chinese government.

The scope of the strategy should include a medium- and long-term project for relations with the country, and should be put into operation via a policy that takes into account the interests of Brazilian companies that want to extend their activities to China.

Finally, the companies noted that it is indispensable to having an effective dialog with the Chinese, to build relations not only between the Brazilian company and the Chinese government, but also to improve the degree of intra-governmental coordination and interface between the Brazilian government and the companies. Better interagency coordination and greater alignment between the public and private sectors are essential for formulating a coherent position and effective action plans to promote Brazilian investments in China that serve the interests of our country.





## 4. Strategic Challenges for Brazilian Investments in China

After presenting the characteristics of the presence of Brazilian companies in China, and their experience in the Chinese market, this Part discusses the positioning of the Brazilian government regarding Brazilian investments in China, based on interviews with members of the government. The analysis indicates the main strategic challenges of the country, from the Council's viewpoint, in light of the still incipient presence of Brazilian companies in China, in contrast with the huge dynamism of the economic relations between the two countries, on both the trade and investment levels of Chinese companies in Brazil. Finally, this document concludes by defining possible initiatives, on the national level, that can help change this situation.

### POSITION OF THE GOVERNMENT REGARDING BRAZILIAN INVESTMENTS IN CHINA

According to the interviews with top government officials, Brazil-China relations have changed considerably in recent years. The trade flow has grown so much that it has had a measurable and very positive impact, from the macro-economic standpoint, significantly lowering the outside restrictions that have historically been a barrier to growth. From the qualitative viewpoint, there has been unprecedented progress, caused by the complementary nature of the Brazilian and Chinese economies. Chinese demand for raw materials brought successive raises in Brazilian export levels, and at the same time it has directly and indirectly benefited Brazilian companies by also causing an unprecedented rise in commodity prices. And in this process, the quality of bilateral relations has changed. To Brazil, China has become a leading player, and the dynamics of its economy began to play

a very important role in the Brazilian economy. Another qualitative leap reported by the government refers to the new component of bilateral relations, that is, mutual investments. As already mentioned, Chinese investments in Brazil and Brazilian investments in China bring a new dimension to relations between the countries. Chinese investments in Brazil have grown rapidly in recent years, and their focus has been changing: where, in 2010, the investments were made in natural resources, like mining, petroleum, and soy, then in 2011 they took on distinct features, with the manufacturing sector drawing the biggest share of Chinese capital coming to Brazil.

However, it is the government's understanding that Brazilian investments in China can be more significant. And that the entrance of Brazilian companies should be dealt with as a relevant issue for the nation's industries. Since establishing Brazilian companies abroad implies creating jobs outside the country, on the part of some government agencies, there is a certain degree of caution regarding the initiatives that promote the internationalization of Brazilian companies. For example, APEX already has a structure and plans in place to facilitate exportation by Brazilian companies to China.

However, the promotion of Brazilian investments in China is still under study and emphasis will be given to sectors where the entrance of Brazilian products to the Chinese market is viable only through direct investments.

The obstacles to Brazilian companies entering China go beyond regulatory restrictions and economic policies. First, the level of integration of production chains in Asia is very high. In recent years, China has been signing free

trade treaties with ASEAN countries, which, combined with significant improvements in transportation logistics and customs and administrative facilitation, making possible increasingly efficient coordination of the production chains in the region<sup>8</sup>. For the Brazilian government, this is a relevant reason for the difficulty faced by Brazilian companies entering China, because their ability to break those barriers would depend on either low costs, which are the result of perfected production technologies in scale-intensive segments (as parts, pieces, components and other materials and supplies), or of a large capacity for setting up an efficient chain ab initio, with the Brazilian entrant being the making the delivery.

Second, the low presence of Brazilian companies in China is associated with the timing of entering the Chinese market. Brazilian companies awoke to China quite late, compared to companies from other countries, like those from Eastern Asia, Europe, and the U.S. The physical and cultural distance of China, with all of its specific characteristics, forced Brazilian business people to take a more cautious stance regarding investments in the Asian nation. And when they finally perceived that they could no longer ignore the Chinese market, they found an environment, in several sectors, where Asian, American, and European companies had already established themselves, and in which Chinese companies were already able to compete as equals.

The government stresses that it has worked with the Chinese government on issues related to approvals and licenses, and that the Chinese government has very clear rules regarding foreign investments entering the country. In some sectors, the barriers found by Brazilian companies for entering China were already provided for in the rules for the entrance of foreign investments. We would emphasize that one point that can delay negotiating approvals with the Chinese government has to do with Brazil discriminating against Chinese investments and products coming into our country. The Chinese government accepts the rules and limits imposed by Brazil, but does not accept discriminatory actions. And any eventual discriminatory measures taken by the Brazilian government against Chinese interests could slow down the progress of negotiations

underway for Brazilian companies to enter China.

Another comment was about the lack, until recently, of a Brazilian bank established in China to give financial support to the investment initiatives of Brazilian companies. The government sees the fact of the Banco do Brasil going to China as an important landmark for facilitating the entrance of the nation's companies to the Chinese market.

Furthermore, the government says that specific action plans must be developed for Brazilian investments in China, and that this area still lacks a defined strategy and policy. However, we must take into consideration the fact that in the field of bilateral relations, a Joint Action Plan was signed by the Brazilian and Chinese governments, in 2010, to be carried out by 2014, which indicates such sectors as energy, mining, and agriculture for cooperation and reciprocal investments. The Plan also provides for forming an investment work group, for the purpose of exchanging information regarding bilateral investments and opportunities, and for promoting cooperation in the investment area between Brazilian and Chinese companies.

Finally, the coordination between the government agencies responsible for different phases of the internationalization process of the companies can be improved, in order to facilitate the promotion of initiatives in China and to put into practice possible guidelines and strategies to be defined for Brazilian investments in the region.

## **INTERVIEW WITH THE AMBASSADOR OF BRAZIL IN CHINA, CLODOALDO HUGUENEY**

Claudio Frischtak e André Soares

*Could you briefly comment on Brazil-China relations in recent years?*

**Ambassador Clodoaldo Hugueney:**

*The growth of trade relations between Brazil and China in recent years has been so significant that*

<sup>8</sup> For more information regarding the integration of production chains in Asia, you must see the series released since 2006, by the Asia Development Bank (ADB), which already has more than 80 reports about "Regional Economic Integration in Asia", and concentrates on subjects related to regional cooperation and integration in the areas of regional infrastructure and software, trade and investment, money and finances, and public assets.



one could apply the dialectical principle: quantity transitions into quality. Spectacular growth in such a short period of time has led China to be Brazil's biggest trade partner. China, however, has also grown to the world, becoming, on a global scale, the biggest exporter, second biggest economy, second biggest importer, and main manufacturing center. That is, the Asian country is now a priority for the entire world.

Relations with Brazil, from a quantitative standpoint, showed unquestionable progress, due to the complementary nature of the two economies, even though there is a lack of diversity in Brazilian exports. The demand for raw materials caused successive raises in our exports to China, at the same time that it indirectly benefited us with an unprecedented rise in the price of commodities. The price of iron ore, for example, achieved very high levels, and its main explanation was the increased Chinese demand.

Therefore, I consider the evolution of the trade perspective to be especially positive, although the effect of the growth of China on Brazil's industrial structure is under discussion. As for the possible impacts of the crisis in Brazil, I am certain that our relations with China have contributed to our facing it with fewer complications. The case of VALE is a good example. With the crisis, the demand for ore from the developed markets took a substantial dip, and the Chinese demand was responsible for sustaining the supply.

*What about the case of Brazil, as a supplier and investor? Will we also have China as an investor in these areas?*

Yes, we will. For this to become a reality will depend a little on the Brazilian response to incoming Chinese investments. But I believe that there is a growing Chinese interest in investing in Brazilian industry. At the Embassy, we have seen that we are moving from large Chinese investments in Brazil, in sectors like mining, petroleum and electrical transmission, to capital and consumer goods, like machinery and equipment, trucks, and automobiles. There are conditions for growing investments in the industrial and infrastructure areas. In the latter, everything will depend on how Brazil is able to positively channel these foreign resources for our development and to attract foreign investors, such as via shared construction work or associations between companies.

On the other hand, we must not forget that there is also another dimension to the growing Brazil-China relations. This is because those who benefit from trade with China are not those who suffer with the competition of Chinese products in our country. This

is the case with the manufacturing sector, not only in the Brazilian market, but in third markets—one of the few manufactured products we export are airplanes. This problem worsened with the crisis. That which China once exported to the developed countries was redirected to growing and developing countries, thus, intensifying the competition in markets where Brazil enjoyed a good position, such as Latin America and in Brazil, itself.

Summarizing, given the complementary nature of the economies and the enormous trade surplus that we have with China, we are in a comfortable position, from a global standpoint. India, on the other hand, has a deficit of nearly 30 billion dollars with China. Nevertheless, from the standpoint of Brazilian interests, by sectors, we have a complicated situation. Sectors focusing on natural resources tend to see the relations as very positive, while the industrial sectors suffer with Chinese competition.

*Could you speak a little about the perspectives for relations between Brazil and China?*

The future of our relations depends on how we will be able to handle this current moment, finding solutions and working out the problems. Protectionist measures might be necessary, but they will be merely palliative, if they are not accompanied by programs that promote competitiveness. We enjoy good relations with the Chinese, and we must not let them deteriorate. Although the Chinese seek retaliations against the Americans and Europeans, so far, they have behaved differently toward Brazil.

Trade relations should continue to evolve in the coming years. However, not at the same pace as recent years, due to the possible reduction in the growth rate of the Chinese economy. From now on, it is possible that Brazil will no longer feel the same positive impact on prices and quantities, as has occurred in recent years. Whether we experience a smooth or forced landing will depend on the rate of slowdown of the Chinese economy. The Chinese government is working to have a more controlled slowdown. The economy grew about 10% in 2010, and 9% in 2011, and probably we will see an average of 8% - 8.5% in 2012. The number 7.5%, released in March, should not be understood as final. When analyzing the working plans for previous years, we will see that the number presented was 7.5% or 8%, and the economy achieved higher percentages.

It is not very likely that there is still enough room for the Chinese economy to grow more than 10%, while the world economy grows at around 3%. The big question we should ask is if the Chinese economy will be balanced, or not, and if there will be a change in the development model. I believe that we will see no big measures being taken in this area, now, since this is a year of political transition. I believe that

the government will make every effort to maintain a reasonable growth rate—of around 8%—and will continue sending signals regarding the need for reform, and adopting measures that open the way for a change in the model.

And what does this mean to Brazil? I think that the complementary nature of the relations will continue. China is moving more and more towards a demand for sophisticated products and services. Therefore, we must be alert to this change in the Chinese consumer, in order to take advantage of the new windows of opportunity that this economic transition will make possible.

*That is very interesting. Does this mean that the Chinese behave in exemplary fashion in their relations with Brazil?*

We have not seen criticisms in the Chinese press regarding the protectionist measures adopted by Brazil. The Chinese have shown a willingness to work out any problems in the relations. We must understand, however, that the one who is uncomfortable with an aspect of the relations is Brazil. Therefore, our country must seek a new position for dealing with this aspect, excluding measures that discriminate against the Chinese.

Brazil, like any other country, can set rules to limit or even prohibit investments in certain areas, and restrict the entrance of imported products. But discrimination, that is, imposing rules against a specific country, would not be acceptable.

If we apply discriminatory measures against China, we must run the risk of reducing the positive aspects of the complementary nature of the bilateral relations. Obviously, China cannot substitute very quickly the soy, iron ore, and petroleum imported from Brazil. However, it is investing in those sectors all over the world, while seeking to diversify its sources of access to natural resources and, to a certain extent, lessen its dependence on some of the players.

*How are Brazil-China political relations?*

They are very good. There has always been recognition of these relations by both parties. The China's first strategic partnership with a developing nation was with Brazil, in 1993.

Recently, the relations, once again, went through a very significant process of change. Today, both countries are relevantly involved with global problems, such as environmental issues, in the G-20, and are partners in the BRICS group. There is a multilateral dimension to this very relevant relationship. And what are the implications? The heads of state, for example, began meeting three to five times per year—with the leaders of the BRICS and the G20, in meetings on the environment, and, also, in bilateral visits. President Lula visited China, in 2004 and 2009. President Hu Jintao visited Brazil in 2004 and 2010, and President Dilma was in the Asian nation, in 2011. This year, a visit is expected to Brazil by Prime Minister Wen Jiabao.

There is an ongoing top-level dialogue with an intensity that did not exist before, which brought about the launch of the Joint Action Plan, for instance. The visit of President Dilma, in 2011, was of significant importance to bilateral relations. She announced, via a communiqué, her expectations with respect to China, and put forth the proposal of a qualitative leap and of the need for change in the relations. That point was remembered, again, in a recent COSBAN meeting. I think that there are no substantial problems, from a political standpoint.

There is one disagreement regarding the reform of the UN Security Council, which I believe can be explained in light of other factors of Chinese foreign policy. However, I think that the areas of convergence in the relations are much greater than the differences.

*Could you say a little about the Brazilian Embassy in China? Brazil recently opened a new Consulate in Guanzhou. We have noticed that the Embassy has been making changes and receiving more resources. Could you comment on how the Embassy is structured, at the moment, and what has changed?*

The Embassy has grown a lot since the time when I arrived, when there were only five of us. Today, we have 15 people, this number will probably continue growing, with the solidification of bilateral relations. Besides the increased number of diplomats, the Embassy has been heavily restructured, in order to better handle the large sectors of our involvement: economic, political, educational, scientific, technological, energy, consular, environment, cultural, and trade promotion—putting the SECOM to better use. Furthermore, we have more than doubled the number of employees.



In the consular area, we had a revolution. If that hadn't been done, we would have had a serious crisis, because the number of requests for visas grew exponentially, as a result of the build-up in trade relations between the countries. The consular sector granted nearly 3,000 visas, in some of the months of 2011—most of which were business visas.

It was also important to open a Consulate in Guanzhou, which was created in 1992, in order to expand our service capability. Guanzhou is especially important, because most of the Brazilian community lives near this city.

I believe that, despite the changes, the structure we have is still not enough for the level of relations with China and for the evolution that those relations should experience in the coming years. But the Embassy went through big changes as a result of recognizing the growing importance of China, and now adequately handles the work, on a par with the level of relations, in all areas. Besides the routine work, we dedicate special efforts to studying China. Based on our personal investigations regarding the country, we have built up a large repository of information, which comes out in an important Embassy document sent to Brazilian authorities, and is already in its fourth edition. The document is constantly revised with additions, substitutions or updates and now totals more than 550 pages. This work has contributed to expanding knowledge, in Brazil, about China and the bilateral relations. So, it is now up to my successor to expand this work even more.

*Could you comment on the entrance of Brazilian companies to China? In recent years, at the head of the Embassy, have you noticed an increased volume of companies interested in entering the Chinese market?*

My predecessor, the current President of the Brazilian Center for International Relations (Centro Brasileiro de Relações Internacionais - CEBRI), Ambassador Luiz Augusto de Castro Neves, during his period in Beijing promoted many important initiatives, among them being the Foro Brasil—an informal mechanism for promoting periodical meetings between the companies, to exchange ideas and experiences regarding the Asian nation, which the Embassy supports, yet today.

I agree with the recent finding of the China-Brazil Business Council, that Brazilian investments in China have stagnated. It is hard to explain this fact, because we should take into account corporate decisions. But some hypothetical reasons can be raised. A series of factors have contributed to Brazilian companies not entering the country. One of the specific things about China is the fact that an investment project demands great effort, as well an

agenda of trips and contacts with local partners. This is a tiring and even discouraging process. A Brazilian company is entering a very distant country, with an exceedingly different legal system, a specific way of organizing its industrial sector, and very distinct regulations.

Another point that can be raised is that Brazil missed the first wave of foreign investments entering China. When Brazilian companies decided to enter the Chinese market, they already found thousands of multinational companies there, ahead of them—all of the world's large companies were represented in China. Furthermore, they found Chinese companies to be evolving and becoming competitive.

*The barriers were much higher.*

Another aspect we should think about is that many companies entered China with the perspective of exporting their products, and counting on the benefits of low labor costs, or incentives that were eventually granted by provincial governments. Many times, there was an intention of making China a manufacturing or export center and, now, those conditions are changing, like wage and exchange policies, for instance.

*That is, an export platform to third markets?*

Exactly. Companies from all over the world decided to enter China with this type of purpose. Furthermore, we saw Asian production chains becoming integrated, and a process of opening to negotiating free trade agreements. At the beginning of the consolidation of this process and of those chains, Brazilian companies were unable to take advantage of the proper timing for entering, except for companies in southern Brazil, from the footwear sector. Many of the companies now in China are producing for the domestic market.

*That is a very important point: the integration of production chains in Asia.*

China has insisted with Japan and Korea on advancing with a trilateral agreement, and that initiative has recently been formalized, with negotiations beginning by the end of 2012. If this process for opening to trade is well done, it will reinforce, even more, the production chains in Eastern Asia.

Finally, the last barrier that I see to the presence of Brazilian companies in China was the lack, until recently, of a Brazilian bank to finance the investment projects of our companies. There is no doubt that the presence of a large Brazilian bank in Chinese territory would facilitate the entrance of Brazilian companies. For example, large legal firms are now in China, offering very adequate legal

assistance. What is lacking is a financial arm that I hope will be overcome by the opening of a branch of the Banco do Brasil.

The operations of Brazilian companies in China, in given sectors, face production difficulties with licenses and authorizations from the Chinese government. How is the Embassy involved in these cases? Does the Embassy work together with the Chinese government to support Brazilian companies, or are these rare cases? If that's true, with what institutions does the Embassy work? We see that a good share of the restrictions are related to the National Development and Reform Commission (NDRC). Does the Embassy work with this institution?

For companies initiating their investments, the Ministry of Commerce (MOFCOM) is the most important agency, reinforced by the fact that on the Chinese side of the COSBAN (Sino-Brazilian Commission for High-level Coordination and Cooperation) is co-chaired by Vice Premier Wang Qishan, who is responsible for this Ministry. Starting with a given amount, every investment project must be approved by this Ministry—indicating its enormous importance to this process. The MOFCOM works in partnership with the NDRC, regarding foreign investments in China.

Our main point of contact is with the Ministry of Commerce, but we also dialogued with the Ministry of Agriculture and with the Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), due, especially to the opening of the Chinese market in the area of meat, which was successfully concluded. The dialogue with the AQSIQ was very positive on the issue of meat. Brazil's Ministry of Agriculture named an agricultural attaché to support the Embassy in these matters and we have made big advances in recent years.

The Embassy is also in close contact with Ministries that can interfere in important subjects for Brazilian companies, such as the Ministry of Industry and Information Technology, which cares for aspects that are important to the area of aircraft. The Ministry of Finance and the China Bank Regulatory Commission (CBRC) play an important role in the issue of trade in local currency and in opening financial institutions. Therefore, the Embassy maintains a good level of contact with these government agencies, always seeking to support Brazilian companies.

We encourage companies to come to the Embassy. It would be positive to organize more frequent visits and missions. Another need is for the Chinese branch of the CBBC to become more active, in conjunction with its Brazilian counterpart. I have noticed that the Council in Brazil has become more dynamic and

is now the only NGO cited in several documents on bilateral relations, in recognition of its importance to the Government.

I would like to ask one last question about the perspectives for Brazil-China relations. Do you see the need for new mechanisms or a new strategy for China?

I believe we can always improve plans and strategies. We negotiated the medium-term, five-year Joint Action Plan, and we are negotiating a Ten-Year Plan. We have COSBAN, with 11 active subcommittees and a large number of work groups. As I see it, there lacks a greater effort at coordinating the implementation of a China strategy, involving all of the Ministries that have a part in the relations. Besides a closer dialogue with the private sector, where I think the Council has had, and still has important involvements. Consequently, we would have better follow-up and implementation of the plans and we would be able to negotiate with China based on a well-defined strategy for moving ahead with the “qualitative leap” in the bilateral relations, as proposed by President Dilma Rousseff on her visit to China. ▀



## CBBC ANALYSIS – STRATEGIC CHALLENGES FOR BRAZILIAN INVESTMENTS IN CHINA

The first emphasis that must be made is that China has a deliberate policy for attracting, selecting and qualifying foreign investments. Since 1995, the Chinese government has published a guide catalogue that establishes certain priority sectors for investments in Chinese territory. The objective is to direct foreign capital to develop given segments of the economy, as well as to regulate, restrict, or even block investments perceived as not being a priority. From this perspective, the guidance of the Chinese government has been changing, in recent years, to attracting and facilitating sectors that have greater added-value and that are technology-intensive. Inversely, there is less interest in encouraging and signing partnerships in segments that focus on consumer goods and even capital goods, with the exception of those that operate on the frontiers of innovation.

Therefore, the first big strategic challenge for expanding Brazilian investments is in promoting partnerships that are within the scope of the sectors where foreign capital is being encouraged to enter in China. We list, here, what the government considers to have priority in the new investment catalogue:

1. latest generation of information technology;
2. products that generate energy savings and environmental protection;
3. clean and renewable energy sources;
4. bio-agriculture;
5. high-performance machinery and equipment;
6. new energies;
7. new materials and composites;
8. vehicles powered by new energies.

A second area that can define the space in which Brazilian companies are involved is described according to the dynamics of the Chinese market and the changes that have been noted in the people's pattern of consumption, especially urban. With increased income, more information

regarding trends and products offered globally, and the growing sophistication of the tastes of a rising middle class, new opportunities are opening that can be caught by Brazilian companies aligned with the changes in the composition of consumer demand over the past decade. Even if the response capability of the companies is limited, the comparative underlying advantages of the country are probably substantially greater than those involving exports. As an example, the new technologies derived from agribusiness and bio-agriculture are sectors in which Brazil has cutting-edge technology and the potential for using them to position themselves in the Chinese market.

The policy of attracting foreign investments to China should be seen as an integral part of the country's medium and long-term planning process. We stress that the Chinese government has had a reasonably clear and consistent idea, all the time, of what is of interest to the nation. The rules it establishes are clear, and they change as the country matures. There is no interest on the part of the Chinese government in attracting either opportunistic investments, or those seeking relatively short payback periods. This fact represents an additional challenge to Brazilian companies: investments must be "patient", that is, have a medium to long-term focus, and the results of which must be derived from a high level of persistence, among other factors.

At the same time, one must not ignore the fact that a strong asymmetric nationalistic bias is involved, and affects all foreign investors (not only Brazilians). In fact, there is a set of obstacles to establishing a base (production and distribution) and to accessing the Chinese market. For example, using China as a platform for exporting to third countries is possible, but the Chinese government is increasingly assisting its own companies to position themselves as integrating and intermediary elements of foreign clients. Overcoming these obstacles, when possible, demands an extra dose of persistence, as well as good personal relations with those who make decisions on the part of the Chinese government.

Finally, one must consider that, as a player, Brazil is on the edge of this process, since the number of Brazilian companies present in the country is very small and of secondary importance to the Chinese economy. Therefore, the probability that managers of economic policies and of attracting investments will agree with significant and non-discriminatory changes is quite low. What changes is how the new investors deal with the barriers, and how the backing of the government is organized.

### INITIATIVES ON THE NATIONAL LEVEL

There are two basic operative premises that guide, in practice, Brazil's relations with China. First, the Chinese government feels that nationalistic policies and initiatives are legitimate, whether with regard to defending the Brazilian domestic market, regulating foreign investments, or supporting national companies while they are foreign investors. The corollary is that policies and actions must not be perceived as discriminatory, whether towards Chinese exports or the inverse movement of its companies. Second, it is up to each country to structure itself in the best way possible and to position itself competently on the playing field of the global economy. Brazil—while a strategic partner of China in terms of international policy, whether in the G-20 or the BRICS—has a certain amount of political credit. However, it is not enough to move the policy of attracting investments from China and to give it a bias in favor of Brazilian companies.

So, what is to be done? There are three initiatives that depend basically on national players, and that in all probability would be well-received by the Chinese, because they signal a priority in the relations of the two countries:

First, to raise the level of visibility of the relations in the government plan, allocating resources for formulating, drawing up and carrying out the policies, while reflecting the true importance of China to Brazil, now and in the foreseeable future.

Second, to improve interagency coordination. It is possible that the sharpest contrast between the stance and actions of the two governments is not found in the competence or effectiveness of a specific institution, but in the limited degree of coordination between them. The dominant perception is that not only do the policies of the Chinese government focus on the long term, but they are also carried out with competence and in a coordinated manner. In Brazil, there are spaces without resources that strictly organize themselves, but insufficiently, within the government plan.

Finally, one could argue that the low level of coordination is not merely an administrative problem, but that it could be seen as the consequence of the absence of a converging vision between the government, companies and civil society regarding the nation's interests. The design of an effective strategy for facing the challenges and opportunities brought to bear by the rise of China will depend on stirring debate, generating knowledge, and mobilizing the resources of society, for the purpose, in the first place, of having greater balance and sustainability in Brazil-China economic relations.





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# Experiences of Brazilian companies in China: Interviews <sup>9</sup>:

Interviews held by Claudio Frischtak and André Soares

## BANCO DO BRASIL

We would like to start this interview by addressing the decision of Banco do Brasil (BB) to set up in China. What motivated you to enter the country? What were the main landmarks in the trajectory of the bank in the Chinese market?

**Admilson Monteiro Garcia – , Executive Director, Banco do Brasil.**

The Bank went to China motivated to explore more closely the business flow between the two countries. First, our offices were in Beijing, but we soon realized that we had made the wrong choice, and eight years ago we moved to Shanghai. It took us almost five years to understand how to do business in China. It was not easy to learn, especially for a Latin American bank, since western and eastern cultures are completely different. Besides the cultural factor, at that time, there was not a large number of Brazilian companies in China.

We began by relating to Chinese banks. One of the first difficulties was the fact that Chinese banks do not engage unless there is a signed memorandum of understanding. Usually, we only sign a memorandum of understanding when we already have decided on a project. But in China, this must be the first step.

Since that was the rule of the game, Banco do Brasil signed memoranda with the largest possible number of Chinese banks and, thus, the business began to flow well. We learned, somewhat the hard way, that the important thing in China is not what the bank can offer, but the “guanxi”.

At that point, we saw a series of Brazilian companies that intended to set up in China. Consequently, they began to demand products and services from the Bank, like those that we offered in Brazil. Since we still do not have a branch in China to serve these companies, partnerships were established with Chinese banks in which we took over the company’s risk and they, the risk of the Banco do Brasil. Thus, based on these three factors, we are able to provide products, services and financing to Brazilian companies in China.

*Do you mean, they take up the risk of the Banco do Brasil, which is clearly at a low ebb?*

Yes, but they do not take over the risk for Brazilian companies, because we do that. In the last five years, we have grown so much in this market that Shanghai is now the Bank’s most profitable office, abroad.

*Do you have more origination, there, than in any other office?*

Yes. That which is possible to handle, outside of China, is done directly by the Banco do Brasil. But, that which cannot be handled outside of the country (demands usually made in yuan) is done in conjunction with Chinese banks.

It was also important to organize access to Brazilian companies. The Foro Brazil exists in China,

functioning as Chamber of Commerce, in which all Brazilian companies take part. We began to meet and, today, the President of the forum, Sérgio Quadros, is our representative in Asian countries, where he is getting Brazilian companies together with Chinese banks. This is necessary, since several Chinese banks do not offer all of the services that our companies are accustomed to using. We have a client, for instance, who would like to get a discount, and the Chinese bank is unable to understand the mechanism. In this case, we went with the company to explain how the operation should be done and, as a result, we began to carry out the transaction with that particular bank.

*Does Banco do Brasil serve as a bridge in terms of business culture?*

Yes, and we even recommend partners.

*Banco do Brasil has recently requested a license to open a branch in China. How does this process work? Is it very different from what occurs in Brazil with Central Bank?*

In terms of the process, it is very similar. But there are some important differences. Whenever a Chinese bank gets a license to operate in Brazil, this license is valid for operations throughout the entire country and includes all the products that the bank can take to its clients.

It is different in China. First, the foreign bank receive an initial license forbidding operations in local currency. In order to obtain an additional license allowing operations in Chinese currency, it is necessary to have a banking license for at least three years, with at least two years of positive results.

This is protection for the local market, because it limits the capacity of the foreign bank to generate income. And, with this limit, it becomes more difficult

<sup>9</sup> Other companies were interviewed but did not authorize the publication.



to achieve balance and get positive results in two of those three years.

*Will this license allow Banco do Brasil to operate in foreign currency in Shanghai?*

Exactly. We can operate with clients from mainland China, but only in foreign currency (not in yuan).

*If the Bank wishes to open another branch in Beijing, would this be possible with this license?*

Yes. There is no restriction, but we can only operate in foreign currency.

*What is your perception of the other foreign banks that are already operating in China for a longer period of time? Are they operating as a Chinese bank?*

No. In general terms, a foreign bank seeks to accompany its clients. A German bank, for instance, initially sets up to support German companies and, then, it begins to enter foreign company markets, but not Chinese. In the local market, it had great difficulty in competing with a Chinese bank, given its penetration and capability for funding the latter.

In general, the banks begin their activities in this manner, until they find a niche where they can be more successful. As time goes by, they specialize in one type of operation, like treasury or foreign trade, for instance.

*Is the major problem the funding or the unwritten rules?*

I believe that, besides the legal limitations, there are mainly problems of funding and of scale. How do you compete in the Chinese market against the Industrial and Commercial Bank of China (ICBC), the largest bank in the world? Furthermore, we suspect that there is guidance that local companies give priority to Chinese banks.

One point worth mentioning is the fact that the institutions are not well-defined here in Brazil. Another problem is the frequent changes in laws, for the purpose of closing any loopholes discovered where a foreign bank can exploit a local niche.

*But, basically, the focus is on other foreign companies or on a very specific niche, which a foreign bank has found and where there is still no Chinese competition. In this kind of niche, will it be able to serve a Chinese company?*

Yes, exactly.

*In the specific case of the BB, there was a sudden growth in trade between Brazil and China and you were subject to these rules. Since it is impossible to be over there, the Brazilian company somehow seeks way to maximize its presence, within those restrictions.*

That's right. There is a growing flow not only of trade, but also of Brazilian investments. Rarely can a company set up its operations, on its own.

Generally speaking, Brazilian companies create a joint venture with a local company, which ends up increasing our restrictions.

This is an issue that maybe the Brazilian government has not thought much about. Today, there is much discussion on comparing agendas. Basically, we export commodities and import manufactured products with a greater added value.

But, in my opinion, You cannot merely compare agendas. You need to take into consideration the transfer of Brazilian companies that used to produce in Brazil and exported, and later began to produce in China. These companies supply both the local market and other markets, based out of China. Many times, China's production is exported to Brazil. It does not seem to me to be a question of only assessing and comparing agendas; it must take this new scenario into consideration. There is no doubt that this is an agenda of transferring manufactured products from Brazil to China.

*And, as you see it, has this been intensifying?*

Yes, that is right. We need to be increasingly competitive here in Brazil. It is much more important to produce in China, because it has a huge domestic market. Furthermore, the possibility of reducing logistical costs to Asia and Europe is enormous.

There are some opportunities for Brazilian companies, besides what is obvious: natural resources and agricultural commodities, that still have not been exploited. Today, China has a huge demand for saving energy and protecting the environment. Therefore, products carrying a green seal tend to be highly accepted.

Chinese air is extremely polluted and this situation comes with a limited expiration date. No country can grow so quickly, and keep on degrading the environment, the way China has been doing. We don't have to go back very long ago to remember that because of the Olympic games, companies granted a general holiday, for the three months preceding the beginning of the games, in an attempt to improve the quality of air. In this context, eco-efficient products would most certainly be well accepted. But today, Brazil still does not identify and take advantage of this opportunity.

*Actually, Brazil has big environmental potential, mainly in terms of renewable energy. Unfortunately, we have some difficulty in transforming our natural resources into products for the new green economy, because we do not invest much in innovation. Today, we have a reasonably good scientific base, but we are not able to change it into innovation and*

applicable technology for markets. Therefore, in many areas we do not have a technological base. But your point is very interesting, and I agree that there are opportunities in China that go beyond our raw materials and secondary products.

Once the opportunity has been identified in some way, we should have a public policy advising the companies to take advantage of it.

We can compare this with Italy, for instance, to which we export leather that is treated and re-exported to Brazil. Italy did the same thing with marble and granite. While we exported the rough stone, Italy was lapidating, treating, making furniture and utensils and re-exporting to Brazil. If our marble and granite policy were a little different, we could try to export a product with greater added value, which somehow would be much more important.

*But, as for the bank, what are the perspectives for the next five years? How does Banco do Brasil see China? For instance, would it be best to start with a branch, make it profitable for at least two years and, then begin to expand? How do you imagine this process?*

We can affirm that we will carry a surplus in two of those three years and we will ask for an extension of the license. This will be done so that the Bank can grow and have a slightly more diversified presence in China, in order to serve the companies and take advantage of opportunities.

Since we still have this prerequisite to be met, I believe that in five years BB will have two branches. It will take us at least three years to make a branch profitable and a few more years to set up a second one. Despite the desire to do more, I believe that this is the most plausible forecast within this timing and given the restrictions on entering the Chinese market.

As for China, we see a growth trend that might not be 10%, but that will achieve 7% or 8%, which still represents very strong growth. In the last few years, the population from the rural areas of China has been moving to the urban centers.

Within this context, there is a growing demand for food supplies, in contrast to less local production. This scenario is beneficial, in a way, to Brazil's situation, which will probably continue focusing on natural resources and agribusiness. Another important actor is the increasing need for Brazilian iron ore, due to China's reconstruction program. All of this signals strong growth and even greater dependence. China is now Brazil's largest trade partner, and this level of dependency tends to increase. The U.S. will gradually become less relevant and China will become more and more prominent. ▀

## COMEXPORT

Regarding entering China, what factors led the company to set up in the country?

### Roberto Milani – Vice President, Comexport

We have been in China much longer than most Brazilian companies. In the early 1980s, we had a mission of moving large volumes of raw materials for textiles, via exports, that were produced by several multinationals installed in Brazil. The Brazilian market was still relatively immature to consume those fibers, which resulted in a significant excess of material during the off-season for consumption. We noticed that we wouldn't be able to sell this product on a spot basis to any country, that is, great volumes in a short period of time—except to countries with very high consumption levels. That was when China came to be the alternative destination for those exports.

This was our first reason for going to China. At that time, there was no big opening in the Chinese structure to foreign investments, and it was very hard to enter the country. We were able to associate with a British company, one of the few western companies that had a trade structure in China, which was a big distinctive difference at that time. The president of the company was well known in China for being the trader that helped the country during the long period of embargo. Therefore, it was given an opportunity to set up in China.

In the early 1980s, we put two or three of our employees in its office to care for the marketing of synthetic fibers in China. On that occasion, everything was very closed. It was prohibited to open an office in a public place, so we were forced to stay in one of the hotels opened for foreigners. Our office functioned out of seven or eight rooms in that Beijing hotel. That was Comexport's first configuration in China, which grew, as time went by. The need to export large volumes in a short period of time was lessened and we were able to find a market for other commodities. For years, until about 1991, the company exported raw materials and textiles to China.

Up to that time, the exchange rate had remained favorable to exports. That situation was reversed by the reform policies of the Collor administration, in Brazil, whose impact made the exchange rate favorable to imports. This brought about a huge change in our business: we, who were exporters of raw materials to all countries, including China, began to be importers of these same raw materials to supply the Brazilian textile industry. With this drastic turn-around in our business profile, China was no longer an important trade partner. Up to that time, the country lacked those products and imported heavily from the Asian Tigers that were much better prepared to meet the needs.

We ended up transferring from China to Korea and Taiwan. We had two small offices, in those days, in association with local partners, and we became importers of those raw materials. What they sent to



China, we sent to Brazil. That was Comexport's second configuration in Asia.

We went back to China in 2001, when the country had enough domestic production volume for a good share of these raw materials and textiles to supply its own industry, and began to have excess product for exporting. That same move was made by many other companies. Companies installed in Taiwan and Korea began to transfer to China, since they began to send the production from their plants to the country.

In 2004, President Lula made his famous trip to China, and one day after the trip, an interesting thing happened: Brazil discovered China. A huge number of business people from a broad range of sectors began looking for business with China. They went to the consulates and trade offices that Brazil had at that time—there were very few Brazilian companies with headquarters, there, at the time. So, we decided to attempt to absorb a little of the new demand that came to Brazil.

Our office grew and, three or four years ago, we became a local trading company with headquarters in Shanghai, and no longer a representative office. That gave us the status of a Chinese trading company, and the possibility of buying and selling on the market in local currency. We will even have opportunities to obtain credit lines, through local banks, to buy products for export. Our focus, in China, is concentrated on five or six areas: such as chemicals, petrochemicals, textile products, railroad materials, and steel.

Today, we are a relatively successful trading company with about 25 employees. They include traders that are dedicated to doing business, as well as quality control technicians who spend most of their time traveling and inspecting the plants where we are producing. Most of the items that we bring to Brazil are developed here, but produced in China. We buy production space, or lease small industries. Comexport produces, controls production, handles shipping, brings products to Brazil, distributes or delivers them to specific customers.

*Who is in charge of controlling production and of monitoring quality? Are you in charge, or is it done by the customers here in Brazil?*

Most of the time, control is handled by both sides. Some of the products we are most familiar with are produced and distributed in China, where we hold 100% of the control. Others, we have chosen to produce in China, in partnerships with plants and clients in Brazil. In those cases, each one has its own criteria for quality, and we often end up taking technical personnel from Brazil to China to follow up on quality control with us.

Having an office in China allows certain openings to adapt to client needs, and this is very important to the market. Of the 25 employees who work with us in China, approximately 20 are Chinese, who practically speak no Portuguese, but only English and Chinese.

The others are Brazilians who help to keep our identity in the Asian country.

Usually, we keep young people, who are still learning, in our China office. In this process, the young people first do an internship of up to one year in our branch in São Paulo and, then, they go to China. In the first semester, they focus more on their classes than on their work. But in the second semester, their time is equally divided. I would say that after two years they are able to speak Chinese for working purposes. There is a constant rotation of participants in this initiative.

*Then, a considerable part of the trading involves products designed or conceived of in Brazil, but produced in China, due to low costs?*

There is a variety of business models. In the case of commodities, for instance, we only accompany production, and we develop nothing here. Products, like textiles, especially, finished textiles, are developed in Brazil, in a partnership with the final customer. We do the design, the color structure, and take them to China. We make up a competitive economic platform for producing these items and bring them back to Brazil. The same thing happens with building materials.

*In terms of government policy, both in China and in Brazil, what do you think should be done to stimulate and facilitate trade?*

First let's take a look at the Chinese side. Every year that goes by, or even every month, we notice how the Chinese are becoming more competitive, aggressive and less bureaucratic in terms of exporting their products. Today, China has all the infrastructure, the capacity and intelligence to export. The country has become an export niche, and it is simply amazing how they managed to get to such a level of excellence. Actually, the competition is not only in production, but in operations and logistics.

On the Brazilian side, we are going through a very complicated moment due to protectionism, characterized by structural bureaucracy. I understand, and even support, the protectionism of anti-dumping measures, which are available in international trade, but I am against those who hinder private initiative. Brazil is breaking export records. In 2010, 83% of the imports were immediate goods for Brazilian industry and not finished products, according to the Brazilian Association of Foreign Trade Companies (Associação Brasileira de Empresas de Comercio Exterior—ABECE). Brazil has one of the lowest rates of finished imported products—we don't realize it, but statistics show this clearly. A great majority of imports are of machinery, raw materials and fuel—elements that go to the industry and supply Brazil and the companies. In my opinion, this poorly organized protectionism is really the biggest problem we now face.

Furthermore, it took years of work for China to become Brazil's biggest trade partner. It isn't by mere chance that Brazilian commodities are worth so much today, but,

rather, it is due to the presence of China in the market and of its purchases from Brazil. I am very concerned when I sometimes see government protectionist initiatives focusing on agendas that are infinitely small.

Today, there is a perception that our exporting agenda is very concentrated in a few products, like iron ore and soy, while the import agenda is more diversified, with manufactured products, for instance. If you were “in the government”, with the job of attempting to diversify Brazil’s export agenda to China, what would you try to do? In your point of view, what could be done to change this situation?

In my opinion, Brazil is going through a moment in which we will continue for quite some time, having an inhibitive exchange rate for exports of manufactured products. So, we need to attract foreign capital. I believe that the most intelligent partnership that one can make with the Chinese is actually giving incentive to investments in Brazil. I think it is very interesting, also, that the growth we are experiencing in Brazil is not isolated—South America, as a whole, has shown a very significant consumer growth percentage, not only in quantity but also in quality. The Latin Americans are becoming wealthier, leaving the poverty level, and the Chinese are experts in meeting this type of demand.

Why can’t Brazil become a production hub for the Chinese? We have structure and many raw materials. China has capital, know-how, technology and the desire to invest. Brazil would gain a lot, during this off-season period of the exchange rate, bringing in investments like it has already been doing. The work done by the CBBC shows the evolution of Chinese investments in Brazil, and the geometric growth projections. I believe that, today, this is the big motivating factor for continuing operations with China.

Regarding exports from Brazil to China, we run into the issue that there is nothing to sell, in terms of manufactured products. However there are interesting initiatives, for instance, plants that are being set up in China, for Brazilian products, like compressors and motor vehicle bodies. This is all very good for the market.

We have noticed changes in the recent priorities of China, such as the focus on the domestic market, rather than the external market, and the promotion of energy savings, in detriment to its intense use. In this context, do you see any sector in which Brazil has a comparative advantage for a more adequate fit into the new five-year plan?

I really cannot see an extensive agenda, in terms of manufactured products, at this time. But considering the energy aspect, maybe our know-how for producing alcohol and ethanol could be something to be pursued with the Chinese? It is known that Brazil has the best technology in the world, both for producing sugarcane and for setting up the mills.

The Chinese see themselves more or less involved with the need for proving to the world that they are environmentally aware, and that is one of the big subjects that should be developed in China, over the coming years, and Brazil has the raw materials and technology.

In a country that holds nearly 20% of the world’s population, there can be no lack of business opportunities.

Suppose that Brazil has a product, whether energy or a natural resource. First, you test the product in the Chinese market, then you verify that they liked it. A decision is made, therefore, to distribute it on a large scale. If there is a surplus of the product in Brazil, would you be interested in exporting it to China? What would be the degree of difficulty in distributing a product of this type?

No doubt about it, this is one of our activities and we unceasingly pursue opportunities for exporting to China. Comexport has all of the instruments for returning to export to China on a large scale.

Unfortunately, the basic issue is that we are not competitive. To that end, we would need to lower the accumulated tax burden on our exports and have an exchange rate that reflects our costs more faithfully.

This is a hypothetical situation: China’s new five-year plan has the objective of reducing its energy consumption and, further more, to be more environmentally responsible. And we have a comparative advantage, in terms of products from the Amazon. How do those products get to the Chinese consumers? Would they have permission to enter China in large volumes?

China, like most of the countries in the world, has competent agencies for approving products, and there is no doubt that a Brazilian origin is positively received in China. Our diplomacy, our government, even the business people, have always done excellent work in China and, for that reason, we are very well-respected in the country.

Once our products are duly approved, I don’t see any problem. The distribution structure in China is no different from other large countries of the world.

But, are the barriers typically high in a phytosanitary plan?

I don’t know how to give you a precise answer about that. In the case of Brazilian meat, I know it has been a long-standing battle to approve and accept Brazil’s meatpacking plants, but I believe the issue is more political than strictly commercial.

I know that Brazilian meat is well accepted in that market, but China also makes great efforts to promote the local production and herd. In this case, there could be some type of protectionism.





This leads us to the following question: how can we diversify our exports, considering that they have a highly competitive manufacturing base?

On a very macro scale, Brazil has difficulty competing in the manufactured products sector, for several reasons. I do not think it is a technological problem, but the inhibitive exchange rate, plus timing issues, like deficient infrastructure, accumulated taxes, etc.

I also think that the exporter lacks knowledge about the synergy that can be used. We have already discussed a little about the need that China has in the environmental and energy areas, and the competitiveness of Brazil, in technological terms, regarding these issues. It is not the supplier that chooses what to sell, but the client who says what he will buy.

A last question: Comexport's situation is very peculiar. It is a Chinese trading company in China. How many other trading partners in China work like you do?

I do not know of any. The Brazilian trading companies that are in China, are representative offices, and most of them are directly aligned with an industrial group in Brazil.

Actually, we take advantage of our presence, there, to become familiar with local laws and, therefore, to gradually obtain registrations and permits to operate as a Chinese trading company, not only for Brazil, but also for other countries. We already export many Chinese products to other countries. ▀

## EMBRACO

This interview was conducted by professor Antonio Barros de Castro.

We would like to know a little more about the decision of taking Embraco to China. What are the factors, objectives, first difficulties, provisions or needs when you get to China?

**Lainor Driessen – Vice President, Operations, Management, and Sustainability**

In fact, the decision to invest was made quite naturally, because we have been present in the Chinese market, since the mid-1980s, exporting products to China, via Hong Kong traders, which facilitated our connection with clients.

Over the years, our position in the market has reached such a level that, in 1995, we took an opportunity to associate with a local compressor company, owned by the Beijing government. We began to supply the market with local products, while continuing, like today, the export of some specific products from Brazil and also from Slovakia.

Regarding the company that, as you said, belonged to the City of Beijing, what would you say were the reasons why they associated with Embraco?

My understanding is that it mainly involved technological interests. At that time, China sought to encourage investment opportunities that would originate in technology for the sector. The company with which we associated had been in existence since mid-1980s, but, as time went by, it lost its ability to compete, due to a lack of technological updating. They saw an opportunity to receive technology through Embraco, initially for products and manufacturing, then of administrative and managerial competence.

Did you enter China with a considerable technological advantage, compared to the Chinese competitors, and with innovations yet unknown by the market?

That's right. The local market appreciated it very much. From the beginning, we have been known in China as the technology leaders, and that is the case, fortunately, in the rest of the world.

Does this mean that you have entered the market in pursuit of technological leadership?

This has always been the objective behind our steps, in all of the initiatives we have been involved with, and it wasn't different in China. We talk of technological leadership, in products with low energy consumption, in manufacturing quality of high-quality products, and in reliability and leadership in client services. That is, we offered the market a set of attributes that were not present at that time.

But there were no problems regarding refrigerant gas?

No, there weren't, but we were positioned to come out of the process stronger. In the early 1990s, the CFC gases that attack the ozone layer were beginning to be substituted, in a process regulated by the Montreal Protocol, signed in 1986.

Embraco was the first company, on the international level, to produce compressors, on a broad scale, that did not need those gases. Since the early 1990s, during our first years in operation, there, this technology and experience put us in a significantly advantageous position in relation to Chinese competitors.

Did China somehow favor Embraco, because it brought technology to the Chinese market? Favored or benefited?

Nothing out of the ordinary. In the sector in which we are involved, we have always been considered a high-tech company, which is a way the Chinese government has of giving value to and recognizing companies with high added value in the industry.

You shifted benchmarking in China and, from that point on, the learning process began on the part of Chinese

companies. Have they already drawn technologically close to Embraco?

I would say that, today, we have a brand and a consolidated leadership position, and that, for that reason, they are under constant attack. The dynamics of the market and the way Chinese competitors act keep us always on alert. Today, there are Chinese compressor manufacturers with an important presence outside of China.

The issue of province/city has always intrigued me. Here in Brazil, we have federal, state and municipal governments. And in China, I think that the power of cities, especially the big cities, is the largest, isn't it?

The relationship between the Central State, provinces and municipalities is well-established, but there is an important aspect of freedom to act, which has given some regional companies strong support for their development and expansion.

What is it like to manage the operations of a company that has Chinese workers?

In the first years, one of our greatest challenges was to learn how to do business in China. Every region has its own peculiarities and way of relating to others, that is different from the West. The time dedicated to negotiations and to building trust between the parties is long and has its own characteristics. Today, I can safely say that overcoming those challenges was the deciding factor for the success of our partnership, as well as strengthening our capacity to be involved in a global scale.

As for managing the operations, like any country/culture that is different from ours, it was important to attempt to understand the way of thinking and acting of the people. That was a critical point, at the beginning of our enterprise, mainly because most of the activities were related to technical areas. Transferring knowledge and developing practices involving technical complexity and people from both cultures, was a relatively long process, which demanded a lot of effort.

Today, our alignment is complete, and we easily understand each other: we have highly skilled Chinese professionals in every business area, including important leadership positions.

Coming down to the present time, I have another question: you are excellent in R&D here in Brazil, but you don't do R&D in China, right?

Worldwide, we have technological development activities and an extensive network with universities and research centers. In China, we have been intensely developing an internal team and we are also investing in closer relationships with universities in the country. In 2011, we launched the Embraco Innovation Award,

with an eye to accelerating the strengthening of our local competence.

Getting back a little to the issue of Chinese competitiveness, how are the local companies comparing to Embraco? Do they have government support? If they do, is it the central or provincial government that give support?

As I said earlier, there are some Chinese companies operating in the international compressor market that have manufacturing bases only in China. Embraco, on the other hand, is present on every continent with plants near clients.

If the Chinese competitors quickly catch up in qualitative terms and have lower prices, that becomes a complicated situation, you have to admit.

The worldwide competitive scenario has changed a lot in recent years, with the Chinese gaining space from other manufacturers. Embraco maintains its position as the largest manufacturer in the world and leader in product technology. We continue investing heavily in technological distinctiveness and in the supply chain, while seeking to optimize costs and strengthen ourselves even more in client services.

If I understand you correctly, speaking superficially, this would open two disjunctive elements: invest much more or back off.

There is a point of balance to be pursued, optimizing growth, and obtaining returns for shareholders. We are well-positioned to solve this equation, since we have a clear strategy that is being developed to competitively sustain our position as leader in the market. ▀

## FELSBERG ASSOCIADOS

We would like to start this interview by addressing Felsberg's decision to set up in China. What motivated this? What were the main landmarks along your trajectory in the Chinese market?

**Thomas Felsberg – Founding partner of Felsberg e Associados**

Our presence in China was absolutely accidental; it happened eight years ago. I was in my office, and a young lawyer mentioned that he and his wife would like to spend a year in China, and that he had found a job as an English teacher, there, in a small country town. A year later, he returned and told me how valuable the experience had been, but that he would like to return to working as a lawyer. He asked me if it was possible to hire him in one of the offices we had relations with China. I made the contact, they accepted him, and he spent several years there. Some time later, he told me



he would like to open one of our offices in China. My partner and I thought about it, and consented.

*What year did that happen?*

I believe our authorization was given three years ago, but the process took about a year and a half. So, I think we decided to open our office four-and-a-half years ago.

*That would be around 2006/2007?*

Right. In China, we serve four kinds of companies. First, the importers, that is, Brazilian companies that buy in China and sometimes need support and certain contracts must be signed with Chinese companies. Another kind of company is those that, as business develops, are interested in creating a subsidiary in China. The third kind are joint ventures between Brazilian and Chinese groups in the country—given the complexities of this case, we work in conjunction with a Chinese firm.

Last, there are Brazilians interested in buying a plant or a Chinese company. At the moment, we are handling our first case of this type, also in a partnership with a Chinese firm. Today, we have three lawyers there: a Brazilian, a Chinese, and a Chinese-Brazilian. I believe that, to a certain degree, we have lessened the cultural difference, establishing a bridge between the two cultures.

For business to work out in China, one must be careful about the timing, regarding some of the decision making, like, for instance, when paying a supplier, when billing a client, what is the inspection that one does when the goods are exported, and so on. This is a mystery to those who are not accustomed to China. Since we have already had this experience with a number of companies, we provide support for Brazilian companies in this scenario.

This ended up being of interest as business for the office. Therefore, since we are established in China, we have also been able to support, by providing assistance to some of Brazil's large companies that are already installed there. We are able to show clients the risks and to produce the documents needed for the company to operate in China.

We should point out that the office assists both with relations with large Chinese companies, and as a bridge of Chinese companies to Brazil. We work out of São Paulo, where the head of our China Desk is a Brazilian lawyer of Chinese ancestry and who speaks and writes perfectly in Mandarin.

So, through the China Desk and the involvement of our lawyers, in Shanghai, we are able to serve some of the large Chinese companies that come to Brazil. One last component of our work is the foreign trade department, which serves companies that have difficulties or legal issues in commercial areas.

*In the case of Brazil's presence in China, have you felt that there is a relatively quick expansion process, or has that been more gradual?*

In my opinion, today, the investor is not their priority, because the Chinese have money and access to technology. Some years ago, a foreign investor was extremely important and well-received. It is not this way anymore. Therefore, Brazilians who want to invest in China encounter a real barrier to their intentions. There is not a receptive atmosphere for this, now, and there are big difficulties. Some companies are well-established in the country, and they have been able to adapt to the Chinese culture, but it's not easy. This reality, where foreign investors are not a priority, limits, a little, the growth of our presence in China.

On the other hand, we sense a growing interest on the part of Chinese companies in entering Brazil, mainly in such areas as mining, finances, logistics, and agriculture—basically products that they need in China. We have received a growing demand for these projects.

*Most of the barriers that we face regarding foreign investments are legal, explicit, or more of a tacit nature?*

I believe that there is an increasing rate of codification of laws and standards in China, that is, a movement from non-existing norms to a clearer reality.

*Then, the degree of discretion is still quite high, but is gradually decreasing?*

Yes, it's decreasing. They increasingly feel the need to establish standards. I think it's inevitable for a more sophisticated and diversified society to begin functioning according to standards and rules. However, there is still no rule of law, with an independent court system or a series of constitutional guarantees.

*Are there restrictions on Felsberg's operations in China? Are the restrictions very complex, or do law firms have a little more flexibility?*

So far, we have felt no restrictions, since we do not work there under Chinese law. When dealing with a more complex subject, we work in conjunction with Chinese law firms, which is somewhat similar to how we work, here. In fact, we will run the risk of losing our license, if we begin to work with Chinese Law.

International firms practice the law of their own country, and this usually refers to New York or British law. Whenever it is something related to national rights, then we use the Brazilian office, if it is necessary to file suit, or something similar to a domestic issue. The contracts that are made for Brazilian companies, for instance, are international contracts, which follow Brazilian standards that are adapted, in some aspects, to the atmosphere we know in China.

*How are disputes over these contracts of Brazilian companies with Chinese companies resolved?*

Usually, when the subject is relevant, we use arbitration. In China there are boards of arbitration that can be used, since arbitration by the International Chamber of Commerce (ICC) is very expensive. Depending on the contract, it does not compensate to name an arbitrator outside of the country or in an organization like the ICC, which is well-known for its efficiency, but is expensive, and does not work for all contracts.

*Has Felsberg had experience in taking a dispute to arbitration in China?*

Yes. There are two problems: you can take the subject to arbitration in China and choose independent arbitrators; this is a way to arrive at a reasonable decision. Then, there is a second point, which is enforcing an arbitrator's decision. Here, you depend on a state judge and, often on a lack of independent court system.

Thus, we have a scenario where, despite having won the arbitration, it does not mean you won the war. However, if the Chinese company has operations in other countries, we can do the arbitration outside of China.

For one of these huge Chinese companies, which have tentacles all over the world, the international arbitration clause works, because even if there were any difficulty with enforcement in China, we could do that in another country.

*I would like to go back to an observation you made about the obstacles to Brazilian companies that are increasingly rigid. Actually, today, the Chinese do not see foreign investments as being so important as they used to. Doesn't this depend on the sector? In your point of view, is this something more general, in nature, even for the so-called priority sectors that are in the investment catalogues?*

Everything is relative. If they are truly interested in what a company does, and if it makes a contribution to the country, this changes, naturally. What I'm saying is that, today, the general perception of the Chinese is that they no longer need foreign capital.

*In political terms, given this asymmetry between Brazilian and Chinese rules, in your opinion, what should the Brazilian government do, but is still not doing?*

Ambassador Sergio Amaral wrote an article in the Estado de S. Paulo newspaper, where he defined this perfectly. He said: "China is a centralized country, under state control, with central control", and, thus, it is not viable to negotiate with the Chinese companies in the same way we negotiate with companies from other countries, that is, in a market-driven fashion.

It is necessary to establish a strategy, have clear objectives, and negotiate them.

That is, I believe that Brazilian companies are at a disadvantage when they go to China, unassisted by the Government. Discovering China should be a part of a project for relations with the country. Therefore, the involvement of the China-Brazil Business Council in straitening the dialogue regarding the position of companies and the Government and about their commercial and business interests has been important.

A broader strategy that truly takes into account the interests of the Nation and of Brazilian companies that want to expand their businesses to China would work well. This is needed, since the countries do not have the same interests.

*A recurring observation in our interviews, and that is actually a type of corollary, is that there is no stricto sensu negotiation between companies without the presence of the government.*

No doubt about that. The government has a strong party. In its various manifestations and subdivisions, it is present in all aspects of the nation's life. Therefore, the business people and Brazilian government need to unite to negotiate issues of interest to us.

*Another observation that was a part of this overall perception is that the Chinese have a very high level of unity. They communicate among themselves and reach a consensus. And, on the contrary, we have a fragmented decision-making process; we don't have a united position.*

This coordination is indispensable. If we want to dialogue effectively with them, there must be not only company-government relations, but also government-government.

*They are very organized. One of the things that most impressed me many years ago, while I was working on projects in China for the World Bank, was the level of structure and discipline in the government. Usually, they do what they say they are going to do, and they are not very amateur about it.*

They have two remarkable characteristics: they are very careful and they do not improvise. This means they talk and discuss a lot about something, until they discover exactly how to do it. The degree of autonomy that they give to their agents is very small. Actually, we have to understand this cultural aspect a little better. My perception is that they understand the reverse situation and will respect those who come with explicit and well-defined positions. We are benefited by having very good people caring for the relations between the governments. The Chinese embassy and Ambassador Clodoaldo are doing excellent work in conjunction with the Chinese government. ▽



## PETROBRAS

We would like to start with the subject of entering China. What factors led Petrobras to set up in the country. What was the chosen means of entry? And what were the main difficulties found during the first months of operations?

### Marcelo Castilho – General Manager, China Office

Petrobras set up its office in China, in May 2004. It was the result of the “discovery” of China by the company, that year. We perceived that the country was a large energy consumer, especially of petroleum. At the time, China was the world’s third largest buyer petroleum buyer. Today, it is the second, after the U.S. We saw that we could no longer ignore it. We opened the Beijing office with the presence of President Lula.

So, the means of entry was a representative office?

Yes, and it still is today. So, what did we do? Ever since Petrobras decided to open the representative office, in Beijing, to prospect possible business opportunities in that market, the company’s petroleum sales to China increased significantly. Today, it is one of the main destinations of our national petroleum sales. First, we attempted to understand the country, especially its business relations: which companies buy and which do not buy; what the relationship is with the government, and other factors. That was a very important learning process. We started selling in 2005 and, since then, our presence has grown solidly. In 2005, we sold US\$ 300 million and we ended last year with a sales volume of US\$ 4.6 billion.

Do they buy heavy crude oil?

Yes, they do. That is what we sell the most in China.

This is interesting, because we import light petroleum, for the refineries. So, it is a very interesting market, in this sense.

It is a complementary market. They really buy what we need to sell.

Did you have to face a lot of barriers to enter the Chinese market?

No, we have had no significant difficulties. We enjoy good relations with the Beijing government, and with the local government. It was a relatively simple process to install the office. We have been audited by an independent Chinese auditing firm. Personal relationships are the most important issue in China, mainly with clients and with the government. It is necessary to pay special attention, in this area, and it is not clear, or even described in books.

And this is gained over time. It cannot be done instantly.

Exactly. I have been here for eight years and I learn every day.

What is the size of the Petrobras office, today?

There are five of us, with two expatriates. Besides me, there is an administrator, an operational technician in sales, a sales manager, and a secretary. Our annual expense is around US\$ 750 – 800,000, for billings of US\$ 4.6 billion.

Generally speaking, informal relations, “guanxi”, are very important. But from the formal standpoint, have there been no great difficulties, from the beginning, whether with licenses or tax problems?

Not for the representative office. However, if we decide, one day, to set up an operation in China, I think it would be more complicated. The petroleum area, for instance, is a national security issue. There can be no company that works with 100% foreign capital. The capital should be at least 51% Chinese.

Who are the competitors of Petrobras in China?

Our biggest competitor in heavy crude oil are Angola and Venezuela. The most direct competition with us, in terms of quality, is heavy crude oil from Angola.

How heavy is the competition for selling petroleum?

There is big competition, especially with Angola. Petrobras’ strategy influences the competition process: when we sell a cargo load abroad, it must go to the destination that pays the highest price for the contract. This way, there is competition with other markets to which Petrobras also can export, like the U.S. and India.

So, actually, is it a double competition? Competition with other clients and with other suppliers.

Exactly.

How was the relationship network created with clients in China? Did you use the representation of our government, or were supported by the Chinese government?

The involvement of our Embassy was necessary and very important, at the beginning of our presence in China, assisting and guiding our contacts with the local authorities. However, for day-to-day business, one must have a very close relationship with the Chinese state-owned companies.

### The big state-owned petroleum companies?

Yes, they are the big buyers of our petroleum. In China, by law, only five, large state-owned companies are allowed to import petroleum. We had a hard time prospecting, in order to discover who were the key people in the companies, conducting petroleum purchasing decisions. China buys four million barrels of oil per day, but, if there is no personal contact, it is impossible to close the sale. We can count on Embassy support, even from the President, but if the purchaser's key person doesn't trust you, no barrel of oil will be sold in China. It took us one year to gain this access and close our first contract.

### Do these five companies talk to each other?

Yes, they do and they compete with each other. They all belong to the same owner, who is the Chinese government, but they compete heavily with each other.

In the past, each company had a function: one dedicated itself to exploration and production; another to refining; a third one to trading. And there was also one for exploring the ocean, and another for land-based exploration. Nevertheless, with the reforms made by the government in recent years in the sector, the companies began to verticalize, being involved in different stages of the petroleum production chain.

Today, all five operate and compete in all segments, including importing petroleum.

### Does Petrobras sell to all five or only to some of them?

Our main client is Unipet, a subsidiary of Sinopec, with which we have a contract for 200,000 barrels per day, corresponding to 90% of Petrobras' sales to China. We also sell to other clients, like PetroChina, but it is rare.

This contract with Unipet is part of a US\$ 10 billion agreement we made with the China Development Bank. Linked to this financing contract, a sales contract for petroleum for Unipet was signed for 200,000 thousand barrels per day. The financing is not paid with petroleum, and the petroleum we sell to China is paid for by Unipet.

### Did you end up using this financing for operations in Brazil?

Yes, this money was used in the pre-salt plan, to finance our investments in Brazil.

### Speaking a little about pre-salt layer, do you have some type of technological development agreement with Chinese companies for pre-salt exploration in Brazil?

No, but that will probably take place one way or another, since both Sinopec and Sinochem have bought participation in Brazil. In the Lula field, which is a part of pre-salt, Sinopec purchase a part of Petrogal

and another of Repsol. These companies are already Petrobras partners and will end up learning on-the-job, during the operation.

### But the operator is Petrobras?

Exactly.

### When the operator is Petrobras, what is their actual participation, besides financial?

They also have a right to remove oil. Their percentage, let's say 30%, also refers to their share in the oil produced. In this case, 30% of the petroleum production is theirs. They can theoretically direct this production wherever they want to, taking it to China or selling it to Brazil.

### And how do you see their entrance to Brazil? Theoretically, this is a market that can take your place in China, right?

That's right.

### Can they do the transfer at prices below market value, for instance, with transfer pricing?

When taking petroleum produced in Brazil to China, or to any other destination, the Chinese will pay royalties based on the higher of two prices: the minimum reference price established by the ANP and the price of petroleum on the international market.

### Do you believe we will see new Chinese investments in this sector in Brazil?

China has a program of investments in the world, in the area of exploring for and producing petroleum. In the area of refining, they have no interest in entering Brazil, because revenues would not cover the investments and others. They have also avoided the segment for manufacturing equipment, due to Petrobras' hiring policy, whose requirement for national content is 60%, which would be unfeasible for their manufacturing model.

### What are Petrobras' perspectives regarding the Chinese market?

That is a good question because the picture has changed a little, recently. When I arrived here, eight years ago, there was no pre-salt layer. We came in with a trade proposal, focusing on selling petroleum, and we also had the intention of taking part in the exploration and production. With the discovery of the pre-salt layer, added to our participations abroad, which already existed, mainly, in the U.S., Nigeria and Angola, the plans for exploration and production in China were put off.

I do not see any different perspectives than those that we have today in the Chinese market. We should continue with the trade office, and increase sales of crude oil. ▀



## SERTRADING

We would like to begin this interview by addressing Sertrading's decision to set up in China. What motivated this? What were the main landmarks along your trajectory in the Chinese market?

### Alfredo de Goeve – President, Sertrading

Sertrading is a foreign trade company, providing import and export services. We started to pay attention to this new China in 2004, when I traveled with President Lula's entourage to the country. I spent ten days there and I was impressed with what I saw. I thought, "We need to do something to be here."

Early in 2006, we found a market niche that would justify our presence in China: the home appliance and electronics market. We opened a commercial representative office in Shenzhen, southern mainland China, near Hong Kong. This region is considered to be a scientific and technological hub, with a high concentration of companies in the area of home appliances, electronics, and telecommunications. We visited over one hundred industries, established some partnerships, created a brand, got a distributor from Brazil, and started operating as intermediaries, developing products and bringing them to Brazil, always focused on the home appliance-electronics sector. This initial work was very good and essentially focused on developing suppliers and products, with no government participation.

When you mention development of products, what do you mean, exactly?

We didn't want to bring commodities, but to make them stand out. We worked two-and-a-half years with home appliances and electronics. We did a good job, but for reasons totally beyond our control, we didn't achieve the expected results. We still have a Sertrading office in Shenzhen, which is smaller and with a different focus. In these last three years, we have concentrated on machinery, materials and Chinese construction equipment for Brazil.

Today, we import and distribute in Brazil and we focus in two groups of products: machinery and construction equipment and materials. We developed the representation of large brands in Brazil, like Zoomlion and Heli.

News came out that Zoomlion intended to invest in Brazil, do you know anything about this?

Zoomlion is our main brand and we have been working with it for three years. It is in the construction machine business and one of the two or three largest in China and eighth in the world. There are three big Chinese companies in this segment: Zoomlion, Sany, and XCMG. Zoomlion takes in over seven billion dollars a year and employs 30,000 people. Sertrading was the

company's biggest client, outside of China, in 2009 and 2010, which shows the potential of the Brazilian market.

From 12 to 15 percent of the company's income is from exports, with Brazil representing a relevant portion of this volume. Besides Zoomlion, we represent another Chinese brand called Heli, a producer of forklift trucks—all being smaller and more accessible products. This allows us to do a better job and it is more interesting to the Chinese.

Summarizing, we went to China in 2004, set up in Shenzhen, in 2006, and we are still there, with a trade office. Today, Sertrading is specialized in bringing Chinese products to Brazil, and we have started selling Brazilian products in China. We want to develop something in the area of food supplies, because of Brazil's potential and Chinese consumer needs.

If you had to mention four or five factors that make it hard for Brazilian products to gain access to the Chinese market, what would they be?

Our main problem is the lack of persistence. Since 2002, Sertrading has a subsidiary, called Serlac, a dairy products exporter—a pioneering and winning model. We noticed that Brazil was not an exporter of milk, but, rather, an importer in the 1990s. It is the fourth or fifth largest producer and also one of the largest consumers. In 2002, we saw that exporting would be possible, but Brazil didn't do it, due to pure inertia. The technical conditions were in place, as were quality, price and product availability, but there was a lack of "attitude".

So, we began preparing the business and developing a supplier: Itambé. We created a division, here in Brazil and invited five producers, each of which was organized as a cooperative for exporting dairy products and supplies. In the first year, we exported eight million dollars, in the second year, 30 million dollars and, in the sixth or seventh year, 250 million dollars. Why couldn't we export food supplies to China? Simply a lack of attitude.

What about the phytosanitary barriers?

The government is extremely controlling, but that is all part of the game.

You are making a very important point: the controlling government, the biased rules, but sometimes there is a lack of persistence, mainly when there is a big market in Brazil that, due to inertia, does not expand.

The big barrier is attitude, plus the distance and the culture.

How do you see the process of Chinese companies that you represent commercially in Brazil coming to invest in the country? Their perspectives, in this

case, would be to invest on their own or to form joint ventures with Brazilians? Would you continue distributing the products manufacture here, or would they set up their own distribution network? How do you see this process?

In the specific case of Zoomlion, I would say that the company is deciding how it will work in Brazil. What seems to be clear to me is that the Chinese still have little international experience, in all senses.

With a support base, like the diasporas in Malaysia and Indonesia, the Chinese find it easier, because they connect more. I consider Brazil to be far away, in this sense, with no natural support base.

I'll give you a good example: Zoomlion is now a seven-billion-dollar company, with a very well-prepared Chinese international Vice President. In Brazil, which is perhaps the most sought after market by them, at this time, they have three or four employees, that is, a very small representation. The businessman is absolutely aware of this, but has taken no position.

There are many examples of successful joint ventures between entre Brazilian groups and companies outside of Brazil. Is an operation of this type, in Brazil, expensive for investors?

Yes, it is approximately a 100-million-dollar operation. But I would say that we are in China because we believe in bilateral relations and we are putting our chips on this. For that operation to work out, it is necessary to be present at both ends, otherwise it is impossible to do business.

*Talk a little bit about the future.*

We are banking heavily on China. Our focus is on straitening China-Brazil business relations. To that end, we are forming a team to identify and develop new types of distribution representatives in Brazil. The other path would be exports. Furthermore, we are investing in expanding the knowledge of our personnel regarding China.

*Do you enjoy a close relationship with the government, Embassy and the Consulate? Does the government help, hinder or make no difference? Can you comment a little about the relationship between Sertrading and the Brazilian government?*

It is a very good relationship, it is a very close one that is a part of our business. There was a time when Itamaraty was the main stimulator of foreign trade. This is a part, or at least it should be, of the role of the private sector, for Brazilian foreign trade to have a close relationship with the government.

We develop this. I would say that the government is less involved, in a good sense, by giving greater freedom of action. As for collaboration, the Brazilian representatives in China—both the Embassy, in

Beijing, and the Consulate, in Shanghai—are very efficient.

The people installed in Brazil are also efficient, but there is a problem with the syndrome of distance and communication. The Brazilian government could name China as a bigger priority than it is today, after all, the country is our biggest trade partner.

*And what about the Chinese government?*

Today, we have no direct relationship with the Chinese government. ▼

## SUZANO

*We would like to start this interview addressing the decision of Suzano to set up in China. What motivated this? What were the main landmarks along your trajectory in the Chinese market?*

**Alexandre Yambanis – Director, Cellulose business unit**

Our case is very simple. The Chinese market for cellulose is number-one in the world, and it is our trade policy to not sell through trading companies. So, just as we have a direct presence in Europe and the U.S., we chose to open an office in China. We have trade representatives all over the world, and we deal directly with our clients. I would point out that having a direct channel in China is of primary importance, because they tend to have very personal relations. Contrary to what many people think, the Chinese market is not characterized as a wholesale market, where you buy things without knowing the client, even in the case of commodities. We must exercise special care in our relations with Chinese clients.

Suzano has a representative office in China, with a staff of around 11 people that tends to grow. We don't sell only cellulose, there, but also source raw materials. We have a research operation, independent of this office—a company that Suzano bought in 2010, called FuturaGene, that is setting up a very complete laboratory.

*Why did you decide to set up a laboratory there?*

A company has a tradition in research in China, in many areas of Chinese agribusiness. So, this is a continuance of that activity.

Getting back to cellulose, the tendency in China is toward growth. The country, which is one of our target markets, is the one that most invests in producing paper, and has very ambitious growth projects—approximately five million tons of paper to be produced over the next 20 months.





We work with Chinese professionals, because we believe that a local executive who is fluent in Mandarin is of great importance in contact with clients. We also arrange executive interchanges between China and Brazil, by bringing Chinese executives to train in our country and taking Brazilians to be enabled in China. In this way, we pursue a deepening of our trade relations and a greater understanding of the Chinese market.

So far, we haven't had significant difficulties in our business with China. On the contrary, it has been quite easy to do business with them.

*With FuturaGene's operations, are they working in a network with Chinese universities or research institutes?*

Yes, that's a good point, and it's worth highlighting. We work with universities and, also, in the area of cellulose, we have a signed agreement with South China University of Technology for an exchange program involving research and development of the use of eucalyptus cellulose in paper produced in China. Representatives from the universities have already visited our plants in Brazil and we have visited their plants, too.

*Was there any attempt by the Chinese trading companies to somehow influence your business?*

No, because we don't sell through Chinese trading companies.

*Did the Chinese government, somehow attempt to influence you by indicating partnerships with Chinese trading companies?*

Absolutely not. Our business is direct. We are the producers, and we exclusively sell our product. Thus, there has been no interference.

We have a very strong brand image in China and we invest in it. The vast majority of our sales are made via long-term contracts, in which we appreciate the relations with our in China. This is a very important factor for us. I go to China three or four times a year, or even more, if necessary, to supervise the team, visit our major clients, or implement our trade policy.

*Do the Chinese import paper, as well, or basically cellulose?*

Basically cellulose. The Chinese export paper.

We are very happy with our operations. We intend to grow significantly, and this doesn't exclude the possibility of forming a future joint venture in China, despite the fact that we have no plans, at the moment. We believe very much in the cultural aspect of building our relations with Chinese companies.

It is of primary importance that we attempt to

understand a little of the Chinese culture. There have been 5,000 years of culture that have led the Chinese to have a strong tendency to long-term thinking, which is different from us Brazilians and westerners, in general, who have a more immediate vision, which usually conflicts with the Chinese business philosophy. For instance, their concept of profits is very flexible, in the temporal sense—the Chinese tend to think of investing over the next five or ten years in their companies.

*I had an experience in China, many years ago, when I was working for the World Bank, and I saw that, too. We were financing a relatively large project, and the perspective of the various ministers and people involved was 20 years ahead.*

Their view is that it is necessary to develop the domestic market. They know that their only real risk is political and, for that reason, they race against time to achieve balanced growth throughout the country, and not merely along the coast, between Shanghai and Beijing. It is impressive how the infrastructure that was built, which is idle, at the present time, was made for the next 20 years.

*From a foreign policy standpoint, would you have any specific advice or comment regarding the strategic perspective of building trade relations?*

I believe that bilateral agreements should be reinforced. We are an important producer of raw materials and we want to continue to supply the Chinese market, in order to collaborate with the country's industrialization process. However, we do not want to export only raw materials and, then, become importers of Chinese finished, high technology products.

I think that the bilateral agreements would be appropriate for seeking a balance between the two economies. We will continue exporting soy, iron ore and cellulose, but we also want to export more airplanes and technology-intensive products.

*Speaking of paper and cellulose, if we were to think of a bilateral agreement in this sector, would there be something more specific for expanding the range of Brazilian exports?*

The Chinese are already exporting paper to Brazil, and they have very low costs, which, obviously, makes us uneasy as paper producers. Nevertheless, we have to act very carefully, because of our interest in maintaining the sale of cellulose. We need more business roundtables with the Chinese, for the purpose of leveling the playing field. One possible solution would be for us to continue selling cellulose, which the Chinese would use more for domestic consumption, and we would open another market to them in Brazil, which is not as competitive as paper is. ▀

## WEG

Interview conducted by professor Antonio Barros de Castro

*I would like to start this interview addressing WEG's decision set up in China. What were the factors that most influenced this decision? What were the main objectives of the company? What were the first steps you took upon arriving in the country?*

### **Siegfried Kreutzfeld – Director-Superintendent, WEG Motores**

WEG went through three big phases over these 50 years. The first was a growth phase (the first 10 years), a second was internationalization—when we created trade branches in more than 30 countries—and the last phase, which began about 10 years ago, called globalization. During the latter, the objective has been to expand production to strategic continents, with the purpose of bringing the company closer to those markets.

Initially, we built plants in Mexico and Argentina. In 2003 and 2004, the Asia markets, more specifically China, were selected. In 2004, we did a study to assess the opportunities of the Asian market and to define where we should establish a production site. WEG needed a local plant, since services provided from Brazil involved very high logistical costs and transfer times. In 2004, after studying thousands of Chinese manufacturers, we chose the municipality of Nantong, in Jiangsu Province. The provincial government offered to sell to WEG a local state-owned company, including all of its assets. The Nantong plant had a building area of about 30,000 m<sup>2</sup> on approximately 67,000 m<sup>2</sup> of land. At that time, the government was preparing to sell many state-owned companies—some are still Chinese, today, but no longer under public control, while others were offered to foreign companies, like WEG. Our case is an example of how the Chinese government looks for alternatives for those who want to invest in the country.

*Was the interest of the Chinese government in WEG related to the innovations that the company could bring to the market, in recognition of your technological superiority?*

That aspect certainly had a lot of influence. They knew WEG and that the company had this competence. The government is dedicated to pursuing global opportunities, mapping the interest of companies and of other governments in making investments in China. In the Asian nation, this relationship is fundamental. From the beginning, in the implementation phase of the plant, the relations between the company and the government were very positive, building the bases for future growth opportunities.

However, not everything is a bed of roses. We set up in China about seven years ago and, during that time, for

instance, we have had to handle the different cultural challenges. That was a big shock, but over time, we had to adapt. What made it possible for this to happen were not the technologies and the machinery, but the key people. We took technology and bought machines. But with the people, things were very different. We had to hire about 20 Sino-Brazilian trainees (who speak Portuguese and English, besides Chinese) and we trained those people at WEG do Brazil. We found many Chinese with dual citizenship, who lived in Brazil, but also understood the Chinese culture very well—mainly engineers. This certainly made a big difference in our local adaptation. We brought people to Brazil from different areas: Engineering, Human Resources, Controllershship, etc.—who stayed for about six months. We have a production manager in training at our plant—everyone must go through this training program. Furthermore, we sent Brazilian expatriates to hold key management positions.

*Is the President of WEG in China a Brazilian?*

Today, our CEO in China is Chinese, and speaks Portuguese and English. The Director of Operations of the plant is a Brazilian, who doesn't speak Chinese.

In China, you need a person who speaks Chinese and is responsible for all contacts and relationships. That is called “guanxi” and is fundamental to the success of a foreign company. I have gone to China many times, and I see that close contact with our partners is essential. It is important to have dinner with them and talk about things in general. Another aspect that we have discovered, over these years, is that the first relationship must be with the top leaders of the potential client and not between sales personnel. Our Director, Liu Cheng, is responsible for the first contact, then we send a Director from Brazil to China, and, only then, does the relationship begin to move, based on the trust that is established at a very personal level.

*That characteristic is very interesting. One question along this line: at that stage, how was the relationship with the Chinese partner?*

We didn't have a partner, and this was an important aspect of our presence in China. Embraco, for instance, experienced a different situation. We acquired 100% of the assets of a Chinese company and, thus, we have a 100% WEG company. Some changes needed to be made, like substituting machinery, making investments, painting the old buildings and, mainly, applying our technology.

*But did the government impose any demands regarding the need for a Chinese partner in the business?*

No, it didn't.



And you were the ones who chose the company?

An international consulting firm did an excellent study and presented us with several alternatives. We evaluated such aspects as location and characteristics of the products already manufactured by the companies, and Nantong was then chosen.

From that point on, did you run 100% of the business?

Yes, we ran 100% of the business.

That seems to be an exceptional situation for a foreign investment in China, and one that did not previously exist.

It didn't exist, and yet today, depending on the sector, the government requires that a company have a Chinese partner. Fortunately, this is not what happened with WEG, in 2004.

I should think it wouldn't be possible in 1994.

It would really be impossible, and it was, at that time, that Embraco set up in China. We should note that the distance imposes significant barriers. Communication is hard and keeping up with the actions and activities demands a different type of attention from executives. I work at night, until 10:00 p.m., to hold conference calls and, many times, I come in early in the morning, at 6:00 a.m. E-mails come in during the night, so, right away in the morning, there is a folder filled with unanswered e-mails. Furthermore, you have to be present. I go to China three times per year to accompany the activities.

WEG has a well-defined plan for Asia. The plant location, in the city of Nantong, near Shanghai, is not accidental. We intend to serve, from this plant, the entire Chinese market, Japan, part of Australia and, in the future, the Indian and Russian markets. There is also a line of products we export from China to Europe, for competitive reasons. All of the other products that we produce there go to Asia.

And has there been any problem with copying?

This is a big difficulty that you face in China. Before installing the plant, we did a round of benchmarking. We talked with our suppliers about how they protect themselves. Since protection is restricted, we had to reduce the information regarding the specifications of our products. Even at that, about 15 days after launching a new product, it can already be found being manufactured by another company.

Doesn't that hinder your staying in China?

No. We attempt to serve the mass production market, but with customized products. That is the big strength of WEG.

The mass production market, with a difference?

Exactly. China does the mass production of standard products. On the other hand, we attempt to reach the market that they don't serve and, in that way, we gain a bigger share.

Why China? Could it be another country?

Just because the processing and labor costs are much lower. Some raw materials also have better prices. Materials, like copper, are commodities, but steel and other components used on our production line are more competitive in China.

How does the competition stand, regarding copying and low costs, among other aspects?

There is nothing that can be done about that. At this point, the relations are a distinctive difference, that is, the quality of the service that the company provides to the client. Intellectual protection is really a big problem. We launch products in Brazil and patent them in several markets. For instance, for a new platform, we got 22 patents, but not in China. I went there in May and found some traces of my product in those of competitors.

So, it makes strategic sense that the product be mass produced, but customized. Customization is like a fishhook, with which the company catches and creates a barrier for those who do not have the same relation with the client. My question is: when going from the customized mass market to the standard mass market, you don't have any more defense? Would it only be competition of price vs. price?

Yes, but in this case, what is left is the product's quality and reliability—the only distinctives when the product is standard.

And you are going in that direction?

Yes. We take all of our technology and development from Brazil—the processes and quality specifications are also being implemented there. Along this line, it is possible to win big clients, like the worldwide equipment manufacturers installed in China (manufacturers of pumps, compressors, etc.). Generally speaking, the durability of the product by Chinese manufacturers is much less, since the processes are not well controlled. That is the difference.

Does WEG sometimes lose employees that are being trained?

In China, employee turnover is much higher than in Brazil. If another company offers a little raise in wages, they tend to change jobs. One of the reasons for this is the fact that they have no equivalent to social security.

Do you think that the same principle also applies, in other cases, to products and technologies?

Yes, it would, because, the principle is based only on

management. China grows much more in productivity than we do, in Brazil. Thus, it is by managing people that we are able to achieve these advances.

*That is in strong contrast to Japan, where reciprocal loyalty between the worker and the company is very high.*

That's true. But this doesn't exist in China. Wages are their religion. We had to change some characteristics of the factory, for instance, such as the management of stock and flows, which did not exist in the company before it was bought by WEG. Employees were paid according to the quantity produced, that is, per piece. Planning was based on ensuring the biggest production, even if it were kept in stock, afterwards. However, this is not planning. To change it, we had to work hard. First of all, we put a lunch room in the plant. The Chinese were used to eating lunch next to their machines. When we bought our plant, some of the bathrooms were mere ditches, so that the employees would not have to leave the work area. It took us three years to implement these changes. The Chinese are becoming internationals and little by little they are becoming accustomed to our cultural standards, which is very interesting. They won't let "guanxi" go, but other aspects are truly being absorbed.

*These things are shown to be dysfunctional in the contemporary work scene.*

Definitely. Among other aspects, there is the type of management. We have a very participative decision-making system. It is one of our big strengths. A factory worker, via the QCCs (quality control circles), is able to take part and implement improvements in the business. In China, there is a very rigorous hierarchy. The boss gives the orders and the employee obeys.

*So, aren't the Chinese encouraged to participate?*

No, they aren't. This aspect has also been highly developed in our plant. We believe that our type of management creates more loyalty. One of the factory managers of the plant was in Brazil and I showed him our participative system. He didn't believe that it could work in China. Today, we are seeing that with this initiative we have improved the plant's productivity. With the implementation of these small changes—drawing closer to our workers, discussing things with them, making them participate and not only follow the hierarchy—we have had improved quality and productivity. Even at that, I recognize that productivity in Brazil is much higher.

*Do you think that the same principle also applies, in other cases, to products and technologies?*

Yes, it would, because, the principle is based only on management. China grows much more in productivity than we do, in Brazil. Thus, it is by managing people that we are able to achieve these advances.

*I was going to ask you about this, next: how has productivity grown so much, there?*

The Chinese do not know about management systems and, for that reason, they are less productive. The companies plan poorly, which does not happen with the government that is very well-planned and efficient. China's construction industry shows big advantages, compared to the sector in Brazil. Two years ago, a high-speed train was announced from Shanghai to Beijing, and it is already to go. It's startling how fast they build things. That capacity, however, belongs to the government. With the companies, it's a different story—but the learning phase is still going on. Productivity doesn't achieve the levels we get, here, because it takes many years to fully implement these systems. That is, there is still a lot to be done in this area in China.

*So, this significant increase in productivity is related to a basic effect, that is, they start on a lower basis, making it easier to grow.*

Exactly.

*And that also means that they have a margin, that is, room for raising wages that does not imply higher costs, right? This is a critical variable.*

Yes, it is a critical variable that must be handled well. About one-and-a-half-years ago, I asked a manager to analyze the excess overtime hours at the plant. He explained that the employees worked more, because they didn't achieve the production goals. That's when I noticed the need for some good management training. Today, with nearly the same number of people, we have eliminated overtime, put wages in order, and we are meeting expected production goals. Production gains were very big but, of course, we had to provide some compensation for wages.

*We call these the advantages of being backward—there are many of them. There are growth reserves, like this, for instance.*

But we still need many people who see opportunities for improvement. In China, the management system is different from ours. There is usually a "line boss" in each section that observes all the employees while they work. And I must say that the Chinese are very obedient.

*Is the foreman there to guide workers, if they have any questions?*

Yes, he is constantly monitoring them.

*The next question is important. There is irrefutable proof of the creativity of the Chinese. The University of Cambridge organized an enormous list of great inventions that come from China. But, on the other hand, the impression we have, from your answer, is that the Chinese would not be participative in proposing*



*improvements. How is this issue of creative workers and participation in proposing improvements?*

As an industrialist, I can say that there is no doubt that the Chinese have great skills at copying and adapting quickly. This occurs in Asia, in general. It was this way with Japan, too.

At WEG, we have a fundamental principle: benchmarking. In order to create something new, like a new product platform, the first step is to do a worldwide study, for the purpose of mapping what already exists in the market. Based on that, we don't reinvent the wheel, but, rather, we adapt it. This is a fundamental premise for developing our products at WEG. That was the case of the new motor platform we manufacture in Brazil, and for which we developed 22 patents. From a commodity product, like the engine, which has existed for 130 years, we created another with innovations.

*I'm going to ask a rather sensitive question. Brazilians are very curious about "guanxi". I would like you to explain a little about what this is. This certainly does not exist in the American culture.*

I can only say what I have learned over these last several years: "guanxi" is purely relational, based on ethics and principles of mutual trust between people.

*Are there ethics in "guanxi"?*

Yes, there are. Nothing in it is anti-ethical. It is based only on trust. It is a relationship where directors and clients talk about categories, growth, and opportunities in an open and sincere fashion. If the client, who is sitting on the other side of the table communicates confidence, the business deal will move ahead; and the same is true to the contrary. There is nothing more than that. This is gaining trust at the highest levels.

*It is nearly the opposite of the American model, which does not mix the personal sphere with the professional, and tends to be totally objective and direct.*

What you see in China is different. In business meetings, some of the commercial topics are dealt with, but the main things are generalities and personal subjects. It is a very interesting ritual. There are protocols: one way to speak and one way to celebrate. "Ganbei" (gift) is fundamental to the Chinese as a form of gratitude. It is a sign of trust. We are a bit uneasy with this. Brazil is more like Americans.

*Does "Guanxi" work with suppliers, too, or basically with the government?*

At all levels: government, clients and suppliers.

*In post-Soviet Russia, there are shocking reports from western business people about the difficulties of mutual trust.*

In Russia, we set up a commercial branch. Initially, we had a partner that bought a certain number of motors, but then gave up. In that case, they simply did not pay us. In Russia, negotiations are very hard. We thought about establishing a plant, there, in the future but, upon analyzing the judicial instability, we felt it was a very risky decision. The Marcopolo company tried for two years and even built a plant, but then gave up. The bureaucracy is very complicated and everything is investigated and analyzed.

*This doesn't exist in Russia. In Nigeria, for instance, it is also complicated. How is it in China?*

In China, it's not. I'm impressed by some aspects of China. Security, for instance, is spectacular. You can't work around loopholes in the law. There are no thefts and the infrastructure, especially on the coast, is impeccable. There is a very good highway and transportation structure. The Chinese are developing some centers in the interior of the country and this has generated more labor turnover. During the Chinese New Year, the employees go home and do not always return to their jobs.

*With respect to the government: you don't have difficulties regarding certain authorizations?*

If we hadn't have established good relations, we most certainly would have difficulties. Fortunately, "guanxi" helps us with this, like, for example, with a speedy approval of some licenses. It is essential that there be "guanxi". For that reason, I was in São Paulo, recently, for dinner with a Chinese delegation from the government of Nantong Province, which was interested in WEG's future plans. This trust relationship is built over time.

*Still on relations with the government: did they offer any fiscal or credit incentives at the beginning?*

No.

Upon entering China, Embraco introduced a significant innovation and received an advantage for it, which was a reduction in the income tax. Now, the innovation has been spread around. In a recent interview of the company, I asked: "So, have you lost your advantage?" No, they still have it. According to them, there are still several points to be achieved by the Chinese, but the initial innovation has already been spread around. You didn't even have any incentives regarding the land? Weren't there any provinces/cities competing to offer you advantages? That's normal in China. Have you taken any innovation there?

No, we transfer products from Brazil and, in this respect, so far, we are in an implementation phase of products similar to those that the Chinese market already has, but with our technology. I wouldn't say that this is innovation. WEG has some benefits to export from China, but they are not driven by an innovative product. I would say that perhaps we could

think about this, some day. I really didn't know that this was possible.

Today, in China, we have our most up-to-date product. We are, perhaps, the only manufacturer of high-efficiency motors in China. There is a trend in the world to save electrical energy and, in this area we are prepared to serve the market. In fact, I have already spoken to the Chinese government about the subject, and we will have a meeting specifically about this. It is an advance toward being green, which is an absolute priority for China.

Our standard is Efficiency and Reliability for the Industry, and it has driven our development over the last 30 years. WEG's involvement, which takes in our policy, research, development, and product portfolio, focuses on ensuring efficiency.

*The WEG research center in Brazil is well known. Is there a center in China?*

We have an Engineering area that does not do research but, rather, develops customizations for the market. Basic research is still done at the company's headquarters. We are thinking about establishing a center in either China or India. In the latter, where we also have a plant, there is a communication advantage, since Indians have English to facilitate things. On the other hand, the Chinese have an impressive capacity for learning. Something I noticed in Nantong is that the street vendors and peddlers, when they're not selling, are reading. It's a cultural thing.

*Since you are very open and the interview is going so well, I want to leave a thought: I think that a center in India would almost insult the Chinese. That could be harmful to you in China.*

We don't know. But in India, we have a plant for manufacturing large machines, which is a very different business from what is in China. Therefore, I believe that we would have no problems.

*At the beginning, did you lose money in China?*

I wouldn't say that. I consider it to be an investment. We took quite some time to make a profit in China. It was an exercise in management and persistence. Brazilian companies should go to the Asian country and see what this type of difficulty is like.

*But the fact is that Brazilian companies do not have this mentality. That is an exception to the rule.*

This year I went to a closed event put on by Votorantim. They want to go to China, and they invited us to talk about our experience. I spoke very naturally about the difficulties, management and relations, among other things. They thought the presentation was very good, and I believe that they have decided to enter the country. At the time, we didn't do that. We hired a consulting firm that performed a study of the best

possibilities. Therefore, we did not use the experience of other companies. Except for a short conversation with Embraco, all of our learning was by experience, over these past seven years.

*If possible, I would like to speak, now, about the Chinese competitors, who I usually call the little dragons. How are they developing?*

This is one area where we notice differences every year. The Chinese learn at a tremendous speed and we are certain that they are now the world's big marketing threat. WEG is a global manufacturer and should learn to take advantage of this competitiveness. I have done some studies of Chinese products and it is hard to understand how it is possible to have those prices. Many times, the cost of the raw materials is higher than the selling price. This worries me. The product by a Chinese manufacturer, if compared to mine, weighs the same, uses the same raw materials and labor. How is he able to sell it 40% cheaper? I think there are incentives, but that's not the whole story.

The Chinese are learning to improve the quality of their products and to customize them, meeting market specifications. However, China still has not achieved the levels of Korea, for example. They export their products, but they are seriously lacking, in terms of services that give continuity to their business. Inside of China, we are already competing as equals. You only have to find the right channels and ways of doing business. In terms of product competitiveness, we are already comparable.

But when I speak of competitiveness, I'm referring also to the competition that China imposes in other countries, mainly in Europe. Europe has a very interesting characteristic: it is possible to sell a product of any nationality, without naming its origin. The Chinese product is on the market, but nobody knows it's Chinese. In the U.S., the Chinese do not bother anyone, since the Americans are very pragmatic. If the product works, it's not so important where it comes from. Some companies choose the Brand Label tactic, where their own project is taken to China only for manufacturing, but it is signed as an original brand. I consider that to be a suicidal strategy. Companies are teaching the Chinese how to manufacture a product. They, on the other hand, can, on their own, become competitors. WEG's philosophy is based on building its brand with its own technology.

*Just so we can understand, I will be the devil's advocate for a bit. First, they could have cost advantages that you don't have. I'm not sure, for example, if they don't get cheaper labor. Second, they are technologically repressed, which allows them to do many things. For example, they have no problem, at the plant, with having a worker moving products with a hand cart, which does not happen in your case.*

I saw this happen: a worker was carrying a motor with a hand cart. In my plant, they would use a pallet truck.



I could continue with this type of thing. The truth is: they use up-to-date technology for the more critical clients and not for the rest. You have a much higher technological consistency. For example, Siemens. Imagine if Siemens were to let someone load its products with a hand cart. So, there are several factors that make the Chinese product cheaper, despite using the same basic technology, having the same weight, among other aspects we have already mentioned. What you could say is that this does not represent such a big difference. I agree. On the other hand, one must take into consideration that, in some cases, they have trade connections for buying at lower prices, on larger scales. Finally, I believe that there are numerous operational resources and a management that allow them to lower costs. Therefore, reducing the difference only with government favors can be rushed, although they also exist.

I think it's impressive that you are able to manufacture a product whose selling price is lower than the cost of the raw materials. Throughout these years, we have discovered some of the factors of Chinese competitiveness. There are certain aspects, which you have already mentioned, like cheaper sources of raw materials. As for labor, even considering all charges involved, today, the Chinese wage is one-third of the Brazilian, on the average. This generates competitiveness. Commodities also have a lower cost in China, since labor is cheaper and the tax burden is lower.

There are other things. Brazilian companies demand much higher margins of return than the Chinese. There is a whole series of factors and, finally, there is prejudice against the Chinese which is obviously not the case. I have read a lot about the slavery to which Chinese workers are subjected. But this does not exist, because they are not slaves. They are workers.

Yes, by definition, there is nothing that disproves slavery more than the high turnover rate.

I visited our competitor's plant. We are friends, despite the heavy competition. I've been to their plants three times. The workers live inside the plant, in dorms, and they work 15 to 17 hours per day, 7 days per week.

You, yourself, said that, if possible, a Chinese worker eats lunch by the machine, because this is their culture. They are former peasants and have always eaten while on the job. The question of prejudice, however, is complex and ends up jeopardizing Brazil. Malicious and incredible explanations are invented, and cannot be taken seriously. This is not your case, at all, rather it is much to the contrary. At the Embraco plant, in China, I asked them, taking into account the progress of the little dragons, how soon they believed they would achieve a global level of quality. They bet that it would be in about five years.

I would say seven years. It won't be long, because they are very quick. Which, to a certain extent, is good. It makes the market develop, demanding more quality.

For seven years I have accompanied the evolution of China and of its products, before we even established our plant, and it has been impressive.

Just see how dramatic this is: WEG and Embraco, which are arguably among the best Brazilian companies, think that within five to seven years, the Chinese will be their equals. Another question: what are the growth perspectives of the company in China? Do they exist? Are they strong?

Yes, they are strong. In our strategic planning, Nantong should become a large industrial hub in that market. We have a growth plan and, over the next seven years, we expect to multiply our present size by five. We will not do this merely with organic growth. At this speed, we will have to also grow through acquisitions. Looking back on the past six years, we are investing much energy, in our confidence regarding growth.

Here in the west, a large number of the countries will practically stagnate over the coming five to seven years.

Analyzing some of the research, in the next 10 to 15 years, the attraction of the machinery and motor area will be very good in Asia.

In your last thought, you mentioned two things: market growth and the growth of WEG in the market. Generally speaking, the market will not increase very much, but your market share could increase.

We are very small, compared to the size of the market in China. For that reason, multiplying by five is a fact. I feel very enthusiastic about this.

I would like to touch on the subject of pre-salt. Pre-salt is a world to itself. How will it change the Brazilian setting for WEG?

At WEG, not only here at headquarters, but at our branches around the world, we can cover all of the opportunities presented by pre-salt. Everyone is working hard on this, which makes it even more competitive. Of the last 40 boats for public bid, we won a part and the other went to our competitor. We are also working on national content. WEG is perhaps one of the few Brazilian companies with enough competence to meet most of the pre-salt needs. Last year, one of the meetings of Petrobras dealing with pre-salt took place at WEG. We are working in synchronizing with demand.

Even working with big motors?

Not only motors. We work with automation, with all of the substations of the ships in the areas, among other things. There is a type of technology, for instance, some motors for deep pumps that we don't manufacture. But, on the other hand, we produce the entire electrical automation package, power distribution, and motorization.

*I am impressed. I knew that WEG was an exceptional case, but the interview has exceeded my expectations.*

*When we decided to go to China, I thought it would be “horrible”. Over these years, I see many more opportunities. In fact, only opportunities. The network infrastructure, the speed with which things are built in China, and especially the speedy decision-making. Even with the need for “guanxi”, in all aspects, China is able to bring much more speed to the business.*

*Maybe because of the “guanxi”.*

*Exactly. If the Chinese do not lose confidence in you, there are really no problems.*





# Interviews with CNI and the Government

## NATIONAL INDUSTRY CONFEDERATION – CNI

*First, I would like you to briefly speak about Brazil-China relations and their evolution in recent years.*

### **José Augusto Coelho Fernandes – Director of Policies and Strategy, CNI**

China became Brazil's main trade partner, and this made both the private sector and the government name it as one of their priorities. However, I believe that the strategic agenda for China is still inconclusive and that Brazil experiences difficulties in dealing with the Asian country.

I also believe that there is an information deficit and a lack of knowledge and, thus, we work with preconceived ideas. Any and all efforts to increase understanding China, by both the private sector and the government, are highly important.

Obviously, for Brazil, we can consider China to be an extraordinary bonus. For Brazilian manufacturing, however, the country is positioned as a more serious challenge. Brazil's understanding of the Asian country needs observations regarding politics, as well as an adequate comprehension of the Chinese form of industrial organization and, mainly of Asia's industrial ecosystem, which is significantly different from ours.

When we look at Asia, we notice a group of hubs. For instance, Shanghai, Singapore, and Malaysia are connected by efficient ports with cost structures and comparative advantages. The result is a surprising capacity for creating complementary chains and elevated intra-industry trading.

This Asian scenario is distinct from what we see in South America. Here we have a format for regional integration that suffers from such restrictions as the presence of the Amazon Rainforest, the Andes Mountains, and a structure of inefficient ports. This implies there are industrial segments that are unable to react to the competition imposed by these Asian chains coordinated by China.

Today, any company that wants to develop a survival strategy must consider China in its assessments, do a diagnosis of the existing chains, and seek ways to be different within this scenario. For instance, if the company chooses specialized automation, its chances of success grow. But, if it decides to produce a generic system, it will most surely lose out to the Chinese. Competition on an equal footing with Chinese products is aggravated by all of the issues of costs

with reference to Brazil, which do not exist in China, like labor costs, taxes and the exchange rate.

Therefore, in order to face this issue, we must first understand China, by investing in knowledge. To that end, the Council plays an important role. We must study their operating logic, where they are headed, and what dilemmas their economy will face.

Furthermore, we need to think about our own global competitiveness. There are enormous difficulties in changing some of the factors in Brazil, like the tax burden and social charges. However, in the medium term, we must advance in issues regarding infrastructure, thus improving our capacity to compete, internationally. There are important private projects along this line. Our connection with China, for instance, is done via the Atlantic Ocean, and not across the Pacific, and that's possibly the way it will be in the future, as the most efficient option. So, if we invest in waterway projects and highway and railway connections proposed for Brazil's northern region, we will be able to reduce the cost to Shanghai by about 25%. These projects are identified in a CNI study, which lists the investments, the rates of return (some between three and five years) that could significantly reduce the cost of placing products in China.

Furthermore, we need to be aligned with the reform process of the Chinese market. And, regarding this point, it seems like the strongest gains, in the short term, are still associated with agribusiness. There was an advance last year, with reference to pork, but I believe that Brazil should deal more seriously with its agenda for phytosanitary negotiations, as a way to open the market for its products. I believe that we would have good returns on these kinds of measures. To this end, however, it would be important to give the area a team dedicated to resolving the existing problems and giving it clear targets for achieving results, by providing the necessary resources for achieving those objectives.

*Having accompanied the attempts of Brazilian companies to enter China, what are the barriers that you see? Do the companies customarily get in contact with the CNI, when they think of setting up in the Chinese market?*

According to our studies, about 10% of the large Brazilian companies have some type of presence in China. The sectors where we see a more intense presence are the labor-intensive industries in Brazil, like leather goods, footwear, clothing, and, to a certain degree, chemicals. It seems like these sectors have the biggest direct presence for their own or indirect manufacturing, via outsourced systems. I believe that, for these segments, the obstacles for getting into China are minimal.

*But did you take a poll to know which Brazilian companies would like to invest in China, but were discouraged by all the rules and obstacles?*

Except for the known cases, like Gerdau and Embraer, we have no records on this.

Changing the subject a little, the footwear area perhaps should have a specific study. We don't have much information about it, but I remember that there was a big flow of labor, formed by the National Industrial Apprentice Service (Serviço Nacional de Aprendizagem Industrial - SENAI) to China. Between 800 and 2,000 people now provide technical support to Chinese companies. They might have become entrepreneurs in China or even migrated to other countries in the region. The question we must ask is: could this Diaspora become an asset?

*In another context, APEX has commented on something about exports from Brazil to China, of more sophisticated shoes, and importing more standardized, low-cost shoes. Who promoted that? Was it Brazilians who are already in China?*

I have no information on this. But my feeling is that, with reference to China, there are many opportunities in the services area, where Brazil would have a good chance, from architectural projects to formulating public policies. If we look at this new China agenda, which is more focused on social security, where Brazil is outstanding, there is much space for exporting services.

It also seems to me that in the future we will have to think outside the box. China raises issues like the need for structural transformation in Brazil, and makes us question the opportunities that follow after that structural change. We have natural candidates, like petroleum and natural gas, but there are also sectors like bio-economics, pharmaceuticals, defense and security, and others. We need new offers, something more than our revealed comparative advantages.

*We think in terms of comparative advantages that are not only apparent or revealed, but also submerged.*

Today, if we map Brazilian science, what will appear? Do we have an outstanding group of new materials? Are there new clusters arising in the country? Mapping these new areas and all of the efforts for developing the clusters would be of great importance to our nation. After identifying our strong points, in terms of science and technology, we will be able to identify corporate opportunities.

*We have had this line of thinking, in order to align, perhaps in future work, on the one side, the new Chinese demands, which will dramatically change over the next ten years, with the dilemmas they are facing in their economy.*

That is an interesting point. I see that the problem of

the price of building is critical for them. Furthermore, I notice the issue of the rural agenda, which is experiencing reforms that could be similar to those that we did with rural social security.

*What is your evaluation of the Brazilian policies regarding China?*

I don't see a very structured exercise. There is a group dedicated to thinking about China, in the government, which should discuss new guidelines for the relations, but I am still unable to see the grand design of a strategy.

*Do you see any lack of coordination between the government agencies that deal with China?*

Yes, besides preparing a strategy, we need to coordinate the government resources for implementing possible plans. ▽

## **MINISTRY OF DEVELOPMENT, INDUSTRY AND COMMERCE (MDIC)**

*We would like to know what your vision and perceptions are regarding Brazil-China relations. In a few words, how does the MDIC see the evolution of these relations in recent years?*

**Ricardo Schaefer – MDIC Adjunct Executive Secretary**

The relationship is very positive, and has been deepening in recent years. In 2009, China became Brazil's biggest trading partner. It is also a relationship that provides room for Brazil to work on its trade agenda and that, obviously, brings benefits to the country from a macroeconomic standpoint. So, it has been growing, but still needs to gain quality. From the quantitative standpoint, it has grown a lot, but from the qualitative standpoint it still needs to improve.

*How, exactly?*

In terms of diversifying both Brazilian exports and Chinese investments in our country. Furthermore, it also needs to raise the level of Brazilian investments in China.

*Could you comment on the entrance and operations of Brazilian companies to China? What have you observed? Do Brazilian companies customarily get in contact with the MDIC at the time when they are studying a decision to enter China?*

I would basically divide the presence of Brazil in China into two phases, more definitely, with respect to the investments.



There was a big first moment when Brazilian companies entered China, which is related to the second half to the 1990s, and extends to 2005/2006. At that time, such companies as Embraco, VALE, WEG, and Embraer invested in the Chinese market. Our companies took advantage of China's big economic growth, at rates of more than 10%, to enter the Asian country.

What we are currently seeing can be considered a second moment for the entrance of Brazilian companies, for instance, when Brazilian companies open franchises in China, or when they form a distribution strategy in the Chinese market. Another example would be the Brazilian financial sector that, through the BM&F, is beginning to approach China. And, finally, in sectors with more technology, where EMBRAPA is studying the possibility of opening laboratories in the Chinese market.

Brazil has a relatively large degree of similarity with China, where practically 50% of what Brazil exports, China imports, in terms of products. This is an important percentage, when dealing with the market that grew and almost doubled in size from 2005 to 2010. In 2010, Chinese imports came to almost one trillion 400 billion dollars.

So, given this degree of similarity, Brazil has the potential for entering other sectors more heavily, whether by investing in manufacturing in the local market, or by having image-promoting actions, actions linked to distribution strategies in China. There are various sectors where Brazil has the potential for being more involved in the Chinese market.

*How do you see the support of our government to Brazilian companies, particularly the support of the MDIC? In your opinion, what would be the role of the MDIC in the process of promoting Brazilian companies in China?*

The role of the MDIC could be understood in two ways. In the first, we have the role of supporting the companies at the time they are negotiating with the Chinese government. There are already a number of agreements underway, ranging from agreements to coordinate statistics, which are important for us to have reliable data regarding mutual trade and investments, to initiatives in the plan for cooperating with China, where we have a strong agenda being negotiated with the Chinese.

The second way is the role of promoting Brazilian exports, through APEX. Since the middle of the first decade of the century, APEX has been working on promoting Brazilian products in China. We could highlight the opening of the Business Center, in Beijing, which provides all types of support to the companies that want to be internationalized for the Chinese market. Furthermore, APEX often supports Brazilian States that take industry missions to China.

We have worked to give priority to the Chinese market, and we have often stimulated the sectors that, perhaps, have not made China a priority market. So, it is a big job, and there is a lot of public relations work. For instance, during the Olympic Games in Beijing, we set up Casa Brazil, which was an initiative of the work of the Ministry of Development. And there was also the construction of the Brazil Pavilion at Expo Shanghai, in 2010. All of these actions seek to bring and improve the image of Brazil in China and, therefore, to help Brazilian industrial sectors to gain a greater penetration of that market.

Finally, there are many opportunities and the work needs to be intensified. However, the issue is often in the nation's private sector that does not name China as the target of its efforts, and it continues to see China as something very distant and a hard place to work.

*Is there a certain standard for observations regarding the barriers that the Brazilian companies face in China? Particularly with respect to authorizations. What do you think can be done to overcome these barriers, and remove some of these obstacles?*

First, the trade barriers tend to arise when the flow of trade between two countries quickly intensifies, as is the case between Brazil and China. However, with respect to China, I don't see that barriers to entering the country are a big inhibiting factor for a greater Brazilian presence in the Chinese market. I think that the distance, transaction costs, lack of knowing the language, and not knowing the market, are often the biggest factors keeping our companies from entering China.

Brazil has imposed more blocks to the Chinese, often due to disloyal trade practices of the Chinese towards Brazil. Of course there are periodical problems. But, normally, the Chinese have a very pragmatic view that even helps us solve problems.

I see, in the studies that we do, that there are still very interesting opportunities for trade and that there is often a lack of stronger promotional efforts, not on the part of the government, but on the part of the private sector. Generally speaking, the business sectors and entities do not make China a priority for their foreign trade. This has been changing, but needs to go much deeper.

*Actually, since our focus is more on investments than on trade, we have found that there is a certain asymmetry, as we could call it, between our rules and the rules of China. In the case of Brazil, there is no discrimination against foreign investments, unless perhaps one or another exception, in terms of national security issues. There is a view that in China it's not exactly like this, that the Brazilian companies, in the Chinese market, get special treatment. So,*

*the concerns that we see are more along the lines of asymmetrical rules regarding foreign investments.*

*China has flexed the investment rule that requires joint ventures and partnerships in the Chinese market. What we have seen, on the other hand, is that China has been working heavily on the issue of building its own brands, the issue of innovation, investments in technology, and this has obviously been bothering many foreign investors who have already been there for several years. But I see that Brazil, as a late entrant, would have opportunities to look for partnerships and joint ventures in Chinese market. I think that we would benefit a lot from these partnerships. Mainly due to the change in consumer standards that is occurring in China.*

*We see that the change in consumer standards in China, which is underway and will go deeper and occur faster over the coming years, could open a whole range of new opportunities for the entrance of Brazilian companies. Do you have any other observation you would like to make, before we finish?*

*We have done a study with data that shows, for instance, that we have opportunities in the areas of food supplies, beverages and agribusiness, homes and construction, and machinery and equipment. Despite thinking that we cannot compete, we have space to work in. For example, the entire fashion, medical-dental equipment areas. So we have room to enter China. Obviously, we are experiencing a moment of much growth in Brazil and business people are concerned more about serving the domestic market than about exporting, but we are attempting to stimulate business people. We see that the strategy must be carried out at two levels: we need to care for the domestic market, but we must be competitive abroad, too. And when we talk of competition outside of Brazil, we most certainly need to look at China.*

*You mentioned studies that were done by APEX.*

*Exactly. At APEX, we created a trade intelligence area that worked to provide information to the private sector in the debate regarding its internationalization strategies. So, we have specific studies about the Chinese market and opportunities that are available for the private sector. ▀*



# Appendix: About the Guidance Catalogue for Direct Foreign Investments in China

The catalogue is an instrument that the Chinese government uses to guide direct foreign investments entering the country. It is published by the National Development and Reform Commission (NDRC) and by the Ministry of Trade, and its main objective is to present broad guidelines that should be followed by other state-owned organizations.<sup>i</sup> This is very relevant to the Chinese economy, because it indicates the paths to be taken and the sectors that the government sees as being priorities over the coming years.

The catalogue has three DFI categories: encouraged, restricted, prohibited. All of the sectors not listed in the catalogue pertain to a fourth category: permitted investments. Encouraged investments receive incentives, such as lower taxes and less bureaucracy, as well as greater flexibility regarding foreign ownership. Prohibited investments cannot be made, and restricted investments are more closely examined by the Chinese government, and suffer restrictions as to foreign ownership.<sup>ii</sup> The first catalogue was published in 1995 and, since then, it has been revised five times: 1997, 2002, 2004, 2007, and most recently, in 2011.<sup>iii</sup>

It is possible to see a relationship between the catalogues published by the government and the expanded investments in the country. The

revisions of the catalogue always present a new perspective of economic reforms opening the economy to foreign capital. This can happen by limiting the number of prohibited sectors or by moving restricted sectors to the permitted and encouraged categories. In 1995, the encouraged investments were those with lower added-value. With the revisions, there was a gradual opening for goods with a higher added-value.

Currently, with the 2011 catalogue, one notes similarities and a few differences compared to the investment priorities set forth in the 2007 edition. The latest catalogue proves the intention of the Chinese government to expand the opening of the economy and to bring transformation and improvements to the manufacturing industry, especially for the leading industries and electronic sectors, like equipment and batteries that are a part of the category of encouraged investments. It also shows the government's objective of developing new strategic industries in such areas as cutting-edge information technology, environmental protection, new energies, and vehicles that are powered by new energies. Among other intentions found in the catalogue are the development of the services sector and the coordinated development of the nation's various regions.<sup>iv</sup>

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<sup>i</sup> Wall Street Journal, China shifts foreign investment focus, 31 de dezembro de 2011.

<sup>ii</sup> China Releases New Foreign Investment Catalogue (2011 Edition), January 12, 2012, Lester Ross, Robert Woll, Kenneth Zhou. Available at: <http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=10011>

<sup>iii</sup> China Releases New Foreign Investment Catalogue (2011 Edition), January 12, 2012, Lester Ross, Robert Woll, Kenneth Zhou. Available at: <http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=10011>

<sup>iv</sup> China Briefing, 2012 Foreign Investment Industrial Guidance Catalog Promulgated, December 30. Available at: <http://www.china-briefing.com/news/2011/12/30/2011-foreign-investment-industrial-guidance-catalogue-promulgated.html>

# ABOUT THE CBBC

## WHO WE ARE

The China-Brazil Business Council is formed by two independent sections, one in Brazil, and the other in China. It is dedicated to promoting economic exchange between Brazil and China and, above all, to stimulating dialogue between companies from both countries. The CBBC proposes to contribute to a good trade and investment environment for those companies, as well as to understand and announce new trends observed in the dynamic Brazil-China relations. Currently, the CBBC is formed by about seventy of the most important Brazilian and Chinese companies and institutions having investments and business in both countries.

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