

Samba nation plays the right tune

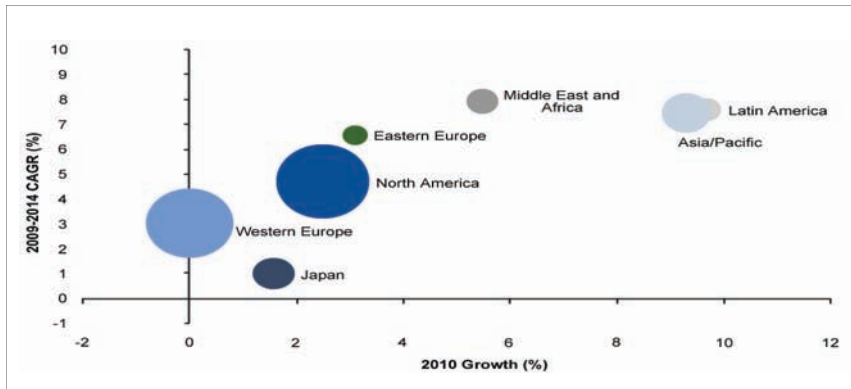
Atul Vashista & Sudeep Mishra take a look at sourcing trends, traps and opportunities in Brazil

DIVERSIFY your stock portfolio – this is a mantra we have been hearing for ages. Well, it is now ringing true in sourcing too! As global sourcing continues to grow, so does the interest in new locations. Companies are interested in new locations to diversify risk but also to better serve their own diverse operations or diverse needs.

One of these rising destinations is Brazil. The nation is emerging as an alternative (or complementary) location to other offshore locations, with an interesting combination of characteristics that are similar but also very different from the traditional low-cost locations, such as India and Philippines. Brazil has a very strong economy domestically, which is one of the least affected in the world by the economic downturn. Many of its Latin American neighbours are also experiencing strong growth in their GDP.

The Latin America services market will reach US\$31 billion in 2010, with a 10.4% CAGR through 2013. Brazil comprises about 40% of this total, with an expected growth rate that is higher than the region's average.

Growth Rate Forecast for IT Spending 2009-2014 - Latin America Leads Spending Growth



Several US and European based suppliers are active in the country. IBM, Unisys, HP-EDS, Accenture, Capgemini and TelePerformance have offshore centres in Brazil. Even Indian firms such as TCS and Infosys are present here. More importantly, several strong local firms seem to have a head start, such as Stefannini, Tivit, BRQ, CPM Braxis, Ci&T and Politec to name a few.

TRENDS

The IT services market in Brazil is characterised by the emergence and growing maturity of local service providers, continuous investment in Brazil-based operations, the growth of all major global providers participating in the Brazil market, and the arrival of the leading Indian players into Brazil (notably TCS, Infosys, Wipro, and to a lesser degree HCL and Cognizant).

All these players have always expressed that they could not afford to be absent in the promising Brazilian market. In fact, Capgemini's recent partial acquisition of CPM Braxis and Chilean IT Company Quintec's plans to merge with Brazil's Politec is a clear signal to Brazil's and LatAm's potential. The various players have also indicated that they expect a solid, steady growth of the internal market in the next one to two years, with a long-term perspective that more-decisive support from the government will make service costs more competitive abroad.

Trends in Brazil that support sourcing

2009	
Population:	193.7 millions (5th Largest in the world)
GDP:	US\$ 1574 billions (8th Largest in the world)
GDP per capita:	US\$ 8220 (57th)
GDP (PPP) as a share (%) of World total:	2.87 (9th)

The worldwide rankings (According to the World Economic Forum's Global Competitiveness Report)

Secondary education enrolment rate:	Rank 22
Availability of research and training services:	Rank 36
Financial services availability:	Rank 27
State of cluster development:	Rank 23

Further information according to the World Economic Forum's Global Competitiveness Report:

- The services sector contributes 65% to the overall GDP, very close to developed economies like Australia.
- Brazil's economy is at "Stage 2" .i.e. "Efficiency Driven" of development along with other Latin American competitors such as Argentina, Colombia, Costa Rica, Ecuador, Mexico, Panama and Peru. The only other LatAm countries at a "Transition from stage 2 to 3" .i.e. "Transition from Efficiency Driven to Innovation Driven" economic development are Chile and Uruguay.
- Brazil ranks at 58 on the Global Competitiveness Index, with only Chile (30), Panama (53) and Costa Rica (56) from LatAm ranked higher – making it a very competitive country for global business.
- Brazil ranks at 10 worldwide in terms of the market size due to its huge domestic market.
- Brazil is fairly stable economically at 58th, after following an impressive upward trend for the last couple of years (between 2007 and 2009). The country's recent dynamism in the rankings has reflected the remarkable strides made in the past



20 years toward macroeconomic stability, liberalising and opening the economy, and reducing income inequality; among other dimensions. These efforts have been instrumental in putting the economy on a much sounder competitiveness foundation and in providing a markedly more business friendly environment for private-sector development.

- Brazil is enjoying a very steady economic growth: while the country's GDP contracted slightly in 2009 (negative 0.18%), the economy has started to grow again in 2010, with an expected annual growth rate of 5.5%.

- Among its solid competitive advantages are its large market size, providing the efficient and dynamic business sector (ranked 31st for business sophistication) with important economies of scale, and a large basis on which to absorb and introduce process and product innovation (ranked 44th and 42nd for technological adoption and innovation, respectively). Moreover, Brazil displays one of the most developed and sophisticated financial sectors in the region (Ranked 50th), coupled with fairly efficient infrastructure by regional standards (ranked 62nd) and a


relatively well functioning higher education system (ranked 58th), notably in its on-the-job training component (ranked 38th).

- **Size and availability of labour force**

Brazil has a labour force of 86 million, 66% of which work in services, in general. Growth rates for the IT services industry indicates that 750,000 additional professionals will be needed in the country in the next 10 years (300,000 for the export market).

Projections indicate that the number of college graduates in IT-related careers will reach approximately 53,000 in 2013. Additionally, graduates from other areas, especially business areas, will also pursue careers in IT. Some of the new professionals will replace retiring professionals among the 600,000 in the IT labour pool (1.7 million, considering call centres). This scenario indicates a progressive shortage of IT professionals. As a result, enterprises in the IT industry undertake the responsibility of preparing the workforce, usually in partnership with local governments in second-tier cities.

More than 60% of IT service companies' labour pools are located in seven major cities — Sao Paulo, Rio de Janeiro, Curitiba, Belo Horizonte, Porto Alegre, Recife and the capital Brasilia. The biggest labour pool in the country is located in Sao Paulo, with a size of 225,000. However, the scarcity of resources is already becoming an issue, and companies are rapidly and successfully reaching out to Tier 2 cities with good universities (for example, Campinas, Hortolandia, Sao Carlos, Uberlandia, Londrina, Maringa, Florianopolis and many more)

Characteristics of flexibility, creativity and client empathy, in addition to specific domain skills (especially in the financial, insurance and communications verticals), make Brazilian resources attractive. A large percentage of workers have good business acumen and knowledge of business practices. 



4.43%, interest rates are continuing to fall, and GDP growth should reach 7.5% in 2010 (and 4.5% in 2011).

The country exhibits high “IT readiness.” For example, elections have been totally computerised for several years; close to 100% of all income tax returns are filed through the Internet; and the Brazilian federation of banks reports that close to 20% of all banking transactions originated on the Internet in 2009.

The Brazilian software and IT services industry reached US\$22.4 billion in 2009. Exports reached US\$3 billion and are growing at a healthy compound annual growth rate of 20%.

Since 2003, Brazil has steadily improved its macroeconomic stability, building up foreign reserves, and reducing its debt profile by shifting its debt burden toward real denominated and domestically held instruments.

After record growth in 2007 and 2008, the onset of the global financial crisis hit Brazil in September 2008. Brazil experienced two quarters of recession, as global demand for Brazil’s commodity-based exports dwindled and external credit dried up. However, Brazil was one of the first emerging markets to begin a recovery. Consumer and investor confidence revived and GDP growth returned to positive in 2010, boosted by an export recovery.

Brazil’s strong growth and high interest rates make it an attractive destination for foreign investors.

Large capital inflows over the past year have contributed to the rapid appreciation of its currency and led the government to raise taxes on some foreign investments. President Dilma Rousseff has pledged to retain the previous administration’s commitment to inflation targeting by the Central Bank, a floating exchange rate, and fiscal restraint.

TRAPS

The World Bank’s Doing Business 2010 report ranks Brazil at 129th out of 183 countries for ease of doing business. It is ranked low because of bureaucratic difficulties in registering property, starting a business, closing a business, paying taxes, employing workers, and doing business across borders.

• Data, IP Security & Privacy

Brazil has several laws and legal protections on privacy, but enforcement is not stringent.

While a growing information security industry exists, considerable work remains to be done in the areas of intellectual property (IP) protection, the enforcement of anti-piracy laws and physical security. Further information with regards to this issue:

A very sophisticated financial industry, integrated through a countrywide, real-time network, commands a very high level of security and intellectual property protection in IT services.

Data piracy rates were estimated at 56% for 2009 (down from 64% in 2005), the

• Cultural Compatibility

Brazil is well connected to the world. Immigration has resulted in cultural diversity. The culture in general, and business practices in particular, are influenced by the US and Western European practices.

Brazil has been the destination for several waves of immigration from different areas, most notably Portugal, Italy, Germany, Japan, the Middle East and other Latin America countries. Since World War II, Brazil has been strongly under the economic, and cultural, influence of American culture. Meanwhile, business practices are influenced by American and European MNCs.

• Political and Economic Stability

Brazilian international risk ratings are low and trust from international investors is high. The economy has been stable and growing, and inflation has been under control. The country has shown continued political stability and this is forecast to continue with the new government. Merger and acquisition activity has increased in 2010 as a rising number of IT service providers look to establish operations in Brazil.

The country ranks among “the best one third” of 178 countries, according to World Audit (democracy, 50/150; press freedom, 54/150; and corruption, 57/149), and is progressing in the rankings each year. Due to the international economic crisis, expected foreign direct investment (FDI) has been reduced to \$38 billion in 2010, after reaching an all-time record of US\$45 billion in 2008. The country remains among the world’s top FDI destinations.

Economic indicators are favourable: inflation was at an all-time low in 2010 at

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lowest in Latin America, next to Colombia (55%).

Brazil's 1996 industrial property law brings its patent and trademark regime up to the international standards specified in the TRIPS agreement, although the fraudulent use of internationally famous brands remains a problem.

Brazil's copyright law generally conforms to world-class standards, and the country is a member of the World Intellectual Property Organisation.

• Restrictive Labour Regulations

More attention is needed to correct antiquated labour laws, which make Brazil labour rates higher than those of competing countries. Greater scale of IT resources, which would lead to greater government support of job creation in the IT sector

• Macroeconomic environment

Despite the progress made toward fiscal sustainability, the macroeconomic environment in the country remains worrisome, with notably low savings rates (15%, 101st), a high interest rate spread (35.4%, 136th), and relatively high public indebtedness (48% of GDP, 84th)

• Attrition rate

Attrition rates are in the 15% range but comparable to the other Latin American countries and significantly better than those experienced in India.

• Taxes and regulatory costs

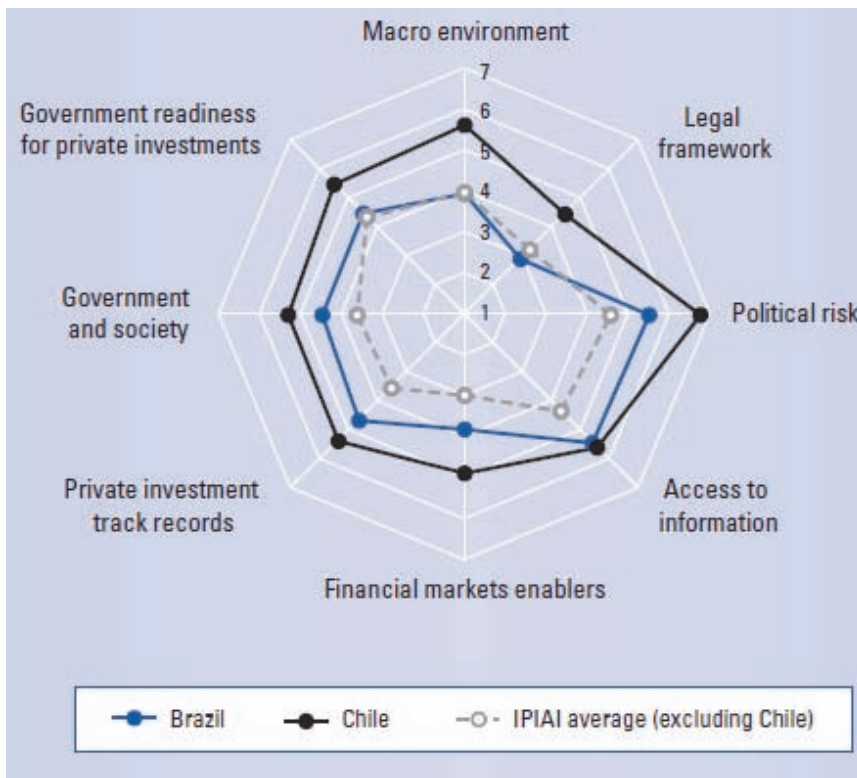
Many corporations say that the high taxes compromise Brazilian competitiveness in the global market. The middle class complain that, besides paying high taxes, there is not a return in services from the government; most middle class families have to pay for private education, private health, and, more recently, private safety. The tax burden is a less in Latin American neighbors like Colombia, Mexico and Peru.

OPPORTUNITIES

• Infrastructure Quality

Brazil's infrastructure is capable of providing the expected double-digit growth for the country's IT services industry with high levels of support. Government investments aim to give appropriate support to the FIFA soccer World Cup in 2014 and the Olympics in 2016. The government plans to spend US\$880 billion on infrastructure between 2010 and 2016, including telecom and broadband access. Telecommunications carriers and infrastructure providers are also ramping up their investment budgets.

The infrastructure challenge in Latin America – (Source: – WEF_GCI and Mia et al., 2007)



The overall quality of infrastructure has to develop more because the current quality results in higher logistics costs and inefficient patterns of inter-regional and international trade. The most problematic areas, as highlighted by the GCI, are the quality of port infrastructure (123rd), roads (105th), air transport infrastructure (93rd), and to a lesser extent, railroad infrastructure (87th) and mobile telephony (76th).

This assessment reflects the appalling state of transport infrastructure in the country, its underdeveloped railroads, the unexploited potential of its 48,000km of navigable waterways, its congested ports and airports, and its costly and underdeveloped telephone infrastructure.

• Education

Brazil has shortcomings in education but inadequate government efforts are complemented by the private sector (IT user companies and service providers), which runs extensive internal IT training programs.

The literacy rate for people aged 15 and older is 89%. Eight years of education are mandatory, but adults have an average of 4.9 years of schooling. Approximately 16.5% of the population attends college. Higher education enrolment has more than doubled in the past 10 years to more than five million each year. Government programs doubled the number of openings in federal universities for 2009 to 230,000

About 10% of the total educated labour force has completed higher education, and about 30% has completed secondary education. The deficiency in higher education availability is complemented by private IT technical high-school programmes.

The government spends 4.2% of gross domestic product (GDP) on education today, but has stated that it plans to raise this to 5.0% in 2012.

Further focus and efforts are required to improve the quality of the educational system at all levels (ranked 106th for primary education and 97th for the quality of the higher education) and to reduce regional disparities in educational access and attainment.

• Language capabilities

English is the primary foreign language, and most college-educated Brazilians can understand written English, but are not comfortable in conversations. This is one of Brazil's major challenges in the international ITO and BPO services market. Nevertheless, language diversity in Brazil makes it attractive for niche language skills.

Portuguese is Brazil's official language, but English, French and Spanish are widely taught as part of regular school curricula. The strong presence of foreign colonies means that Japanese, Italian and German language capabilities are also available. English is regarded as the most important foreign language, but the local educational system still struggles to provide the required proficiency levels.

▣ A typical student requires additional courses at private language institutes. Export-oriented service providers will often take it upon themselves to provide English language education, through internal training or by subsidizing language course fees.

• **Cost of Labour**

Despite the steady appreciation of the Brazilian real against the US dollar, the country still offers competitive service costs. In a risk-adjusted total cost comparison, relatively competitive costs, coupled with strong business acumen, solid infrastructure, low geopolitical risk and high international business exchange structure, highlight Brazil's overall attractiveness.

Brazil has relatively competitive salary rates among the various countries in Latin America. Average annual salaries are: IT programmer (US\$20,000 to US\$40,000); IT project manager (US\$53,000); software engineer (US\$32,000); and IT manager (\$77,000).

Hefty social taxes, which can reach almost 100%, are applied to salaries and collected from the employing company. However, there are several incentives for service exports, which combined can reach about 15%. 2010 salary increases in Brazil are expected to be 5.7%, down just slightly from 2009 (5.9%).

The cost differences between Tier 1 and Tier 2 cities can reach 50% in the three biggest cost areas for IT services — salaries, facilities and telecommunications — demanding extensive due diligence from providers and clients alike.

The Brazilian currency (the real) has been appreciating steadily and now floats at around 1.7 per US dollar. This represents a 25% increase in costs over two years for American buyers of Brazilian services.

The cost of living in Brazil — especially in the major cities — is higher than in other countries in Latin America. Sao Paulo (ranked 21) and Rio de Janeiro (ranked 29) are the only Latin American cities among the top most expensive cities to live in the world.

• **Government effectiveness**

Outdated labour laws and a slow-moving official bureaucracy continue to reduce the agility and flexibility of businesses in Brazil.

Outdated labour laws pose hurdles, and although currently under debate, they are not expected to change significantly in the short term. However, the country has made important forward strides in the past few years.

Government continues to create incentives, such as tax breaks, to boost technology-oriented innovation and workforce development, with the double objective of developing the IT services industry and making Brazilian service costs more competitive abroad.

The Brazilian Association of Software and Service Export Companies (Brasscom) enjoys high visibility and drives strong



programmes (including education, marketing, regulations and intelligence). Its President has a seat in Brazil's Economic Development Council and is widely respected. Brasscom also has talented leaders focused on the USA market and is well connected with USA based CIOs.

A large percentage of Brazilian workers have good business acumen and knowledge of business practices.

Other IT industry organisations – the Brazilian Association of Software Companies (ABES, representing software companies) and Assespro (representing software and Internet companies), join Brasscom in incentive programmes and government lobbying. Apex-Brasil (a government export promotion agency) and Softex (an organisation focused on software and services development) develop additional activities in partnership with Brasscom.

CONCLUSION

Brazil can be a viable outsourcing choice for a wide range of IT and IT-based services, including IT and application outsourcing and business process outsourcing, especially for Brazil based operations. Also, the nation can be considered for US-based operations for clients with mature offshore experience. Total risk-adjusted costs for specific services are competitive with those in many other offshore destinations. Monitor effective control and transparency regarding required local compliance with complex, bureaucratic legal requirements.

Keep in mind that its outdated labour laws and slow-moving official bureaucracy reduce the agility and flexibility of businesses. And, often, you'll be competing with the strong domestic demand.

Nevertheless, despite the steady appreciation of the Brazilian real against the US dollar, the country still offers competitive labour rates. In a risk-adjusted total cost comparison, Brazil is very competitive among Latin American countries and against many African, Middle Eastern and Asia Pacific destinations. Relatively competitive costs, coupled with strong Western culture alignment, business acumen, solid infrastructure and high international business exchange structure, highlight Brazil's overall attractiveness as a service sourcing country.

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