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Economist Intelligence Unit

A complex picture

Investing and trading in Latin America

In the spotlight – Latin America

A complex picture - Investing and trading in Latin America is the third in our series of reports examining the potential risks and rewards of trading with the world's emerging markets.

As many home markets stagnate under a cloud of global economic gloom, those businesses with an eye for an opportunity are turning their attention to new markets that promise real profitable returns. That's definitely borne out by our latest survey. In August 2008 we contacted 326 senior executives from companies that trade or invest in Latin America or plan to do so. Over half of those surveyed said that their decision to trade in Latin America was influenced mainly by the slowdown in developed markets elsewhere.

Nearly two-fifths of the executives surveyed have their headquarters in the USA, a fifth in Europe and the remainder from emerging markets - including Latin America. The sample includes respondents from a wide range of industries, notably in IT and technology, professional services and manufacturing.

A third of the companies in our representative sample have annual revenue under US$100m, while a quarter have annual revenue of US$5bn or more. As with our previous reports, we have supplemented our survey through in-depth interviews with a number of senior executives and experts.

We would like to acknowledge the expertise of the Economist Intelligence Unit who undertook this survey on our behalf, and in particular their experts Thierry Ogier and Paul Lewis who, respectively, wrote and edited the report.

As the global economic landscape continues its radical change, we hope that our report gives you a glimpse of a region that still has much to offer.

Executive Summary

Investors and traders of all sizes and in all sectors are recognising the market potential of Latin America, as its political and economic stability has improved. This report looks at the region as a whole, but focuses on its main markets: Brazil, Mexico, Argentina, Chile, Colombia, Peru and Venezuela. Our findings, based on a survey of 326 executives operating in the region and on in-depth interviews, reveal a generally positive outlook, despite the worsening global economic outlook and lingering concerns about the business operating environment. The key conclusions of the report are as follows:

The impact on the region of the US downturn has been limited—so far.
At the time the survey was taken, respondents said that the US economic slowdown had not significantly affected their Latin American operations. Three-fifths of respondents reported little or no impact over the past year. However, the same proportion (60%) predicted a moderate or large impact over the coming year, suggesting tougher times ahead, but nothing that is likely to derail business plans. In fact, the rewards of the market have generally strongly outweighed risks.

Modest sales and profits growth is expected in the medium term.
Annual revenue is expected to increase by at least 6% or more on average over the next three years, according to 61% of respondents (while only 42% reported a similar average over the past three years). Equally, profits are expected to improve: 59% of respondents expected their annual profit growth to reach at least 6% in Latin America in the next three years, while only 40% experienced a similar performance in the past three years. Nevertheless, this outlook is not as favourable as that expressed by firms operating in South-east Asia.

Market opportunities and geographic diversification are the main drivers.
Some 83% of survey respondents said that market growth was the reason for entering these markets, with 93% of west European-based companies stating this. The interest is fuelled in part by the economic slowdown in developed economies (a motivation of 62% of respondents), and competitive pressures at home for one-half of survey respondents.

A significant presence in the market helps.
Having a physical presence in the region is likely to boost profitability. Over one-half (52%) of respondents from companies with a significant operation in Latin America (either a manufacturing base or a service operation) said they performed ahead of their peers, double the survey average. Only 11% of respondents primarily involved in importing or exporting in the region said they outperformed their peers, while a sizeable 24% of importers or exporters believed that they underperformed their peers (compared with a survey average of 17%).

Cultural differences hamper regional integration.
Two-thirds of respondents reported that cultural differences posed either a major or minor obstacle to a region-wide strategy. Despite the region's linguistic, religious and historical similarities, the cumulative impact on culture of socioeconomic and geographic issues appears strong. The clearest divide is between Portuguese-speaking Brazil and Hispanic America, but even within Hispanic America many differences arise.

Concerns about politics, economics and corruption persist.
A clear divide operates between governments that pursue market-friendly policies—namely Brazil and Mexico—and those failing to take a hard line on inflation—such as Argentina or Venezuela. Despite significant progress in taming inflation and entrenching democracy in recent years, political and macroeconomic stability, bureaucracy and corruption remain significant concerns for around 80% of respondents across the region. Corruption and excessive bureaucracy also appear endemic in many countries, even though executives express guarded optimism about improving conditions.

Organised crime remains a major challenge.
Political problems for business are often connected with issues of crime, and this affects the fundamental question of business security. In Mexico, the government's campaign against organised crime—in particular kidnapping, cargo theft and exploitation of legal weaknesses—is viewed by some executives as being more critical than the impact of the global financial turmoil.

Brazil presents the best sales opportunities, but the market suffers from excessive bureaucracy.
Brazil, the largest market in the region, has made great strides in stabilising its economy in recent years. It is the best market for selling high value goods, according to two-thirds of survey respondents; for manufacturing (according to 45% of respondents); and sourcing of goods (42%). But many rated the country poorly for customs clearance, and complain of heavy-handed bureaucracy and corruption.

Skills gaps at all levels hold the region back.
Almost one-half of respondents reported skills shortages in foreign languages (44%) and in marketing, finance or risk analysis (43%), while even basic writing skills were a major constraining factor for 29% of respondents in their main Latin American markets.

Introduction

Latin America boasts major attractions for traders and investors worldwide. It is not the most dynamic emerging-market region in the world, when compared with parts of Asia and Eastern Europe, and proximity to a faltering US economy is a source of some concern. As one Latin American director of a US manufacturer who preferred not to be named, notes of its US management: "The new management of the company does not really know Latin America's reality and its potential. It has been too busy trying to survive the impact of the international crisis and unexpected higher costs." Nevertheless, business executives operating in these markets generally retain a moderately upbeat outlook. Our survey shows that interest in Latin America is overwhelmingly driven by the need to escape stagnant home markets and find new growth opportunities. With its large and youthful population of nearly 550m and robust economic growth of almost 5% annually since 2003, Latin America fits the bill.

Interest in Latin America is overwhelmingly driven by the need to escape stagnant home markets and find new growth opportunities.

But not all is well on the continent. Aside from the growing impact of the worsening global economy, executives highlight local political and macroeconomic instability, and numerous operational obstacles—especially weak infrastructure, corruption, crime and bureaucracy—that have undercut the potential of the region. Although much of the political violence and the economic shocks inflicted on the region over the past decade has subsided, especially in the two big markets Brazil and Mexico, bureaucracy is seen as a heavy burden in the former and organised crime, while a persistent problem in Brazil, has become particularly pressing in Mexico too. Few executives believe that economic bad times are entirely in the past: rising inflation and macroeconomic instability continue to haunt executives trading or investing in Argentina and Venezuela.

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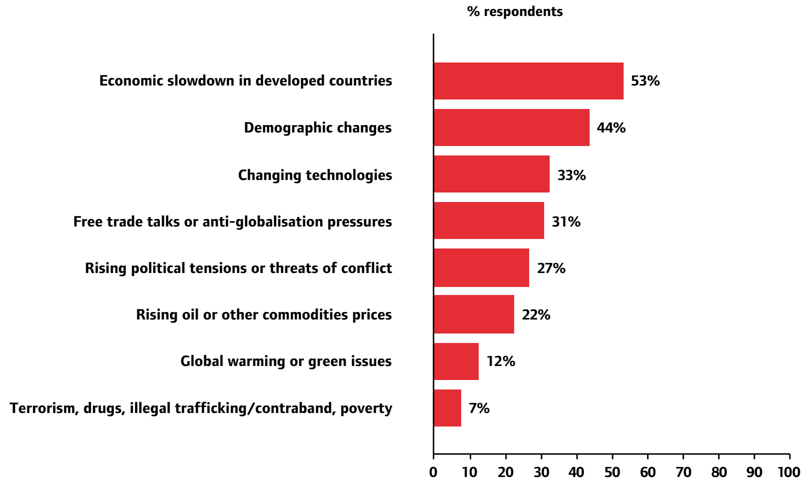
The strategic view

Why are foreign businesses keen on the region? Over one-half (53%) of our survey respondents said that the economic slowdown in developed countries was the most important global trend influencing the decision to do business in Latin America, an outcome that is consistent with our global survey of emerging markets (see *Promise or peril? The lure of the emerging markets,* June 2008) in which 50% of respondents said the same. Demographic trends generally were seen as a particularly important factor too. Latin American populations are very young compared with those in the US, EU and Japan, and this presents excellent new sales opportunities in certain sectors.

Latin America presents excellent new sales opportunities in certain sectors.

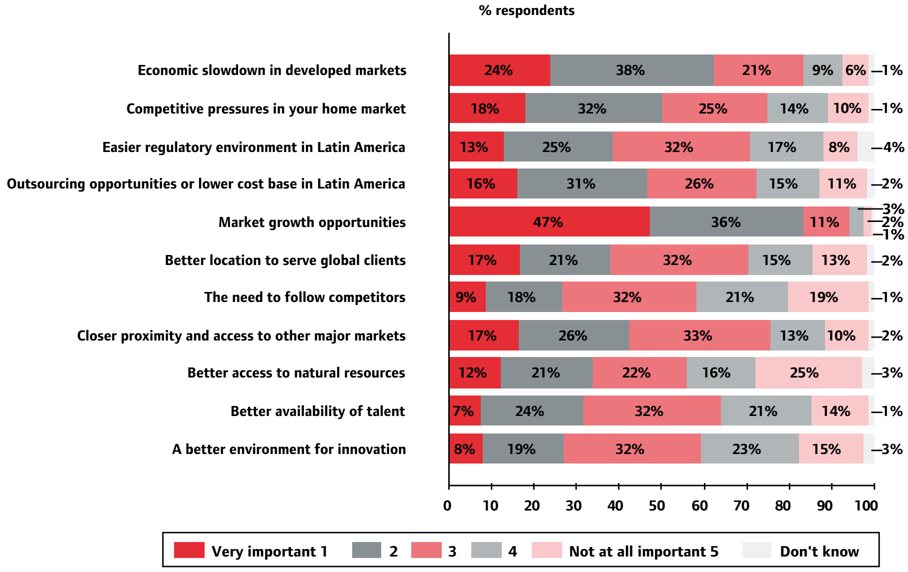
Which of the following global trends are the most important factors to your company when selecting trade or investment locations in Latin America?



Source: Economist Intelligence Unit

Despite the mineral wealth of much of the region, and the low wages in some parts, companies view the region overwhelmingly in terms of new market growth opportunities—an attraction deemed "very important" or "important" by 83% of respondents. This was especially the case among European-based companies (with scores of 93% from firms based in Western Europe and nearly 90% based in Central and Eastern Europe). Competitive pressure in home markets was another important factor mentioned by one-half of respondents, while seeking scope for cost-cutting was a motivation for 47%. Other relevant factors included closer proximity and access to other major markets (43%) and better location to serve global clients (38%). Only one-third of respondents included better access to natural resources among the main factors driving them into the region.

How important are the following factors in driving your company's plans in Latin America?

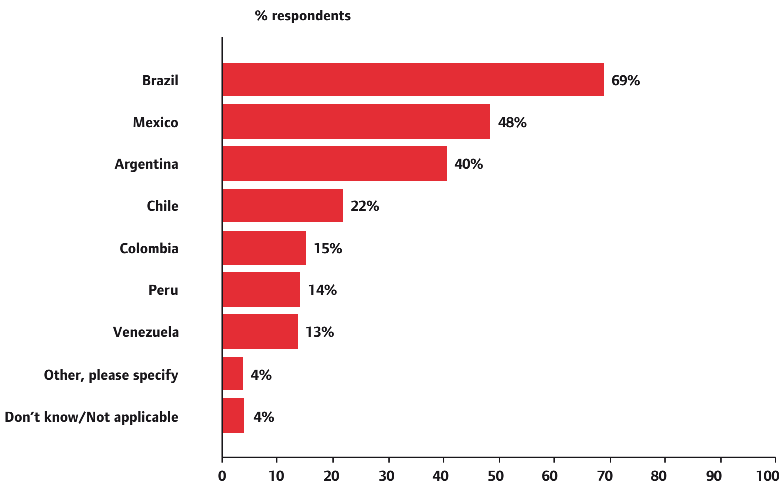


Source: Economist Intelligence Unit

Brazil and Mexico account for 60% of the region's GDP, although reforms elsewhere have broadened the interest of traders and investors. Some 69% said that Brazil is a priority market for the next three years, followed by Mexico (a priority for 48%) and Argentina (40%). Chile, regarded as having the best operating environment, was a priority for only 22%, probably because of its relatively small domestic market. This outlook has barely changed over the past three years.

Brazil and Mexico account for 60% of the region's GDP.

Over the next three years, which of the following markets do you think will be priorities for your company's expansion?



Source: Economist Intelligence Unit

Foreign direct investment (FDI) inflows and the Economist Intelligence Unit's own forecasts generally support these findings. FDI soared by 42% in 2007 to US$125bn largely on the back of the region's economic recovery and global demand for commodities (although this is less than the inflows forecast for Eastern

Europe, for example). Brazil and Mexico are expected to take the lion's share of FDI inflows to the region forecast for 2008-12—with Brazil receiving US$155bn and Mexico US$110bn. Chile is expected to attract US$86bn, followed by Colombia (US$38bn) and Argentina (US$24bn).

Projected increases in trade are starker. Annual imports to the region are forecast to double between 2007 and 2012 in US dollar terms, especially to Brazil (up by 118%), Chile (105%) and Argentina (96%). Although Mexican imports will remain the largest in nominal terms at more than US$400bn in 2012, this represents growth of only 50%.

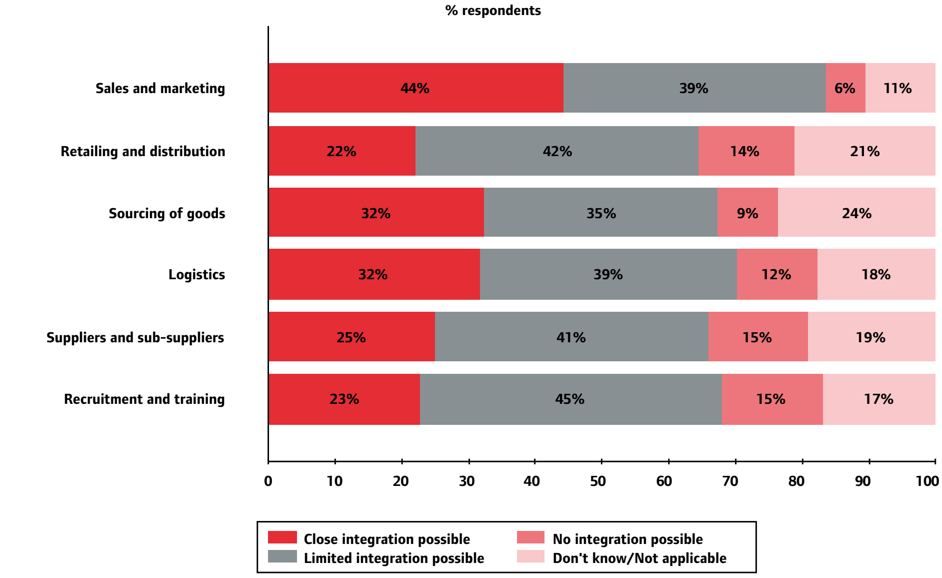
Companies adopt varied strategies for the region's smaller markets. These are generally clustered with the nearest large market, especially if there is a close cultural relationship. This trend was most clearly identified among US-based companies, while Latin America-based companies would rather "treat all markets, large or small, separately".

Regional integration has its limits. Two-thirds of respondents reported that cultural differences posed either a major or minor obstacle to a region-wide strategy. That may seem surprising given the region's linguistic, religious and historical similarities, but the cumulative impact on culture and way of life of other socioeconomic and geographic issues are factors too. The clearest divide is between Portuguese-speaking Brazil and Hispanic America. But even within Hispanic America, many differences arise, including, depending on the country, different indigenous minorities, different immigration histories (Spanish, Italians, Germans and African), vast income disparities (Latin America is the most unequal region after Sub-Saharan Africa and far more unequal than most of Asia and Eastern Europe), a rising middle class, a rural-urban divide, population size, geography, topography, US influence and crime levels, to name a few.

Cultural differences posed either a major or minor obstacle to a region-wide strategy.

Although 44% of respondents said that their sales and marketing operations could be "closely integrated" region-wide, this was less easy to achieve when it came to sourcing or logistics, and there was limited scope for integration in recruitment or retailing. Respondents from Europe-based companies tend to be less enthusiastic about the benefits of such regional integration prospects than those working for US-based firms.

To what extent can the following business functions at your company be integrated into a wider Latin America regional strategy (involving three or more markets) rather than being operated on a country-to-country basis?



Source: Economist Intelligence Unit

The Brazilian market presents the best opportunities for selling high value goods in the region, according to two-thirds of respondents. Nearly one-half of respondents also pointed to the country as offering the best opportunity for manufacturing (45%), and to a lesser extent sourcing goods (42%). Mexico presents the best opportunities for selling low value goods by 25% of respondents, just ahead of Brazil (24%), but it is trailing the latter in all other categories.

The Brazilian market presents the best opportunities for selling high value goods in the region.

In your view, which markets provide the best opportunities for the following activities? Select up to two countries for each activity.

% respondents

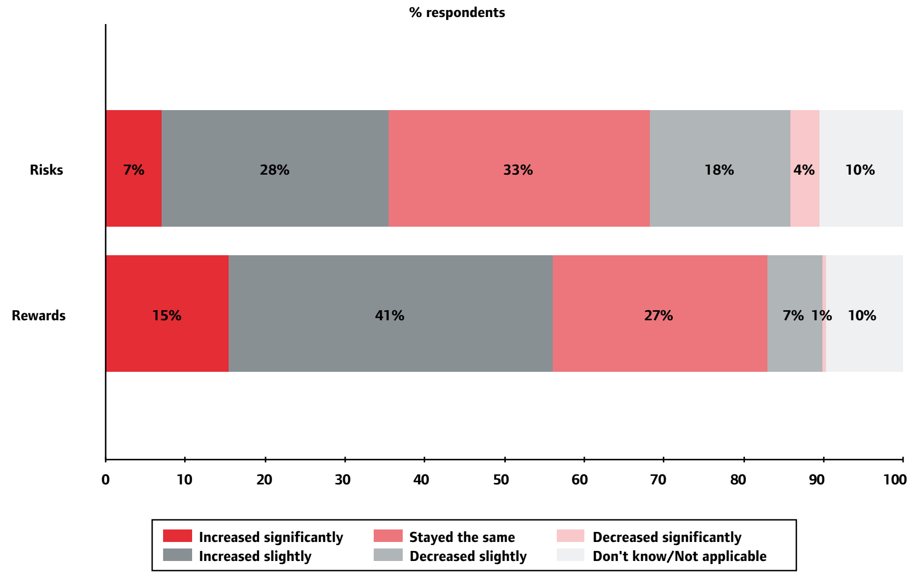
	Argentina	Brazil	Chile	Colombia	Mexico	Peru	Venezuela	Don't know
Selling high value goods	27	67	18	3	27	1	6	12
Selling low value goods	17	24	11	17	25	19	13	22
Manufacturing	16	45	9	7	34	6	4	20
Sourcing goods	17	42	10	10	30	6	7	21

Source: Economist Intelligence Unit

In general, the market has not disappointed. For most, rising rewards have offset increased business risks. When assessing performance over the past three years, 35% of respondents stated that risks had increased, but a much larger proportion (56%) said the levels of reward had also risen, 15% saying substantially so. Companies in energy and natural resources, logistics and distribution, and telecommunications say they are faring particularly well. However, the response is less upbeat when compared with our April 2008 global report on all emerging markets *(Promise or Peril)*, in which three-quarters of respondents globally believed that the rewards had increased, including one-third who said it increased substantially. This difference may in part be explained in terms of Latin America's relatively less attractive business environment, but it may also reflect a gradual diminishing optimism about the global economy in the months since the earlier survey was conducted.

Companies in energy and natural resources, logistics and distribution, and telecommunications are faring particularly well.

How do you think the levels of risk and reward in Latin America have changed for your company over the past three years?



Source: Economist Intelligence Unit

Another factor determining profitability may be the simple fact of having a significant presence in these markets. Over one-half (52%) of respondents from companies with a significant operation in Latin America (either a manufacturing base or a service operation) said they performed ahead of their peers, compared with only 26% for all respondents. Only 11% of respondents primarily involved in importing or exporting in the region said they outperformed their peers, while a sizeable 24% of importers or exporters said they underperformed (compared with a survey average of 17%).

More trouble ahead?

As the US sub-prime mortgage crisis spreads across the global economy, signs of nervousness in Latin America have also surfaced. This sentiment is captured in our survey: 60% of respondents reported little or no impact on their companies' operations or plans in the region over the past year, while around the same proportion predicted a moderate or large impact over the coming year. One indicator of this may be "payment morale". This has generally improved over the past year according to 32% of respondents, while only 7% reported deterioration. But companies are signalling possible credit difficulties and arrears ahead: with experience of delays in Argentina (of around three months) and Venezuela (of up to six months).

Companies are signalling possible credit difficulties and arrears ahead.

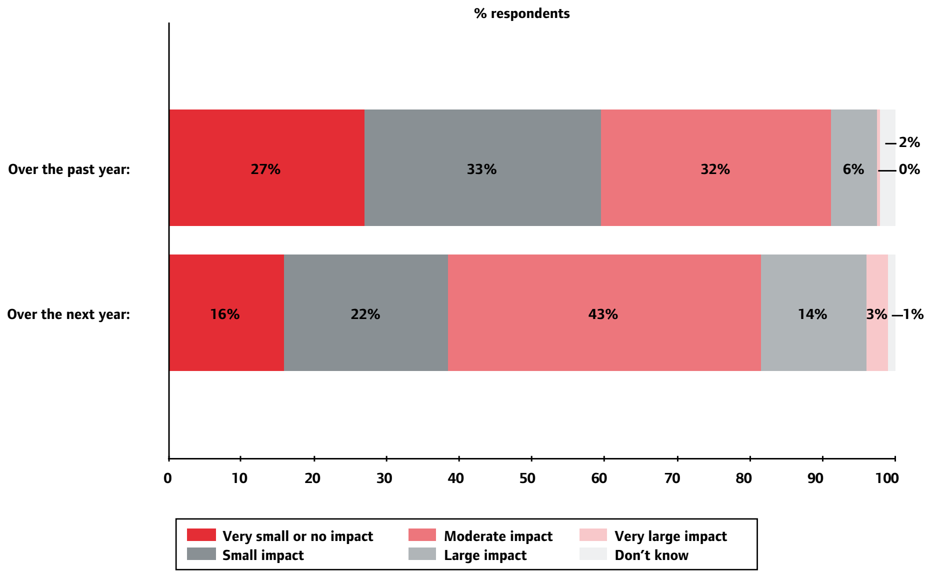
Mexico may be particularly vulnerable. Its GDP growth has been sluggish in recent years, and the economy is tightly integrated into US supply chains. "The crisis will affect Mexico (especially in the car industry), as 80% of our exports are directed to the US," says Iker Arriola, a partner with a US law firm, White & Case, in Mexico, which serves a range of US business clients operating in the country.

Mexico is not alone. According to Jairo Mejia, president of the 3C business consultancy in Colombia, "We all know that we are going to be affected. Some sectors of the economy are already feeling an impact. Construction of new dwellings is showing an important slowdown (especially at the high end of the market) and receivable of mortgages and credit cards are also showing unwanted deterioration." Gaston Donoso, a director at DYS, a Chilean retailer, agrees: "The main impact [of the crisis] is inflation, higher interest rates and a slowdown in domestic consumption. Nevertheless, long-term investors still have positive expectations about the performance of the economy."

The worst fears appear to be held at bay, at least for now: a mere 3% surveyed expect a "very large" impact next year (compared with none having experienced a similar impact this year). It is also notable that fears of a downturn seem of greater concern to locally based firms in this and other emerging-market regions, particularly China and Eastern Europe, compared with a more sanguine view expressed by representatives from developed-market companies. This might be because developed-market companies have greater flexibility, or that problems in their own home markets are so much tougher.

Fears of a downturn seem of greater concern to locally based firms in this and other emerging-market regions.

What do you think has been, and will be, the impact of the current economic downturn in the US on your company's operations or plans in Latin America?



Source: Economist Intelligence Unit

In any case, openness to the global economy has its upside. The region's economies have benefited strongly from the proliferation of bilateral and multilateral free-trade agreements that underpin these markets. "Mexico has benefited from [the North American Free-Trade Agreement] NAFTA but it now needs to balance its trade priorities with the rest of the world to depend less from the US," says Mr Arriola of White & Case.

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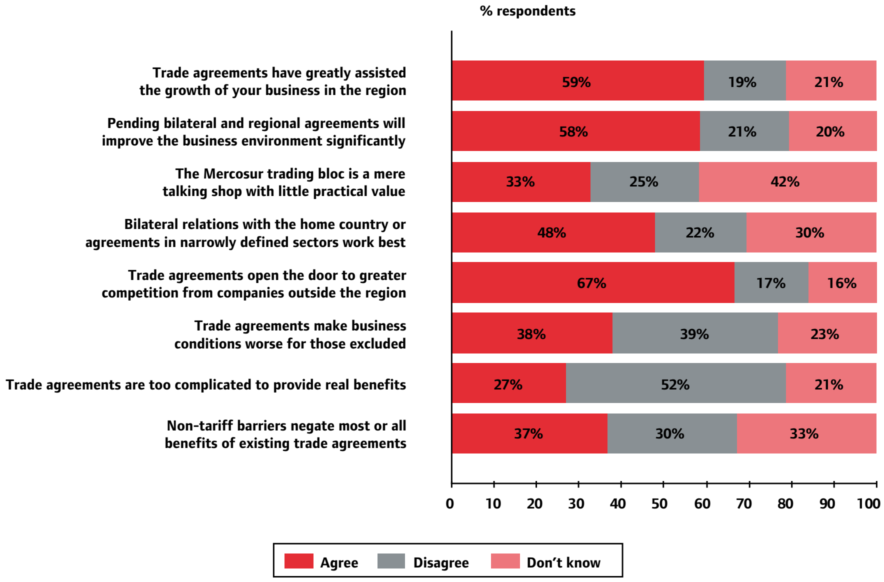
Nearly three-fifths (59%) of survey respondents agreed with the idea that trade agreements had greatly assisted the growth of their business in the region; 58% said that pending bilateral and regional agreements would improve the business environment significantly; and 67% agreed that "trade agreements open the door to greater competition from companies outside the region". Only around one-third of respondents who expressed an opinion believed that trade agreements are too complicated to provide real benefits.

There was less enthusiasm about Mercosur, the "Southern Cone" customs union that has been a central plank of government policy in Brazil and Argentina. Asked whether Mercosur was a mere talking shop with little practical value, more respondents (33%) agreed with the statement than disagreed (25%). Those companies headquartered in the region expressed greatest cynicism. It may be that local firms have less to gain, and are left exposed to foreign competition. Indeed, some two-thirds (66%) of respondents said that their main competitors were subsidiaries of foreign multinational companies, mainly from the US (61%) and the EU (43%), although 30% also cited Brazilian companies, and 20% pointed to Chinese firms.

Do you agree or disagree with the following statements about the impact of trade agreements in Latin America?



Source: Economist Intelligence Unit

Although the shadow of a global downturn looms ever larger, the local political and economic environment in many countries poses its own, perhaps larger, challenges. Despite progress made in combating hyperinflation and strengthening democratic institutions over the past two decades, by far the most common concern—shared by around 87% of survey respondents—relates to political or macroeconomic stability.

The local political and economic environment poses its own challenges.

A clear divide seems to separate governments that pursue market-friendly policies—namely Brazil and Mexico—and those failing to take a hard line on inflation—such as Argentina or Venezuela. "The [Argentinian] government does not have a long-term strategy and straightforward-looking policies, such as in Brazil," says Sebastian Cesario, an IT provider based in Buenos Aires, who reports that some 40% of companies in his sector failed to meet their targets during the first half of 2008. Falling commodity prices could also undermine export revenue growth and confidence in public sector finances. But fears of economic instability were also seen as one of the top three worries for all selected countries except Chile. It was the main concern about Argentina, the second about Brazil and Peru, and the third about Mexico.

Fears of political instability were also widespread. Although pragmatic policies have calmed nerves in Brazil, political anxiety is ever-present in Hugo Chávez's Venezuela, and its allies Bolivia and Ecuador, and to a lesser extent in Colombia and Argentina. Mexico, where political issues are intertwined with the issues of crime, suffers too.

Crime corruption and bureaucracy

Mexico's campaign against organised crime is viewed by some as more critical than even the global financial turmoil. "Political stability was not an issue until recently, but some issues have remained unresolved within the past six years," confirms Mr Arriola of White & Case. Organised crime took advantage of political disorganisation to extend its influence in several cities. "Insecurity has increased and business has been suffering. This is becoming an issue for foreign and local companies," he adds. Issues involve kidnapping, cargo theft, and lack of legal certainty and stability. The situation is most critical in the northern region, especially in Ciudad Juárez, in the state of Chihuahua, according to Mr Arriola. The city used to be a magnet for investment in past decades, but he says has now become "one of the most contaminated cities. Factories have closed down because of security-related issues." Mr Arriola also notes problems in Matamoros and Reynosa (state of Tamaulipas) and Tijuana (state of Baja California).

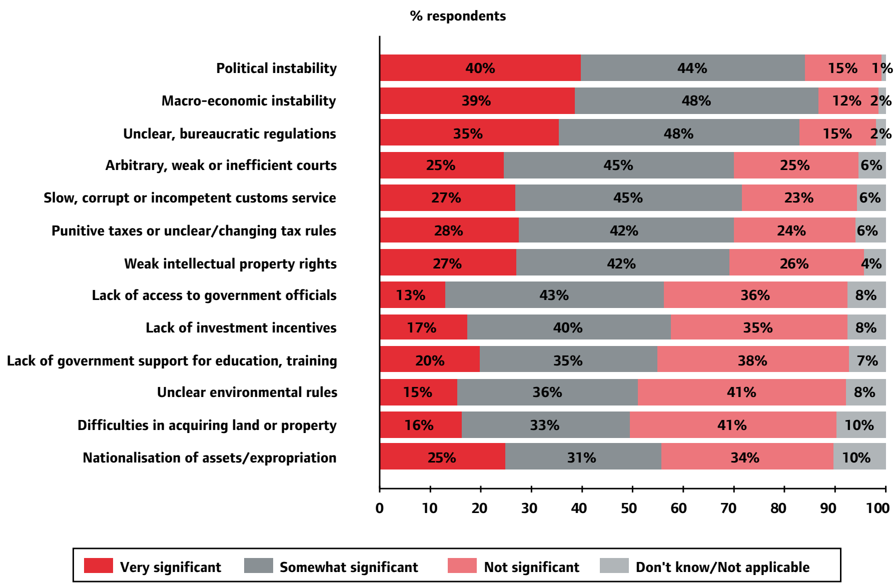
Mexico's campaign against organised crime is viewed by some as more critical than even the global financial turmoil.

Corruption, bribery and weak governance are seen as "significant" or "very significant" operational shortcomings for 78% of respondents. Specifically, unclear or bureaucratic regulations (a significant concern for 83% of respondents), arbitrary, weak or inefficient courts (70%), slow, corrupt or incompetent customs officials (72%) and punitive or opaque taxes system (70%) are cited. For traders especially, customs procedures are a constant grievance, even in the most business-friendly countries, such as Chile, in terms of the "time and requirements to run a business", says Mr Donoso of DYS. Mr Arriola of White & Case reports similar tales in Mexico: "We have an open economy but there are still a lot of regulations to comply with and permits at the discretion of the local authorities." Such discretionary powers are often a shortcut to corruption. One particularly candid importer in Brazil recalls, "We had to bribe officials all the time," prompting suspicion from the federal tax office.

Discretionary powers are often a shortcut to corruption.

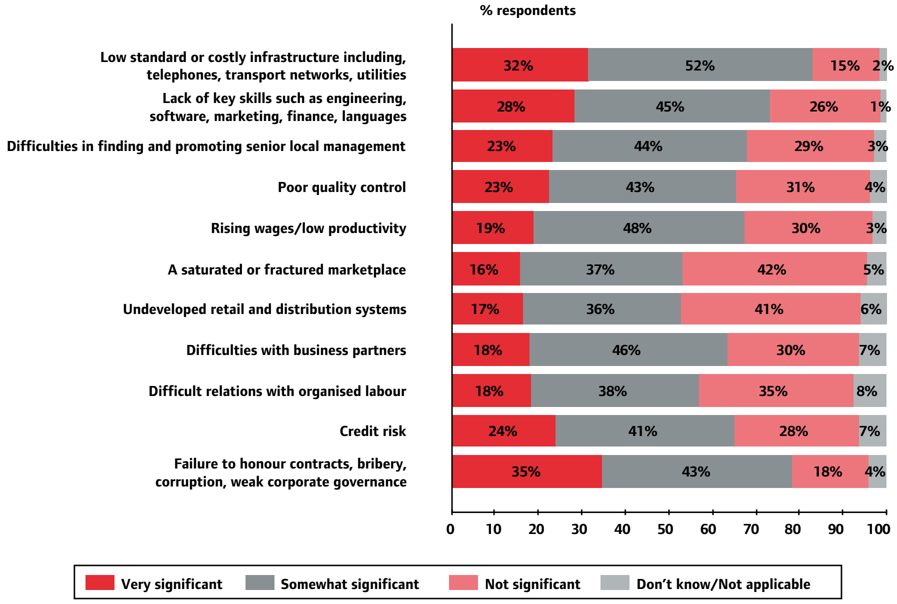
In several countries, importers complain about the norms for registering their products, a process that is seen effectively as a non-tariff trade barrier. In Colombia, a permit to import a product that is granted to one distributor is not valid for another distributor. In Argentina, the process may take up to 90 days, according to Mr Cesario, an IT provider. "Regulations for compliance with local norms are not clear and interpretations are very wide, which is critical for products with a very short life cycle," he says.

How significant to your business are the following government or bureaucratic obstacles in your company's main Latin American markets?



Source: Economist Intelligence Unit

How significant to your business are the following operating obstacles in your company's main Latin American markets?



Source: Economist Intelligence Unit

National variations are of course key. Survey respondents rate Chile best on almost every operational obstacle of the region's main markets. Colombia has the best score for settlement of contract disputes, while Peru is ahead in terms of corporate governance (Chile is second best in both cases). Peru, Argentina and Chile also rank highest in our survey for customs, while Brazil and Venezuela rank lowest—findings that might point the way for further reforms.

Which operational issues in the following emerging markets present the greatest problems to your business?

% respondents

	Poor infrastructure	Political instability	Economic instability	Corruption	Contract disputes	Poor corporate governance	Inadequate legal system	Inefficient customs service
Argentina	18	25	37	27	14	18	15	11
Brazil	17	13	22	37	18	21	20	19
Chile	16	13	17	20	12	14	13	11
Colombia	23	27	22	37	11	17	21	16
Mexico	17	13	20	39	15	21	19	17
Peru	27	17	25	25	13	12	17	11
Venezuela	24	33	26	35	18	20	26	19

Source: Economist Intelligence Unit

One further shortcoming must be added to the plethora of state failings, namely the lack of key skills—an issue that features highly in almost all emerging markets worldwide—and one of the top three operating shortcomings in Latin America, according to nearly three-quarters (73%) of survey respondents. For 29% even basic writing skills are seen as a major constraining factor, and almost one-half of respondents reported skills shortages in foreign languages (44%) and in marketing, finance or risk analysis (43%).

In search of a safe port

Brazil is the key market in the region owing to its size and the dynamism of its economy, but operating conditions can be tough. "Brazil is the most complicated country in the region in terms of state bureaucracy, red tape and operating obstacles. There are taxes everywhere, the paper work is impossible, and there are too many civil servants," says Romano Morosini, a partner at Equiport, a Chile-based port equipment importer, who has been trading in Latin America for over 30 years. Nevertheless, once companies manage to go through all the hoops in Brazil, the rewards are usually higher than anywhere else in the region. "If the business structure was working properly, Brazil would enjoy a fantastic return," he adds.

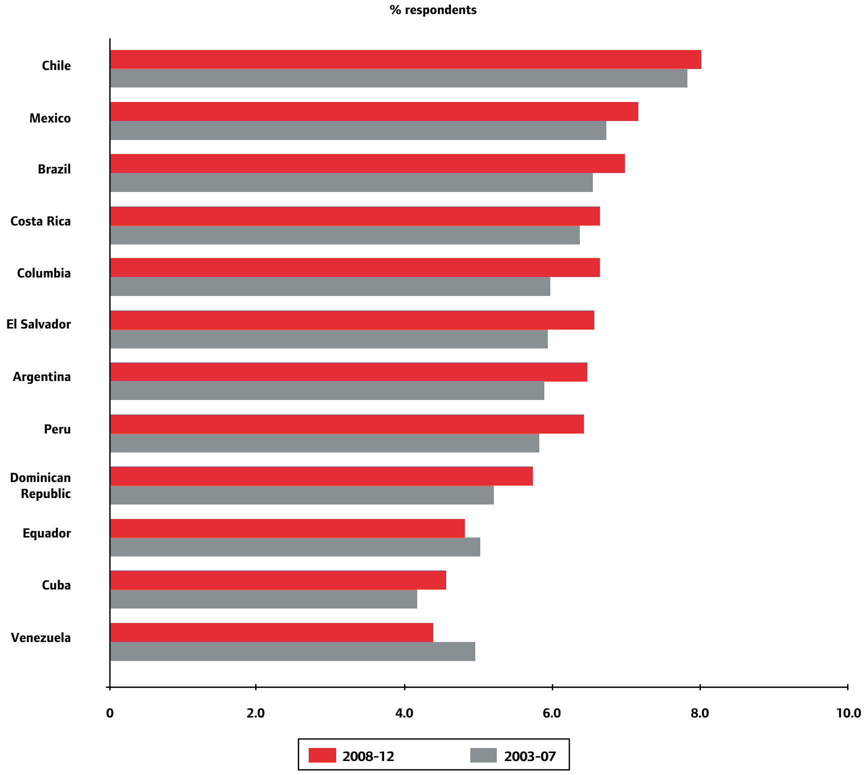
San Marino-born Mr Morosini currently imports reach-stackers (used to move cargo in port terminals) from Europe, the US and China, to various Latin American ports. Privatisation in several countries has helped to modernise port operations in the past ten years. "Port evolution is a measure of the state of the country and its economy," he says.

"Peru has become a simpler place to do business with since privatisation [in the 1990s], but Brazil has just not made enough efforts." Customs are the main stumbling block. Procedures are so complex that shippers have to rely on custom brokers, known as despachante, which are paid to solve any problems that may arise. "This is the gateway to corruption," says Mr Morosini. He recalls how one of his customers had equipment stuck in the port of Manaus for over two months, while another had its machines released on the day of its arrival in a Chilean port. When the goods are stuck at the Brazilian customs, companies often have to bear the extra cost of hiring some equipment before their imports are cleared.

The rules in Brazil and Venezuela are particularly unpredictable, as state officials often act on orders from political or business clans, according to Mr Morosini. He says that businesses can expect strong return on investment in Colombia, Peru, Chile and Uruguay, but he gives a negative assessment of Venezuela, Ecuador, Bolivia and Argentina

These views are also broadly in line with the Economist Intelligence Unit's five-year forecast of Latin America's business environment ranking (BER), which ranks markets on a range of tax, regulatory, macroeconomic, labour-related and infrastructure criteria deemed essential for doing business. Overall, the region is expected to be an easier place to do business (with the exception of Venezuela, Ecuador, and Bolivia). Chile tops the regional ranking—19th globally—followed by Mexico and Brazil. Colombia and Peru are expected to make the biggest improvements in their business environments. But Latin America's overall BER improvement will be relatively slow compared with other emerging-market regions and will continue to lag Asia and Eastern Europe.

Business Environment Rankings scores (maxiumum = 10, higher is better)



Note. From forecast period to historical period. Qualitative grades are assigned according to the following scale: very good, score more than 8; good, 6.5-8; moderate: 5.5-6.4; poor, 5-5.4; very poor: less than 5

Source: Economist Intelligence Unit

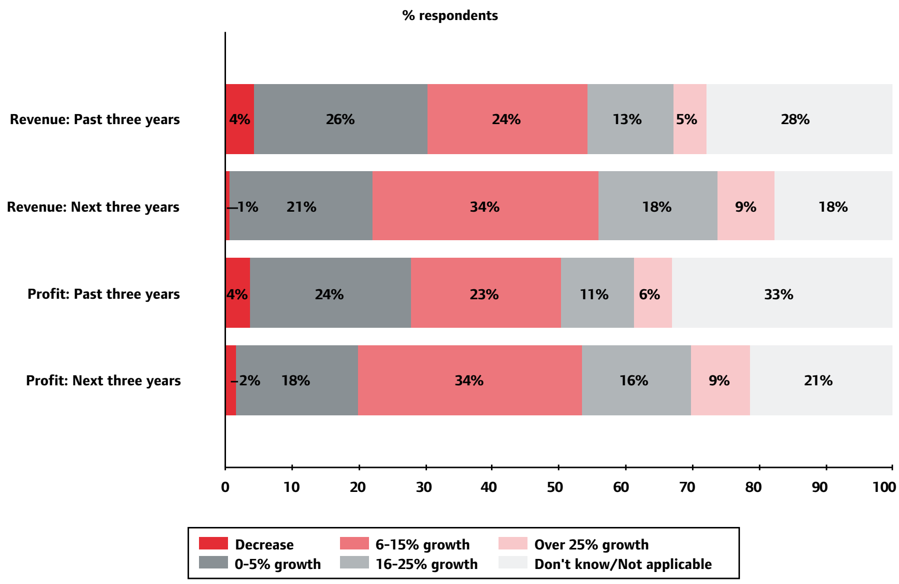
An upbeat outlook

The BER forecast above suggests a positive outlook for revenue and profit growth, and this is supported in our survey. In general, business prospects appear moderately upbeat in the medium term. Annual revenue will increase by at least 6% or more on average over the next three years according to 61% of respondents (while only 42% reported a similar average over the past three years). Equally, profits are expected to improve: 59% of respondents expected their annual profit growth to reach at least 6% in Latin America in the next three years, while only 40% experienced a similar performance in the past three years (although one-third replied "don't know" or "not applicable"). Breaking this down, one-quarter of respondents expected profits to increase by more than 15% over the next three years (compared with 17% in the past three years); and 6% reported profit growth of over 25%, while 9% forecast this level of return in the next three years.

Business prospects appear moderately upbeat in the medium term.

Nevertheless, this outlook is not as favourable as that expressed by firms operating in South-east Asia (see *Rich pickings: Opportunities in Southeast Asia's emerging markets*), where nearly one-third of respondents said they expected annual profit growth to exceed 15% over the next three years, and 12% expected profit growth of over 25% in the next three years. Revenue expectations were also higher in South-east Asia.

Over the past three years, what has been the average annual rate of revenue and profit growth in your company's main Latin America markets? What average annual growth rate do you expect over the next three years?



Source: Economist Intelligence Unit

CASE STUDY: Wine that doesn't travel well

When Jean Raquin decided to start a new business after taking early retirement from Eurocopter, the French helicopter manufacturer, he did not choose the easy way: he launched a wine-importing business in São Paulo. He has also opened a wine store, "Le Tire Bouchon", in a traditional district of Brazil's business capital, which hosts a restaurant and a wine bar. Three years later, he sounds like a survivor who has climbed Mount Everest. "If I had to do it again, maybe I would not do it," he confesses.

Mr Raquin was attracted by the great potential of the wine market in the largest Latin American country. "It is a country where wine consumption is increasing and will keep growing," he says. "Annual wine consumption has increased from 1.8 litres per head to 2.1 litres within ten years, but it still remains quite low," says Raphaël Allemand, a business consultant at EOC International in São Paulo.

Nevertheless, Mr Raquin soon discovered the huge amount of hassle involved in starting and running a small business. "It's tough to begin with. Nothing happens according to plans," he says. Regulations are complex, and entrepreneurs need lawyers, accountants and countless middlemen who need to intervene to grease the wheels of business.

Once the company is formally opened (which may take between one and five months), the importer needs to register the wine producers with the Brazilian Ministry of Agriculture, as well as each of its products—which, again, may take several months. The importer then needs to obtain an import licence and another permit to prove that it has sufficient funds to pay for the imported merchandise. When the shipment arrives, it needs to clear customs (where the Ministry of Agriculture lifts two bottles from each shipment for analysis). Then there are an array of taxes (charged on a cif basis that includes freight costs, as opposed to fob—free on board), which amount to more than one-half of the final retailing price of wine, according to Mr Raquin.

Bad news comes in threes

"Importing to Brazil is quite an adventure. It is not a scientific enterprise," says Mr Allemand. Mr Raquin's business is quite small. "Le Tire Bouchon" imports one container every three months, as opposed to several hundred for large wine and spirit importers, such as Brazil-based Expand. It's far from a unique experience. "Ninety per cent of wine importers, large and small, run into trouble. Things never go smoothly," explains Mr Allemand.

As a result, business plans require extra care. "You need to multiply everything by three. Costs may suddenly triple, or a deal may take three times longer than originally envisaged. You also need a level of cash flow that would allow you to survive three times longer than initially planned before you can reach break even. That often means taking a substantial [profit] margin [on sales] because things will not go according to plan," Mr Raquin says.

The nitty gritty of the importing business may be disheartening at times, but Mr Raquin reckons that the key to success lies in macroeconomic and cultural trends. "Progress in terms of wine culture [among Brazilians] and purchasing power gains are more important. The administrative hassle is almost secondary. There is little hope that the system will change," says Mr Raquin. "Brazil is a dangerous country for business. It is difficult to plan things with precision; there is a large margin of error. But it is one of the few battlegrounds where things can get done," he says.

Conclusion

Emerging markets in Latin America present good business prospects. Political and economic reforms over the past decade have stabilised much of the region, and markets such as Brazil and Mexico have reaped the benefits. Several countries have also taken advantage of the recent commodity boom to strengthen their foreign accounts and their economies, thereby reducing their vulnerability to external shocks. A more liberal trading regime has also made a big difference to the economy and business. That is not to say the region's economies will not be affected by the current economic downturn in the US and other developed economies—traders and investors alike are already anticipating a worsening environment. But it does suggest that these markets will prove to be more resilient to the next set of shocks.

Brazil and Mexico have reaped the benefits.

Markets will prove to be more resilient to the next set of shocks.

Certainly, reform efforts could go further: organised crime, corruption and excessive bureaucracy are areas that the region's governments can address—and which our survey demonstrates have a major impact on business operations and perceptions of the region's stability. It may mean that companies doing business in the region will require a more hands-on approach if they are to reach desired levels of profit growth. But for the short term at least, many companies expanding into the region are doing so because their home market is stagnating. In this context, the region's shortcomings are perhaps not so grave.

About Atradius

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