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Article — Digitized Version

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Intereconomics

Suggested Citation: Olbricht, Bernd (1975) : Business policies of large and medium-sized German companies in Brazil, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 10, Iss. 4, pp. 128-130,
<https://doi.org/10.1007/BF02929605>

This Version is available at:

<https://hdl.handle.net/10419/139186>

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Business Policies of Large and Medium-Sized German Companies in Brazil

by Dr Bernd Olbricht, Munich

The present article and its conclusions are based on a fundamental study of the differences in business policy displayed by German large and medium-sized companies in Brazil. The basis of the investigation was supplied by the answers to a questionnaire distributed to 17 companies domiciled in Brazil and 16 similar enterprises active in the Federal Republic of Germany¹.

In spite of all the political and economic difficulties resulting from World War II German investments in Brazil were successfully revived. Direct investments of German concerns in Brazil take pride of second place, after the United States, among foreign investments. About the middle of 1974, their total value (transaction value) reached DM 2.3 bn². Both for Latin America and among LDCs, this total makes Brazil by far the most important target country for investments of German companies abroad. Brazil's share in total direct investments made in LDCs by German investors thus has reached some 25 p.c.

There is, however, no complete consensus about the exact volume of German direct investments in Brazil because the volume of foreign subsidiaries' reinvestments through self-financing is not included in the statistical returns about German direct investments. Yet these investments are likely to be highly important because remittances of such subsidiaries to parent companies at home have, so far, remained negligible, and this not only because of initial losses during the starting period.

The number of German investors is estimated at some 400, among them companies of all sizes. However, since six subsidiaries of German concerns alone, between them, show investments of over DM 100 mn, it may safely be surmised that

direct investments are heavily concentrated on a small number of highly capitalized concerns³. More than one half of German direct investments are wholly-owned subsidiaries, usually operating in the form of "closed" joint-stock companies⁴.

Managerial Planning

It is intended to discuss now the decisions having been made on business policy after German companies had sunk direct investments in Brazil, laying special stress on the comparison between large-scale and medium-sized enterprises. The main areas of managerial policy are here considered to be general planning, organization, financing, staff selection, production, and marketing. Decisions made on business policies based on direct investments in Brazil can be shown to be wholly different in all areas of activity from parallel decisions made when investing in the Federal Republic. Data of observation will differ, depending on the size of the business subject to analysis. Generally, it can be shown that different conditions must be met before making a decision, and more careful considerations will be needed than those preceding a similar decision on new investment in Germany. If such a decision is to be made by a big enterprise, more long-term considerations contribute to it than for a medium-sized company. Not one of the medium-sized units questioned was able to display genuinely long-term planning, showing clearly certain tendencies to be incorporated into new plans year

¹ cf. Bernd Olbricht, *Unternehmenspolitik bei Direktinvestitionen in Brasilien* (Business Policies in regard of Direct Investments in Brazil), Vol. 13 of *Aachener Studien zur internationalen technisch-wirtschaftlichen Zusammenarbeit*, Baden-Baden 1974. — The companies in Brazil answering the questions are domiciled in the two big industrialized areas round Sao Paulo and Rio de Janeiro, where about 70 p.c. of all manufacturing output is concentrated. In selecting the recipients of questionnaires, care was taken to send these to types of business whose investments were directed to the main branches of manufacturing typical for the areas. Special attention was paid to size of company, using as a yardstick the sizes of their management staff.

² cf. BMWi (Federal Ministry of Economics), *Tagesnachrichten* (Topical News), No. 6976, Oct. 11, 1974, p. 2.

³ cf. E. G. Lipkau, *Die deutschen Investitionen in Brasilien* (German Investments in Brazil), in: *Gegenwartsfragen der Wirtschaft Brasiliens, Deutsch-Brasilianische Gespräche* (Present-day Problems of Brazil's Economy, German-Brazilian Discussions), held at Ingelheim-on-Rhine, May 4 and 5, 1970, published by Ibero-Amerika-Verein, Hamburg, 1970, p. 53.

⁴ cf. German-Brazilian Chamber of Commerce, *Das Image der deutschen Direktinvestitionen in Brasilien* (Image of German Direct Investment in Brazil), Rio de Janeiro and Sao Paulo, 1971 (unpublished), p. 3 et seq.

by year. It is likely that long-term planning is absent from medium-sized firms because companies of a moderate size are not imbued by the same confidence as large concerns in future developments in the Brazilian market.

Admittedly, both larger and smaller concerns markedly prefer wholly-owned subsidiaries as the *form in which to invest*, yet in recent years, joint ventures have been coming more to the fore. *Deutsche Gesellschaft für Wirtschaftliche Zusammenarbeit* (Entwicklungsgesellschaft) (German Company for Economic Cooperation — German Development Company) also advises medium and small-scale German businesses to seek, as much as possible, joint ventures as the method for direct investments in LDCs. Through such joint ventures, both local and foreign capital will be mobilized, and they harmonize foreign technological and local know-how of the domestic investor. Moreover, bilateral partnerships are likely to deflate political and emotional prejudices formerly raised by foreign private investments and frequently are still part and parcel of old tradition⁵.

In addition, because of the limitation of capital participation, this method of acquiring an interest will also assume decisive importance in planning ahead for medium-sized firms.

Organization

On the side of *organization*, it was found that medium-sized companies operating in Brazil through their clear structure were very flexible in arriving at decisions. Large groups, to the contrary, were often heavy-footed in this respect, because they generally, during the process of initial growth, create far too complex an organization, whilst neglecting, until it may be too late, their economic efficiency.

Medium-sized enterprises in LDCs lack the complicated and involved hierarchical order of big business, and thus are protected against slowness in arriving at decisions. This will determine in part, at all levels, the potential profitability of a direct investment.

Finance

As regards outside financing, it was found that big concerns had an easier time than medium-sized firms in Brazil in tapping the local capital market. It is frequently a name of world renown, the economic efficiency, and in the main the importance of big groups for Brazil's development policies which make it "easier" to attract funds from the Brazilian credit market.

The questioned medium-sized companies are frequently unable to channel funds from the Brazilian

capital markets into their coffers, because local credit costs are too high for them, because they are usually precluded from ploughing back into their business past earnings, as is the habit of big concerns, and because they can only call for help on merchant banks, on a number of West German bodies that promote foreign investments, or on their own parent companies⁶.

To provide *self-financing*, nearly all the companies that have answered the questionnaire use their locally-earned profits for ploughing them back into their business, in order to keep abreast of technological advances, and for benefiting from the expected long-term growth of the Brazilian market. The same observation has been reported by Grosche and Lehmann-Richter⁷, who have analysed the results of 52 German investors active in LDCs, the average reinvestment share of whom in 1965–67 came to 70 p.c. of their locally-earned profits.

Staffing Policies

There are also differences in *staffing policies* between large and medium-sized companies. Thus, big concerns frequently call Brazilians to sit on the Executive and Supervisory Boards (Control Councils), whilst management of medium-sized companies is usually in German hands only. On the other hand, positions in "middle management" are handed over by all sorts and sizes of companies to Brazilian personnel to a larger extent, even if this is only due to compulsion by the local "Brazilianization" laws prescribing that the labour force of foreign companies must consist to the extent of two thirds of natives⁸. Staffing policies by medium-sized companies which exclude Brazilians from the managerial positions, for this reason, deprive such firms of the privileged position granted to others with a more accommodating staffing policy. Such policy, moreover, is condemned to neglecting one of the crucial purposes of any development policy: encouraging the talent of foreign workers to plan and organize and giving highly skilled personnel further vocational training.

Another point of strength in large-scale concerns is the fact that they usually, after a few years, recall their German managers or board members

⁵ Deutsche Gesellschaft für Wirtschaftliche Zusammenarbeit (Entwicklungsgesellschaft) mbH (German Company for Economic Cooperation [German Development Company]), Annual Report for 1969, p. 8.

⁶ cf. Bernd Olbricht, loc. cit., p. 105 et seq.

⁷ cf. Günter Grosche and Rolf Lehmann-Richter, Die Gewinne aus deutschen Direktinvestitionen in Entwicklungsländern (Profits of German Direct Investments in LDCs). Bochumer Schriften zur Entwicklungsforschung und Entwicklungspolitik, Vol. II, Düsseldorf 1970, p. 55 et seq.

⁸ cf. Paul Garland, Doing Business in and with Brazil (no indication of place), 1971, p. 146.

to second them to equivalent positions in the parent company or in another foreign subsidiary of theirs. Big concerns have more staff to choose from for such purposes, which also yield benefits in a more thorough training of successive generations of managers.

In contrast, medium-sized firms answering the questionnaire, as a rule, let their managers stay in Brazil until they reach retiring age. The dearth of suitable personalities, the absence of long-term planning of staffing the boards of subsidiaries in foreign countries where they invest, and insufficient preparations of younger staff for operating abroad, all have contributed to faulty staffing policies letting founder a number of investment projects⁹.

Manufacturing

Big groups tend to decentralise *research and development*, whilst medium-sized companies prefer centralization of these facilities in the Federal Republic. On the other hand, both types of businesses are evolving a tendency to buy Brazilian in the fields of raw materials, semi-finished goods, machinery and tools. However, big business is usually accorded preferential treatment in charging duty on essential imports from the Federal Republic.

In determining shape and quality of their products (design) both large and medium-scale companies tend to adapt themselves to local Brazilian preferences. *Manufacturing* itself, in the narrower sense, is being usually geared by those companies in the middle range to labour-intensive production processes, because they cannot expect of their, frequently, unskilled workers either operation of highly sophisticated machinery with the required technological knowledge and understanding, or the, likewise, indispensable feeling of responsibility. In addition, firms of this size do not forget about low Brazilian wage levels which — though they are progressively growing to the levels prevalent in Southern Europe — are a major factor for smaller firms that want to cut their costs. They therefore usually prefer wage-intensive methods of production.

The big companies that have answered questions, unlike the smaller ones, prefer capital-intensive processes, in some cases even installing abroad more advanced machinery and equipment than in the Federal Republic of Germany. True, such methods do not help much in creating new jobs for Brazilians, but they represent a useful transfer of technological know-how, which may fertilize all

the sectors of the national economy. More Brazilian labour will be trained and promoted to higher skills in such a case.

Marketing

For *marketing their products*, big concerns tend to stick to the methods used at home, in the Federal Republic. But medium-sized manufacturers prefer marketing through established and authorized wholesalers¹⁰. The reason adduced by these firms for their behaviour are the high initial costs that have to be sunk in building up a marketing network of their own.

The wholesalers needed by medium-sized manufacturers for marketing their products publicize the maker's name and the products' quality without the need for the manufacturers to mount widespread advertising and market research. Wholesalers usually know their potential markets pretty well, they are aware of the native Brazilian trading customs, and by appealing to their old-established clientèle, the financial risks of an often very difficult starting period will be kept at a moderate size. Using this path, it will be easier for manufacturers to hold out for longer periods with scant revenues. Price risks, maintenance and repair costs for motor vehicles, costs of paying sales agents, storage risks — in short all the risks involved by marketing will be shifted on to the shoulders of wholesalers when a medium-sized firm selects this approach. It must not be forgotten, moreover, that Brazil, compared with the Federal Republic of Germany, largely consists of wide empty spaces.

Our enquiry has resulted in the observation that in Brazil, too, the economic scene is predominantly lorded over by the big groups. But even so, medium-sized and small firms still have ample scope there for successful direct investments. It is true that such direct investments are not free of risks for such companies and cannot be undertaken without an element of calculated gambling. But it should be possible to cut down these risks to a minimum, and to prevail successfully as a business by careful probing of market and environmental conditions, by feasibility studies for projects, by a modern marketing strategy, and by generous financial aid. It will be of focal importance for such a business policy how rapidly further liberalization of international trade makes progress, how fast LDCs will succeed in their industrialization drives, and to what extent science, modern technology, the back-up economy at home and ample credit and energies spent on development aid can come to LDCs' aid.

⁹ cf. Bundesverband der Deutschen Industrie (Federal Association of German Industries), *Deutsche Direktinvestitionen im Ausland* (German Direct Investments Abroad), in: *Schicksalsfragen für Wirtschaft und Gesellschaft*, Cologne 1971, p. 54

¹⁰ With the exception of pharmaceutical products, for which there is no wholesaler network in Brazil.