What Consultants Say About Brazil

Idea In Short

Brazil's macroeconomic slump in 2016 masked industry-specific opportunities that consultants tracked through targeted research. Strategy firms focused on chemicals, consumer goods, trade logistics and healthcare rather than the headline economy.

Brazil's Economic Slump in Context

In 2016, Brazil hosted the Olympics. The country also faced its biggest economic slump since the 1930s. According to the Economist, the recession was deep and prolonged, reversing the optimism that had surrounded the BRIC countries, Brazil, Russia, India and China, just a few years earlier.

Gross domestic product growth had turned negative. You did not need to be an economist to see that the economy was shrinking. The unemployment rate trended upward like a hockey stick, surpassing 10 percent just months before the Olympics. One might have expected employment to rise from fiscal stimulus, construction spending and tourism.

To compound the mess, President Dilma Rousseff faced impeachment for corruption. The threat of the Zika virus led some to call for postponing the Olympic events. The pessimism was thick and well-founded.

What Consultants Actually Research

For all this macro pessimism, most consultant research was not macroeconomic. Instead, it targeted specific industries. This makes sense because firms are more likely to be hired by a retailer, chemical manufacturer or medical device company than by the government.

That said, all the signs pointed in the same direction, which was trouble. The research offered a granular view of where the pain concentrated and where opportunity persisted despite the gloom. 1

The New Brazilian Consumer

McKinsey surveyed Brazilian consumers and found grim results. Consumer confidence in Brazil was the lowest among 26 countries surveyed, with only 8 percent of Brazilians optimistic about the national economy. This was a departure from the positivity Brazilians had historically displayed even in troubled times.

Fully 72 percent of Brazilians said they were worried that someone in their household would lose a job in the next year. Forty-nine percent said they were living paycheck to paycheck. The country's recent economic woes had shaken confidence in ways that prior downturns had not.

McKinsey advised that during downturns, Brazilians tend to gravitate toward either high-end or low-end brands. Consumer packaged goods companies should maintain a clear and complete price architecture, with a premium offering to attract up-traders and a compelling low-priced offering aimed at down-traders and mass consumers.

A National Chemicals Strategy

Bain examined Brazil's chemicals industry and found both scale and vulnerability. Brazil's chemical industry had grown over the prior 15 years and was the sixth-largest domestic market globally, with revenue of 157 billion dollars in 2014. However, the industry met an increasing portion of this growth with imports.

The trade deficit in chemicals had been 6 billion to 9 billion dollars prior to 2007, but by 2014 it had risen to 31.2 billion dollars. Bain classified the primary focus segments into four groups according to their principal competitive advantage: strong local demand, competitive and available raw material, potential competitive raw material, and competitive raw material with emerging technology.

Brazil held natural advantages in biomass, accounting for 30 percent of global sugarcane production and 18 percent of soybean oil. Bain estimated that chemicals from renewable sources could represent as much as 10 percent of Brazil's chemical industry by 2020, but reaching that target would require roughly 20 billion dollars in new investment. 2

Unlocking Trade Growth

Bain also studied how Brazil could unlock billions in trade growth. One step toward improvement was reducing the cost to export. In 2014, it cost an average of more than 2,300 dollars to ship a container from Brazil. That was 21 percent higher than the cost in South Asia and 5.5 percent higher than sub-Saharan Africa.

Bringing just two key supply chain barriers, border administration and transport and communications infrastructure, even halfway to global best practice could unlock 84 billion dollars in Brazil. The approach was to view trade barriers across the end-to-end value chain in the most important industries, then tackle those barriers to make each industry competitive.

Improving particular industries would set the stage for improvements in others. The logic was that targeted, sequential reform beats sweeping but unfocused policy. 3

Currency, Manufacturing and Competition

Deloitte noted that turning toward Asia was a step in the right direction for Brazil, given Asia's ascendancy in the global economy. With commodities as a key export to Asia, Brazil remained vulnerable to fluctuations in the global commodities market, as it was painfully finding out.

A weak currency could aid exports. The Brazilian real had lost 41.1 percent against the US dollar since December 2013. However, a weak currency alone would not restore Brazil's manufacturing advantage. The shares of two key exports, airplanes and vehicles, in manufacturing exports had declined.

Brazil also faced formidable competition in manufacturing. Mexico fared much better in the World Bank's ease of doing business rankings, scoring 38 against Brazil's 116. Structural reform, not just currency devaluation, was the path to competitiveness.

Private Healthcare Expansion

LEK estimated private health expenditure at 70 billion dollars, ranking Brazil as the sixth-largest private health market in the world. Fueled by aging, obesity and the increasing presence of private payers linked to rising formal employment, the private market had expanded at double-digit rates.

Carlyle, through its investment in Rede D'Or, Amil (UnitedHealth) and DNA Capital appeared to be the contenders to consolidate the market. They seized opportunities in core markets like Sao Paulo and Rio de Janeiro. LEK's fundamental belief was that local market structure defined the strategy for a hospital business and the potential need for investor participation.

The healthcare story stood in contrast to the broader economic narrative. Even amid recession, demographic and structural forces drove sustained growth in specific sectors. This is the value of industry-level analysis over macro headlines.

Lessons for Strategy Consultants

Brazil's 2016 predicament offers a template for how consultants should approach emerging markets in distress. The instinct to write off a country during recession is tempting but wrong. Beneath the macro gloom, specific industries held momentum driven by demographics, natural resource endowments and structural reform opportunities.

The consulting value proposition is to find those pockets of growth and frame them as actionable strategy for clients. A retailer entering Brazil needed to understand the trade-down consumer and price architecture. A chemicals manufacturer needed to see the biomass opportunity and the import-driven trade deficit. A logistics investor needed to quantify the 84 billion dollar unlock from supply chain reform.

The discipline applies beyond Brazil. For any market facing macroeconomic headwinds, the consultant's job is to disaggregate the story by industry, identify where structural forces override cyclical ones and translate that into a recommendation the client can act on. Headline pessimism rarely tells the full story for a well-positioned business.

- 1McKinsey: Meet the New Brazilian Consumer
- 2Bain: Developing a National Chemicals Strategy for Brazil
- 3Bain: How Brazil Could Unlock Billions in Trade Growth

Summary

Brazil's downturn in 2016 created pain across consumers, trade and manufacturing. Yet consultants found pockets of opportunity in chemicals, healthcare and trade reform. The lesson is that macroeconomic gloom rarely tells the full story for industry-specific strategy.