Financial Services in Brazil

An emerging country with strong Financial Services players
**Introduction**

As Brazil’s economy grows and its businesses reach into new markets, financial services organisations are following suit. Brazil is building the capacity to become a Financial Services hub for South America and businesses within the sector are aiming to extend their footprint not only into Americas and Europe, but also into Asia, Africa and Middle East countries.

At the same time, there are key challenges that the Brazilian Financial Services environment pose to foreign institutions that are reassessing their potential within these regions. The first is how to break into the market when acquisition costs are increasing, competition is so strong and there are several barriers to entry. The second is differentiation, both in how products and services are developed and distributed and how banks, insurers and asset managers engage with an increasingly demanding client base.

Opportunities for growth will continue to exist in different sectors even though the underlying challenge is that the Brazilian Financial Services sector needs to undergo significant changes to prepare itself for lower interest rates and spread environment.

**An emerging country with strong Financial Services players**

**Financial crisis accelerates**

**Brazil’s economic rise**

Already growing strongly in the lead up to the global financial crisis, Brazil’s move to economic superpower status has accelerated since.

Among the emerging nations, Brazil has the most liberal capitalist system in terms of market openness to foreign investment and stability of its democratic and legal structure.

The fact that we a have now one of the lowest real interest rates in our history (about 2%) and that FX has been stable around R$ 2.00 per US$ creates a positive scenario for growth in foreign direct investment and local capital market, and therefore good opportunities for the Investment Banking business.

Brazil is the world’s fifth most populous country, after China, India, the United States and Indonesia. Additionally, it is expected to experience a huge increase in the working population in the next 20 years. “Bankarization” of this huge population is a great opportunity for the financial institutions.

Investments in alternative energy are a present-day reality in Brazil. More than 80% of all new cars sold in Brazil are flex-fuel cars, which run on any combination of ethanol and gasoline.

A number of foreign funds are looking at timber investments. The reason: a pine tree in a Finnish forest takes 50 years before it can be harvested for producing pulp and paper. A eucalyptus tree in Espírito Santo, on Brazil’s coast, is ready in only 7 years.

Brazilian agribusiness is highly productive in several sectors: Growers in Brazil’s north-east region harvest grapes twice as often as their competitors in France. Brazil is the world’s largest exporter of sugar, coffee, orange juice, and is highly ranked in the production and export of soy, corn, ethanol, pork, beef and chicken.
A huge offshore oilfield in the “pre-salt” layer has enormous production and investment potential and may catapult Brazil to a position among the top oil exporter countries in the world.

All these industries will need long term financing to grow. Even though we still face a gap in long term funding, the financial markets are starting to structure infrastructure and agribusiness funds to finance some of the projects mentioned above.

BM&FBovespa, the result of the merger of the São Paulo Stock Exchange and the Futures and Commodities Exchange is a public company and the world’s third largest stock and futures exchange in market capitalization.

**Domestic potential**

In terms of demand, products, technology and regulation, Brazil has an advanced Financial Services sector. Its banks are highly profitable and well-capitalised and have suffered little impact from the global financial crisis.

While a number of international Financial Services groups have been able to establish a strong position in the Brazilian market, domestic financial institutions are taking advantage of the significant retail growth over the past decade and using their dominant distribution networks to create a high barrier to entry.

Financial Services in Brazil is now entering the next phase of its development, creating both challenges and opportunities. While relatively high by South American standards, credit penetration is less than half of major Asian economies, highlighting the potential for further growth as aspirations and affluence increase.

More long-term finance is needed to meet the increasing retail demand for mortgages and durable goods consumption and the corporate and infrastructure investment requirements. In turn, the capital markets will need to mature and expand by providing more debt instruments, increasing their market liquidity and by enhancing the sophistication of the stock market.

Saving for retirement is a further growth area. The country has more pensioners for every 100 contributing workers (35) than the US (34) and the government spends more on pensions as a percentage of GDP than Germany, France or Japan¹. The private savings and pensions sector will need to grow quickly to relieve the pressure on the public purse and provide for an ageing population – the government has already begun to put a cap on its liabilities². While assets under management are the highest in the region³, the market is still weighted towards the institutional sector, opening up considerable opportunities on the retail side. In the past, asset managers were able to rely on the country’s high interest rates to deliver good profits and returns for investors. But as interest rates fall, asset managers will need to diversify their portfolios, both through fixed and variable rate instruments and, in time, more foreign investments.

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¹ Economist, 24.03.12
² Bloomberg, 29.02.12
³ FTSE Global Markets, 08.02.12
The main challenge is how to ensure sustainable growth. Financial Services businesses will also need to look at how to improve efficiency and control costs as they can no longer rely on high interest rates to sustain margins and returns.

**Growing global interconnectivity**

While Brazil’s domestic potential is considerable, the country’s position at the epicentre of trade within the emerging countries opens up even greater opportunities for its Financial Services sector.

**Major players on the world stage**

The expansion of Brazilian financial institutions abroad is going to be complementary to their local strategy and business focus.

Two of Brazilian banks already feature in the global top 20 in terms of market capitalisation and a number of groups are seeking to follow the country’s multinational corporations by developing their presence in Asia, Africa and other parts of Latin America. Building on the strong domestic foundations and growing international presence, we anticipate that Brazil will have risen to fifth place in the global banking rankings in terms of assets by 20504.

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### A new model of growth

**Developing an international footprint**

Prior to the global financial crisis, a number of Financial Services groups from Europe and North America were able to make multiple acquisitions to rapidly build up their global footprint. The challenge for Brazilian groups looking to follow suit by extending their international presence is that this type of fast acquisitive growth is now much more difficult.

Prospective entrants may face restrictions on foreign ownership, China and India being notable examples. Even in open markets, there may be little market share for sale and it may be prohibitively expensive if it is. Entrants may also face entrenched competition from dominant local rivals. In some cases, like African countries where markets are less evolved, an entry strategy may consider participating in the development of the financial system as a whole.

A more targeted growth model could emerge as a result, in which the ability to differentiate, develop niche segments, seek out untapped geographical markets and gain access to new digital distribution networks is critical.

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4 ‘Banking in 2050’, 2011 update, published by PwC on 18.05.11

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**Top 20**

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In many of the difficulties to access markets, the main route to entry would potentially be to form joint ventures. With many local businesses already having established partnerships in a number of areas, incoming organisations will need to think about what distinctive attractions they can offer that competitors cannot. It might be product or credit risk expertise. It might also be complementary international coverage. Very few groups are going to be able to cover all the key markets. So collaboration between competitors – ‘co-opetition’ as it’s sometime called – is going to become ever more common.
Reinventing the organisation
Designing the organisation of the future will be crucial as Brazil’s Financial Services businesses seek to create more nimble and adaptive operational capabilities and make sure their talent, structure and governance reflect their increasingly international horizons.

Operating models will need to reflect the changing geographical focus of the business. They will also need to deal with more extensive partnership and co-opetition arrangements and be sufficiently agile to respond quickly to unfamiliar market conditions, distribution channels and cultural preferences.

Global crises demonstrated that businesses also need to contend with a more complex risk profile.

In turn, reporting will need to be upgraded to reflect these more risky and extended operations. International operations also tend to accelerate growth.

People continue to be key in this new scenario. The underlying challenge is the need to train, hire or re-locate unprecedented numbers of skilled people in markets where suitably qualified and experienced people may already be in short supply. Short-term and reactive approaches, be they seeking to lure key people from competitors or bringing in large numbers of expatriate personnel, are likely to prove excessively costly and may still fail to provide the people needed to meet strategic objectives. A more systematic and forward-looking workforce plan capable of anticipating and meeting skills needs could reduce costs and enable Financial Services organisations to build a more sustainable platform for business development.

Where next?
As Brazilian Financial Services groups look to follow their corporate customers into new markets and take advantage of their increasing financial strength, the key questions are where, how and how quickly they should grow.

We believe that the ability to adapt and take advantage of technology and economic interconnectivity will be the key differentiators for Financial Services businesses in the new global economy.

We believe that there are some key questions that Financial Services businesses should consider as they look at how to gear their strategy and operations to achieve successful growth.

How are your corporate clients following the shift in the focus of global growth and how can you help them to respond more effectively?

How can you use technology to provide customer access and financial services in different parts of Brazil (new consumer base) and of the world?

How will you need to adjust your risk management capabilities, talent management and operating model (more joint ventures, longer lines of communication etc)?

Making sense of an uncertain future
We’re working with a range of financial services organisations to judge the impact of the trends shaping their industry and where and how they can compete most effectively.
How PwC can help

Our Brazilian Financial Services experts are closely connected with our global network and together are prepared to help you reshape your strategy and implement the changes that will be necessary to face the challenges that are to come.

Our multidisciplinary vision over the different areas allows PwC to offer complete and integrated solutions. After all, one of our principles is to establish long-lasting relationships and we know we will be together with the future leading groups of the Brazilian Financial market.

Our solutions

Our solutions will help our clients to deal with their issues in one of the following key topics:

Navigating Risk and Regulatory Complexity
In this area, we have been concentrating on assisting our clients in managing the increasingly complex world of risk and regulation. This includes such diverse issues as developing a comprehensive response to the risk management failures of the financial crisis, addressing the complexities of recent regulation such as FATCA, Basle III and Solvency II and reducing the cost of the risk and compliance function while improving its effectiveness. We are prepared to work on projects associated with the changing risk profile of our clients, increased pressure on cost effective risk management and compliance activities and impact of new regulation across banking, insurance and investment management sectors.

Delivering Cost Effective Technology and Operations
The focus of this area is to assist our clients in their goal to lower per unit cost of transaction processing while improving client service and functionality. We are prepared to offer financial institutions solutions that can be tailored to meet specific needs in a number of particular areas such as Insurance Claims, Consumer Lending and Derivatives Technology. Our professionals have a significant capability in advising Chief Information Officers (CIO Advisory) as well as delivering customized technology solutions. We can also benefit from our Tax international network to optimize the tax burden of the financial institutions and of their clients. Finally, on the operations side, we have solutions for process re-design, outsourcing/off shoring advisory and cost reduction initiatives.
Providing Actionable Financial Information
The core of finance transformation is to not only improve the cost of delivery, but to provide management, investors and other third parties (e.g., regulators) quality information on a timely basis. This applies to such diverse areas as the implementation of new finance technology and process improvement surrounding the budgeting and closing processes. PwC is able to bring process change, technology, risk, finance, accounting, tax and people/change skills to sophisticated finance transformation programs.

Supporting the Client Growth Agenda
At this point in the economic cycle we are prepared to help our clients in their growth agenda. We have solutions focused on strategy reassessment and product portfolio evaluation. We work with our clients profitability optimization and how to leverage demands to gain revenue and market share.

Maximizing the Value from Mergers & Acquisitions (M&A)
We are able to incorporate our due diligence capabilities with our merger integration capabilities. Brazilian financial institutions are still looking for local acquisitions and international expansion. At the same time global players that were not in Brazil are looking for niche opportunities. PwC has been and continues to be active within the scope of bank and insurance company acquisitions, private equity activity and asset management consolidations, working on pre and post deal phases.

Navigating Risk and Regulatory Complexity
• Internal audit (Outsourcing/Co-sourcing)
• Compliance management
• Performance Assurance
• IT Risk & Compliance
• Positive bureau “Cadastro Positivo”
• Internal control optimization
• Tax compliance

• FATCA implementation
• Financial Statements Audit
• Basle II e III
• Solvêncy II
• Actuarial Provision management
• Information Security
• Crisis management & Business Continuity

• New players (inbound, outbound) and Consolidation support
• Business plan, due diligence, valuation, tax planning, post deal support, culture change management

• Tax optimization
• Operational efficiency
• Process improvement
• Sustainable cost reduction support
• Sourcing contracts review
• Shared Service Center
• Business Process Management (BPM)
• IT modernization strategy

• Strategy reassessment
• Product portfolio evaluation

• Finance Transformation - how to get Finance closer to Business areas

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• Strategy reassessment
• Product portfolio evaluation

• Finance Transformation - how to get Finance closer to Business areas
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