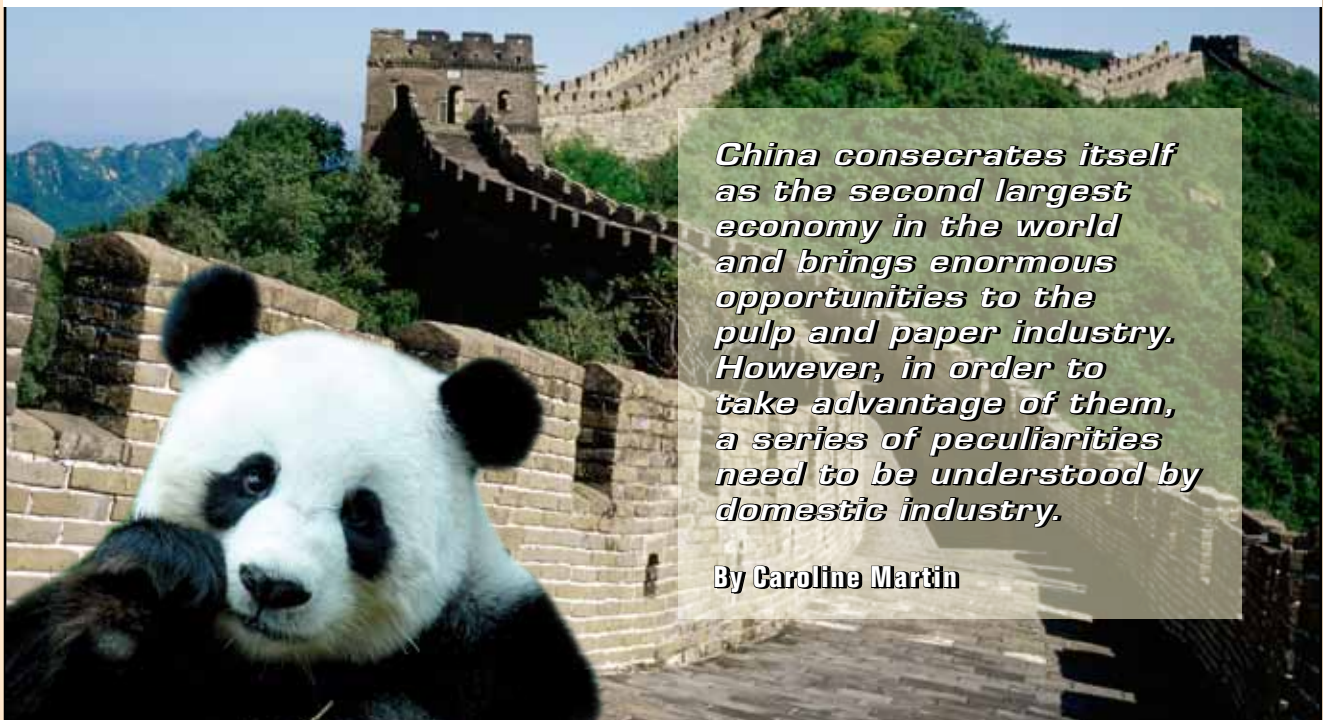


FMAIS



# *The gigantic challenge*



*China consecrates itself as the second largest economy in the world and brings enormous opportunities to the pulp and paper industry. However, in order to take advantage of them, a series of peculiarities need to be understood by domestic industry.*

By Caroline Martin

**T**he handshake between Dilma Rousseff and Hu Jintao halfway through April, emblematically consolidated China's position as Brazil's largest trade partner – nonetheless, it is not as of today that the Asian giant is expanding its negotiations with the Brazilian business community. From the year 2000 up to now, bilateral trade has leaped from US\$ 2.3 billion to over US\$ 56.3 billion, in other words, nothing less than 22 times in less than 10 years.

However, the noteworthy result produced by mutual imports and exports is far from reflecting absolute business harmony. These emerging nations are still seeking consensus as to strategic points for both. Upon leaving the country destined for the Asian continent with an entourage of more than 300 businessmen, the Brazilian president took with her the intent of increasing the volume of domestic product exports to the Chinese market.

More than balancing the bilateral trade relation, Rousseff desired to increase the range of the exchange, linking supply of commodities to manufactured goods. On the Chinese side, expectations orbited

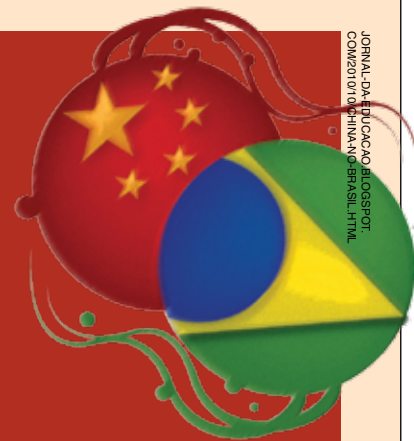


SÉRGIO BRITO

**“We have never made a dedicated effort to get to know the country that is our greatest trade partner”, points out Guanaes**

## CNI suggestions in favor of more effective bilateral relations

- Overcome the Chinese tariff and non-tariff barriers to more technically prepared Brazilian products.
- Improve commodities supply to China, with research, innovation and logistics.
- Develop new sectors and products, whether in biodiversity or renewable energy exploitation.
- Increase capacity to attract more direct Chinese investment.



JORNAL DA EDUCAÇÃO EMPRESARIAL  
COMUNICANDO O BRASIL PARA O MUNDO

around their recognition as a market economy – a promise made by Lula in 2004, which, one could say, never left the drawing board.

During the personal encounter, Rousseff agreed to afford more attention and effort to the issue, although no practical resolution has been taken. “There is still too much pressure from Brazilian industry against it”, explains Kevin Tang, director of the Brazil-China Chamber of Industry and Commerce (CCIBC). According to the executive, recognition would make interchange between both countries easier, but, on the other hand, it would reduce the arsenal of commercial defenses adopted by certain segments of domestic industry.

According to Robson Braga de Andrade, president of the National Confederation of Industry (CNI), China's growing importance in the world economy and its role of sustaining agricultural, mineral and fuel product prices oblige Brazil to tighten bilateral relations.

In order to achieve the objective, however, CNI banks on other means. (see box with CNI suggestions). “Brazil needs to increase its competitiveness, and China's ascension affords this challenge and undeniable sense of urgency”, stated Andrade, in a meeting of the Brazilian business

mission in which he participated during the president's trip to the country.

### POTENTIAL PARTNER OR COMPETITOR?

Ever since it entered the World Trade Organization (WTO) in 2001, China has made international trade its economic growth strategy. It seems to be working out. Today, the country already stands out as the second-largest world economy, only behind the United States. “In order to cater for the challenge of feeding 1.3 billion inhabitants, China really needs to make its economy grow at exorbitant rates. Seeking to fulfill this objective, the country has created a policy targeted at exports”, explains Rafael Guanaes, partner and director of BG Corporativa Cultural, a consulting company specialized in corporate internationalization projects.

In practice, the Chinese Communist Party is designing a change of course in three fundamental aspects. The first is with regards to the development of its internal market. Investment in education and innovation is the second point of focus for the Chinese government, and the third is a process of corporate internationalization.

“When the international crisis set in, China not only started to look more closely at its internal market, but also started to think about



**Suzana: “Brazilian companies suffer from lack of government support to launch themselves into foreign trade”**

diversification of its international investments, which were previously focused on procuring U.S. Treasury securities”, contextualizes Guanaes, specialist in trade with China. Brazil is certainly included in this diversification agenda. After all, as defined by Tang, “It is a country in ascension, with a heated economy and thriving consumer market”.

For the CCIBC director, the trend is for growing integration between both nations. “The largest Chinese investments in Brazil are in oil, gas and mining. Telecommunications and electronic appliance industries are also being contemplated”, listed Tang.

Even though Chinese commercial interest opens the door to a series of beneficial investments for Brazil, a fear still hovers over Brazilian industry: the loss of domestic market to Chinese products. According to a special survey carried out by CNI last February, 45% of companies that compete with Chinese companies have lost space in the domestic market. The survey, that included participation of 1,529 companies, also indicated that, when exposed to Asian competition, small undertakings lose more custom-

ers than their larger counterparts. Segments most affected by Chinese presence are electronic and communication materials, textile, precision hospital equipment, shoes, machinery and equipment.

The lack of trust regarding the Asian partner is intensified due to the lack of knowledge as to their objectives. “The Brazilian business community still has an ambiguous view of China; there is still doubt whether China is an ally or a competitor”, argues Guanaes. In the opinion of the foreign trade consultant, the lack of information is not only with regards to Chinese intentions, but mainly the lack of a Brazilian strategy to establish international targets. “A clearer position is required as to what Brazil desires from these trade relations”, he underlined.

It is calculated that currently there is an average of 700,000 foreign companies installed in China. Of this total, only 50 (considered joint ventures) are Brazilian. “We do not occupy a prominent position within China, due to the low level of internationalization of our economy”, points out Guanaes. “We never dedicated ourselves to get to know the country that is our greatest trade partner”, he completes.

Suzana Bandeira, also partner and director of BG Corporativa Cultural, considers Brazil as an extremely closed nation. “Companies suffer from the lack of government support to launch themselves into foreign trade. When talking about China, the issue becomes even more complicated, especially because of the large cultural gap.”

With the intensification of trade dialogue forecast for the next few years, Brazilian industry can no longer postpone awareness of Chinese practices. In reality, dedication towards the Asian country should be instituted in an emergency fashion. Even though there are still few Brazilian representatives established on the other continent, more than 20,000

national companies already negotiate with China, with 90% of these importing their products.

With the objective of further reflection on the culture that governs Chinese business, last March the Federation of Industries of the State of São Paulo (Fiesp) created a study center dedicated to China. “In order for us to be successful in our trade relations with China, the government and the private sector need dialogue as to the main points of interest and seek a coordinated strategy”, believes Paulo Skaf, the entity’s president. (see more details in the Interview section)

More than analyzing the features that afford the Asian giant its competitive power, Fiesp wants to incite debates addressing Brazilian industry bottlenecks. Skaf mentioned the tax burden as an inhibiting factor for the generation of income and employment in Brazil. “Is it interesting for the country to maintain a high tax burden that makes employment and investment unfeasible?” he questions.

The director of the CCIBC follows the same rationale and stated: “A major part of a country’s competitiveness on the global market depends exclusively on itself”. He underlined that high taxation, overvalued foreign-exchange, scarceness of qualified labor and infrastructure failures result in the “Brazil cost”, an old acquaintance of Brazilians that makes domestic industry more vulnerable to foreign competitors and subject to concentration on primary products.

Also in Tang’s opinion, the strengthening of the Brazil–China partnership will amount to more advantages than risks. He believes that Brazil has a lot to gain through Chinese investment, especially in infrastructure. “While some sectors lose, others gain. Instead of being afraid, Brazilian industrial segments should find ways of taking the best possible advantage of the alliance”, he advises.

## SECTOR PRACTICE

The pulp industry can be mentioned as an example of a sector that knows how to take advantage of the windows of opportunity opened by the Chinese. Since the world economic crisis triggered in 2008, Brazilian commodity producers tightened their ties with Chinese paper plants. “Revenue from exports to China went from 17% to 33% of the total amount exported in 2009”, stated the president of the Brazilian Pulp and Paper Association (Bracelpa), Elizabeth de Carvalhaes.

Despite reflecting peak movement at the time, the country maintained a good rate of imports, making Asia today take on the position of second main destination for Brazilian pulp production. According to last March’s Conjuntura Bracelpa, pulp exports to China during the first two months of 2011 amounted to US\$ 210 million, coming in only behind Europe, which amounted to US\$ 332 million.

According to Giacomina Frasson Manhães, commercial area executive with passages through the Orsa Group, Klabin and Aracruz, the trend is clear: soon China will overtake European leadership as paper center. “A year ago, Europe was still leader in some paper segments in production volume, but China should supersede these amounts in all types of paper”, she indicated.

As strong prospective evidence, Elizabeth de Carvalhaes (who was in China in 2010 and made contact with the executives of various companies), mentioned the recent installation of three large paper machines, which enabled the country to overtake North American production during the crisis. “The smallest of these is capable of producing 650 thousand tons/year”, she said referring to the size of the equipment.

Chinese massive investment in their paper industry explains the increased demand for Brazilian pulp.

“At the beginning of the decade, the Chinese still based their raw material procurement exclusively on price. However, the new industrial plants now require quality pulp”, explained Giacomina Manhães, who recently concluded the thesis on international pulp trade competitiveness.

Continuing with the transition phase, Elizabeth remembers that China also started to be pressured by the international community to seek more sustainable manufacturing processes – a point in favor of Brazilian pulp! “The fact that China has become more demanding in terms of quality positively affects the entire productive chain, especially Brazil, which is ahead at the competitive level”, assesses Giacomina.

Cenibra is one of the domestic players that took advantage of this momentum and continues to do so. Since 1997, the company earmarked a significant portion of its production to the Asian country. “We send

PAULO SÉRGIO DE OLIVEIRA



**There is no doubt: the key to Brazilian industry competitiveness lies in dominating forestry technologies**

an average of 45% of our annual production to Asia. Of this total, about 50% goes to China”, revealed Alfredo Mavignier, manager of the Trade and Movement Department.

The executive stated that China is a fundamental market for the company, not only because of its enormous population, but also because of the moment of expansion it is experiencing. When questioned about eventual risks on focusing pulp exports to China, Mavignier only managed to point out one inconvenience: systematic Chinese procurement. “They are market negotiators; they don’t have the same regularity as European and American purchasers. When pulp prices are low, they buy and stock up; when prices are higher they get out of the market”, underlines Cenibra’s manager.

However, Giacomina stated the way in which pulp is traded has changed greatly over the last years. “Besides the price, some partnerships are established based on product and service quality. It is already possible to make long-term contracts, which justify discounts, as is the case with mature markets. We also perceive a concern about environmental quality, which is something that 10 years ago wasn’t taken into consideration”, she exemplified, commenting transformations in relation to the industry’s trade relations.

The real commercial challenge for Brazilian pulp producers, however, is hidden in the long term. “China is clearly organizing itself to achieve self-sufficiency in the production of a series of raw materials – of which pulp is one”, alerted Giacomina. According to her, competition is currently as yet intangible, but it is worthwhile remembering that, “30 years ago, it was absurd to imagine that the Canadian pulp industry would lose its leadership”.

Chinese investment in pulp plants and forestry arise as proof of the



SÉRGIO BRITO

**Giacomina believes that the growing Chinese demand for pulp positively affects Brazil at the competitive level in the future**

executive’s statements. Giacomina believes that the impact on Brazilian pulp exports will still take a few years. “Five, ten or 15 years, who knows? The Chinese are still in the research phase, identifying the most appropriate genetic material for the climate and perfecting forestry management techniques”, she contextualizes.

The Brazilian pulp industry has demonstrated being fully aware of the future segment competition. “We have information that China is investing in a forestry base and plans to increase its own pulp production”, confirmed Mavignier. “Even so, Cenibra will not stop betting on the Chinese market and hopes to maintain a good sales percentage to the country”, underlined the Trade and Movement Department manager. This optimism is justified: “taking into consideration Chinese growth rates, the expected “own pulp production” will not occupy pulp market space”.

Bracelpa’s president also believes that the gigantic Chinese demand overrides the risk of eventual self-sufficiency. “There is most certainly investment in pulp plants; after all, China also produces the commodity.

However, I don’t believe that by itself it will be able to produce a total of 85,000,000 tons of paper per year; it’ll continue purchasing pulp from international markets for many years” she said. Difficulties in access to water, obstacles with state-owned lands and rigorous winters are examples of the hurdles to be faced by China.

Distinct opinions apart, one consensus stands out: the key to Brazilian industry competitiveness lies in the domination of forestry technologies. “Without doubt, Brazil is way ahead in this issue”, stated Giacomina. On the other hand, the constant need for innovation represents an issue that requires caution. “Players that lose focus on innovation are going to realize, little by little, that foreign companies are being increasingly more innovative and competitive. Ideally, everyone should prepare themselves for future competition”, she underlined.

### **BRAZILIAN VERSUS CHINESE PAPER**

When compared to pulp, it is undeniable that the Brazilian paper industry is more sensitive as to the technological frontier. Industry fragmentation into a series of types of paper is accompanied by significant differences in technological production levels. For example, there are plants that maintain themselves on the market with basic technologies, while others that contemplate advanced processes and equipment, but the domestic paper industry does not have the same international recognition that Brazilian pulp producers have achieved. “The paper industry as a whole never went after innovation and improvement as so energetically achieved by the pulp segment”, commented Giacomina.

According to the researcher, what in fact happened can be translated as a vicious circle. While Brazilian per capita paper consumption doesn’t get into gear, domestic industry does not plan major investments. In other



**Last year, Asia Pulp & Paper exported 142 thousand tons of paper to Brazil**

words, without a more demanding market, both in volume and in diversification, the financial risks will continue to be more prominent and current production will continue to remain at the same technological level – Differently from what takes place with the pulp industry, as investment and increase in quality and volume are incentivized by external demand.

Reflexes on the sector's posture are already beginning to be felt in practice. Although the data portrayed by Conjuntura Bracelpa reveal an advance of almost 4% of total paper production in 2010, some segments are losing space to imported products, as for example printing and writing paper. Also according to Conjuntura Bracelpa, imports of this type of paper have already increased from 499 thousand tons in 2009 to 735 thousand in 2010. This variation indicates a loss of market for national representatives.

The entry of Chinese paper into Brazilian territory accounts for a major portion of current imports. What enables their product to arrive here so competitively, to the point of making the exchange of national paper for imported paper so compensatory?

A set of factors, such as cheap labor, large-scale production and tax exemptions has been cautiously assessed by industry players. However, one fact already surfaces in midst of speculation: Chinese paper is no longer a product that was known for its poor quality.

“Nowadays, paper quality is largely determined by the plant; a fact that depends much more on capital available for investment than on paper tradition”, clarifies Giacomara regarding the rapid transition. “A Brazilian paper plant that wishes to achieve state of the art, orders its equipment and project from Swedish, Norwegian or Finnish companies; countries which are a reference for industry machinery, in the same way in which a Chinese paper factory will do with the same objective”, she exemplifies.

Asian market leader, Asia Pulp & Paper (APP) has exported paper to Brazil since 2002. Last year, the company recorded sales of 142 thousand tons to the domestic market. According to Geraldo Ferreira, general director of APP Brasil, this number is, on average, 37% larger than the amount achieved in 2009.

“We take advantage of the opportunity to seek for new supply alternatives for the Brazilian consumer. Furthermore, the heating up of the market as a whole and the dollar exchange rate have helped”, itemizing the reasons for the growth achieved over the last year.

With regards to the influence of the Brazilian currency on national and imported paper competitiveness, Ferreira admits that the valued exchange-rate may be an advantageous ingredient for APP's exports revenue, but not very significant. “If there were a devaluation of the real (R\$) at this precise moment, the immediate reflex could be greater difficulty for sales, but, after a short time, national plants would also increase their prices, in light of the fact that they depend on imported consumables”, argues the executive.

Despite the current tide appearing to be more favorable for imported paper, Ferreira disagrees with those who state that national paper is being threatened by foreign similars. “Brazil is not self-sufficient in various paper sectors”, he highlighted. As a major example of this, the APP director mentioned coated papers. While Brazilian annual consumption is 600 thousand tons, domestic players together produce an average volume of 280 thousand tons. “It is more than natural for foreign suppliers to make up the gap in internal demand. Therefore, I don't see any possibility of a dispute between the domestic paper industry and foreign representatives”, he stated.

According to Bracelpa president, Brazilian companies have sufficient industrial capacity to cater for domestic demand. In her opinion, the issue is another. “China, and likewise Indonesia, the United States and European countries, are part of the scope of exporters that send large volumes of printing and writing paper to Brazil. A large portion of these products have been illegally declared as being



## **Paths of access to the Chinese market**

Forums, lectures and debates underlined the months preceding President Dilma Rousseff's visit to China. The immensity of the aspects that surround the trade relations stimulated innumerable debates regarding the issue. A recently included course in the PUC-SP curricula, promises to go deeper into the issue at a global level, presenting a Chinese culture panorama, the country's socio-economic structure and its politics, in order to enable interested participants to better understand and act within this scenario.

"The initiative seeks to understand the way in which the Brazilian way of doing business impacts the final results, taking into consideration that the other end of the negotiations comes from an ancient culture, with well characterized habits and traditions", summarizes Rafael Guanaes, partner and director of BG Corporativa Cultural and one of the creators of the Negócios com a China: Ambiente Cultural e Econômico course.

Suzana Bandeira, also partner and director of BG and creator of the curriculum, stated that the objective is to prepare businessmen, academics and other professionals that work with foreign trade, but states that there isn't a list of topics divided into "right" and "wrong". According to her, the issue is much more complex than that – and as such, resulted in a 60 hour course. "Culture is included within the portions that make up trade negotiations, but, as opposed to cash and market, it is an intangible aspect. It has to be understood that Chinese conduct is based on a heritage, which has been strongly impregnated into the population for a very long time", she contextualizes.

Amongst the differences from the Western way of negotiating, Suzana highlights "maturation time". She explains that the term reflects how much the Chinese value social interaction outside business meetings. "The chance of establishing a solid and successful relationship increases according to the business person's manifestation with regards to their conduct", she stated.

According to the partner and director of BG Corporativa Cultural, upon visiting the country it is a must to set aside free time in the agenda. "Refusing a dinner invitation because a return flight is booked may abolish any opportunity to discover points in common and create empathy", she stated. Obviously, good manners do not guarantee closed deals, "but one sees a sharp difference amongst those professionals that leave here with minimal preparation, taking their folders and business cards already in Mandarin and even risk a few words in the language. The impression caused is another."

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for editorial purposes." According to Carvalhaes, national manufacturers of paper for books and magazines have already lost 57% of the internal market, due to final usage deviations.

She highlights that both Bracelpa and its associated companies defend all practices common to a free-market. "We absolutely do not target a culture aimed at closing the market. In light of the fact that we are both exporters and importers, we believe in free competition", she assured. "What we seek, together with the government and other entities connected to the industry, is to strengthen supervision on "immune" paper and reduce illegal tax benefits."

Bracelpa's president also stated that this is the current main focus of the domestic paper industry. "There is a market being cannibalized by illegal imports, and the solution is the responsibility of Brazilian authorities". According to Ferreira, pressure on the government in favor of stricter and well-structured supervision and inspection will benefit all players. "Obviously, the application of legal procedures is the fairest way of acting in the market, whether by domestic or foreign representatives", defends the APP general director. 