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Understanding Brazilian Shopping-Center Market Stakeholders

Navigating the Retail Real-Estate Landscape

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Abstract: *Although the Brazilian market for shopping centers is promising, many barriers face foreign investors who hope to establish new businesses there. This article highlights the impact of the global industry on domestic shopping-center owners; the transformation of the industry due to the role of pension funds, the stock market and international partnerships; and the challenges and potential opportunities associated with transportation.*

Retail development expanded tremendously in Brazil over the last 10 years. Currently, the nation's shopping-center stock has grown to 457 properties in operation as of February 2013, and 47 more are projected to be open by the end of 2014.[1] With this boom in retail properties, there is much interest among foreign investors and international tenants in the Brazilian market. However, before entering that market, a few key facts should be known about the domestic players and influences. This article will explore the role, function and mindset of entrepreneurs, investors, retailers, franchises, consumers, employees and the government to better help the international community navigate the Brazilian market.[2]

Entrepreneurs

Most Brazilian shopping centers are owned by a few companies: BR Malls, Multiplan, Sonae Sierra, Aliansce, Iguatemi, Ancar, General Shopping and Westfield Almeida Junior S.A. The way these companies design, develop and manage their centers is strongly linked to the way their landlords learned the business from the global competitive marketplace, which—in turn—heightens the competitive environment for new entrants into the market.

An important feature about Brazilian shopping-center entrepreneurs is the family history of many of these companies. With the exception of BR Malls, a company recently formed as a foreign investment, most shopping-center businesses in Brazil grew out of family-managed companies created from the work, vision and ambition of the founders/entrepreneurs who, in hereditary fashion, trained their children in the design, management and operations of the firm. These family operations learned from foreign companies that often pioneered best practices. Because these management methods had already been successfully tested in shopping centers around the world, such enterprises have also effectively managed to control costs and increase revenues in Brazil and expanded its rate of return by 15% from 2010 to 2011 and by 10% from 2011 to 2012.

Investors

To understand the development of shopping centers in Brazil, it is important to discuss three sources of capital that have changed the landscape over the years. Those capital sources are from pension funds, the stock market and partnerships. The direct investment from pension funds, whether private or public, was crucial to the building of many of Brazil's first shopping centers. In those early days when domestic investors were more focused on other investment opportunities, pension funds allocated a substantial portion of their investment to retail projects. These funds, which were seeking the safety of long-term real-estate investments while preserving the consistency of their returns, were a critical source of money to enable Brazilian entrepreneurs to build centers, and they continue to play an active role in the industry even today.

However, beginning around 2005, Brazilian companies began to increasingly tap equity capital through initial public offerings (IPOs). These IPOs unlocked value in the professional management and ownership of these properties, which triggered significant asset-value growth

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1 ABRASCE (Brazilian Association of Shopping Centers)

2 In addition to these players, it is also relevant to consider additional influences on shopping-center and retail operations, including unions, the community, suppliers, associations and non-governmental organizations.

and funding opportunities for additional ventures. Helping this wave was a move by the Brazilian stock market[3] to adopt advanced, safe and accurate procedures and mechanisms to ensure protect investors' capital against deviations and irregularities that could affect these companies. In other words, investors in the Brazil's shopping-center and retail industries can trust in the stock market, especially because the entity responsible for the regulation and organization of the market shares, CVM (Comissão de Valores Mobiliários),[4] has proven to be one of the main symbols of economic stability in Brazil.

A third avenue for the Brazilian industry to access international capital was through a joint venture, which was a significant factor spurring growth over the last decade. For instance, companies such as General Growth Properties, Cadillac Fairview, Ivanhoe Cambridge, DDR and Westfield have partnered with local entrepreneurs.

Therefore, it is not happenstance that this market has grown so much in recent years, but a direct result of the waves of capital infusion.

Table 4-1
Regional Breakdown: Brazilian Shopping Centers

Region	Number of Shopping Centers	Share of Total	Gross Leasable Area (Square Meters)
North	18	4.0%	400,211
Northeast	60	13.2	1,660,728
Central West	41	9.0	859,200
Southeast	254	55.8	6,586,741
South	82	18.0	1,660,242
Total	**455**	**100.0**	**11,167,122**

Note: The above regions are broken down into the following areas: *North*: Acre, Amazonas, Roraima, Rondonia, Amapa, Para, Tocantins; *Northeast:* Maranhao, Piaui, Ceara, Rio Grande do Norte, Paraiba, Pernambuco, Alagoas, Sergipe, Bahia; *Central West*: Mato Grosso, Goias, and Mato Grosso do Soul; *Southeast*: Espirito Santo, Minas Gerais, Rio de Janeiro, Sao Paulo; *South*: Parana, Santa Catarina, and Rio Grande do Sul.
Source: ABRASCE (Brazilian Association of Shopping Centers)

Retailers

Battered by rapidly-changing technology and consumer whims, with uncertain and erratic sales, Brazilian retailers operate in a highly competitive environment while still being largely concentrated in their original home markets in the country.

This heavy retail (and shopping center) concentration exists in the South and Southeast regions (as seen in Table 4-1) mainly because these areas have historically been highly developed in terms of industrialization and services.

In addition, Brazil's inadequate transportation infrastructure makes it difficult to transfer goods, increasing freight costs and requiring a sophisticated logistics system. Consequently, products become more expensive for consumers.

As a result, consumer-goods production and warehouse distribution remain near their core southern markets of Rio de Janeiro and São Paulo. Thus, it is not surprising that Brazil's President Dilma Rousseff announced in late February 2013 that Brazil needed greater investment in its transportation infrastructure, which she was making a government priority as a key element to boost the economy. This initiative builds on the government's 2012 plan to attract private financing to build or improve roads, railways, seaports and airports.

Another challenge for retailers in Brazil is the widely used practice of *key money*. For each new lease contract with a term longer than 60 months, the retailer must bear the cost. Although key money is not burdensome for anchors, it can average between US$1,000 to US$1,200 per square meter for non-anchor tenants.

Despite these difficulties, the index volume of retail sales in Brazil was up a strong 8.4% in 2012.[5]

Franchises

Brazil currently has nearly 106,000 franchise establishments,[6] a number much lower, for example, than in the United States, which in 2012 reached approximately 746,800 units.[7] Using franchise history in the U.S. as a yardstick, Brazilian expansion and creation of new franchising units is a near certainty in the short and medium term.

With many consumer markets underserved around the world, not only national but international franchises can benefit from the Brazilian market.

Franchise development in Brazil is simple. Applicants need not comply with specific regulations. Moreover, the terms to be negotiated between franchisors and franchisees are based on specific trading conditions. However, market entrants must be aware of issues

[3] BM&FBOVESPA is a Brazilian company, created in 2008, through the integration of the São Paulo Stock Exchange (Bolsa de Valores de São Paulo) and the Brazilian Mercantile & Futures Exchange (Bolsa de Mercadorias e Futuros).
[4] www.cvm.gov.br .
[5] IBGE (Brazilian Institute of Geography and Statistics).
[6] ABF (Brazilian Association of Franchising).
[7] "Slow, Steady Growth To Continue for Franchise Businesses in 2013" (December 20, 2012 press release), International Franchise Association, retrieved March 14, 2013.

concerning the marketing and operational structures that are also linked to these franchises.

Market demand, especially from lower-income consumers, has risen in recent years. On the other hand, this increased demand has generated profound changes in the supply of products and services, which is currently limited by the organic, internal growth of the leading companies, instead of by the development and expansion of operations and brands.

The retail market, while extending its offer, is not necessarily diversifying products, services and brands. Rather, it is mainly increasing points of sale for existing operations.

Employees

The role of employees in shopping centers is also very important. Legal issues, high labor costs and employee qualifications all need to be understood before developing a new business in Brazil.

According to ALSHOP (the Brazilian Association of Tenants in Shopping), currently about 1.1 million employees work for retailers in shopping centers, with around 81,000 employed in shopping-center administration.[8] So new market entrants need to grasp the relationship between employers and employees, as well as the social risks inherent in any labor relationship.

Most of the fundamental rules of Brazilian labor legislation are set out by Decree-Law No. 5.452/43, known as CLT (Consolidation of Labor Laws),[9] which has protective rules in favor of employees, establishing various obligations for employers and ensuring many rights for employees.

While Brazilian labor law deserves more detailed analysis, one should remember that such legislation needs to be analyzed in association with other complementary rules involving unions.

Therefore, it is necessary for companies to be prepared to comply with legislation, so that the risks and contingencies arising from conflicts between employers and employees can be mitigated.

Beyond the legal issues, worker qualifications must be considered. At the upper levels of organizations—directors, managers and supervisors—most professionals exhibit considerable expertise, training and knowledge. They represent a significant share of the economically active population, with access to high-quality educational institutions (including abroad), and can be counted on to perform efficiently. But the Brazilian population is still very young, and, particularly at the entry level, many employees lack the training required to perform technical activities related to the retail industry.

A major challenge for companies wishing to establish themselves in Brazil, therefore, is employee development, education and training. In this way, productivity, performance and profitability will be enhanced through the collaboration of more prepared and qualified employees.

Consumers

Increased worker incomes, greater accessibility to information and previously unavailable products and services are transforming the consumer landscape, providing more opportunities for retailers. Brazilian consumers more than ever before want products that offer value and cutting-edge technology.

Since Brazilian consumers have the buying power and willingness to spend, the nation's luxury retailers have expanded. Many of these latest entrants come from the United States and Europe. A good example of this fact is the performance of Louis Vuitton stores in Brazil, which, individually considered, achieve significant profits compared with other company stores around the world.

Government

The Brazilian government can be considered the most challenging player for companies who want to develop their business in the nation. Ensuring that a business fully complies with detailed requirements set by the government for a newly constructed shopping center or store is essential to prevent future liabilities and unexpected contingences against the project. These requirements originate from three Brazilian government levels: federal, state and municipal.

Three issues that every business must deal with are especially important:

1) *Obtaining licenses and permits* for business operation is a process quite complicated by the three-level governmental system. However, these permits and approvals are required almost simultaneously. Stated simply, the main licenses and permits necessary for operating a shopping center or store are:

- *approval from the municipality*, requiring detailed demonstration of all aspects of the project related to engineering, as well as the impact of the development on the neighborhood in which it will be built;

8 www.alshop.com.br
9 The full version of Decree-Law No. 5.452/43 can be found at: http://www.planalto.gov.br/ccivil_03/decreto-lei/Del5452compilado.htm.

- *inspection for fire department and sanitary licenses,* attesting that safety and health conditions are in accordance with the law;
- *certificates called PPRA* (Prevention Program Environmental Risks) and PCMSO (Control Program of Medical Occupational Health);
- *HABITE-SE*, an authorization for occupancy of the building; and
- *An operation permit*, issued by a mayor to authorize the operation of businesses at certain times, the practice of certain activities, etc.

In addition to these licenses and permits, every company must be duly incorporated, demonstrating the establishment of its corporate structure, a CNPJ (National Register of Legal Entities), as well as register corporate papers in the Commercial Registry Office (public state agencies that regulate commercial activities and businesses) and register the construction project in the Real Estate Registry Office.

Fortunately, many competent professional consulting firms, lawyers and experts in Brazil have extensive experience with the challenges that entrants to the Brazilian market face in meeting legal and regulatory requirements, and can help in overcoming them.

2) *The Brazilian tax system* can also raise concerns among companies unaccustomed to the tangle of laws that regulate and organize the business activities of all companies.

Each of the three levels of Brazilian government has the right to receive and collect taxes on a wide range of activities that generate these charges, such as payroll, circulation of goods, industrial production and income.

Still, most companies have found solutions to offset the enormous tax burden that represents the biggest hurdle affecting Brazilian industries' competitiveness, including setting the price of their products, improving strategies to stimulate consumer demand, and obtaining legal benefits when the company runs activities that offer social, environmental and economic advantages for society.

3) *Environmental risks* may occur in the acquisition of a piece of land or area or with the impact of waste produced by business, commercial or industrial activities. Such issues are especially complex in Brazil because of increasingly stringent legislation verifying, compensating and punishing companies that do not comply with rules related to all aspects of environmental protection. (One of the duties of the Public Prosecutor, for instance, is to ensure that environmental legislation is obeyed.)

When an environmental infraction occurs, Brazilian law allows the company responsible for the damage to be heavily punished, from the imposition of a fine to the obligation to comply with various counterparts, and, in a much more severe case, it can even lead to the arrest of those who are convicted of environmental crimes.

The challenge to develop an environmentally sensitive project has been overcome when businesses and entrepreneurs create sustainability programs, which increasingly appeal to Brazilian consumers who attribute a significant value to this kind of initiative.

Conclusion

Although the challenges facing a new shopping center or retail operation in Brazil can be complex, they can be easily overcome if new entrants have plans in place to fulfill all requirements for managing their business in a positive, secure way.

Not only economic concerns, but also social and environmental factors are relevant for a company to achieve its objectives. Included in this process is analysis of the trade area, such as appropriate economic planning for absorbing social, tax and labor costs. By adopting an appropriate marketing position (price, product and place), it is likely that any company that intends to establish a business in Brazil will achieve its goals.

Indeed, new entrants following these procedures will find strong demand from Brazilian shoppers, who are increasingly open to better products, different solutions and more modern consuming experiences. Great opportunities exist for creative, ambitious and structured companies with a strong purpose to accomplish their plans for expansion, creating value not just for partners and shareholders, but also for society as a whole.

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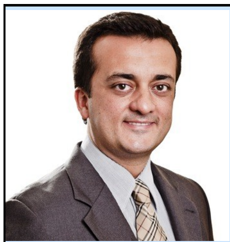

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