Brazil*Views*

Brazil—Land of Opportunity?

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Much is written about the Brazilian growth phenomenon. But can UK software and IT services suppliers hope to get a slice of the action? In this, the first of a series of occasional notes on the Brazilian IT scene, we take a sounding on market trends from some of the leading players.

Here's a statistic that may surprise you. According to industry estimates, at $10.1b the Brazilian IT services market was larger than the Chinese and Indian domestic markets combined ($5.7b and $4.2b respectively). Not bad for a country with a population a little under 200m people. And what's more, the Brazilian IT services market is expect to grow at double-digit rates by 2014.

Certainly Brazil has not been immune from the global economic crisis, and indeed government forecasts for GDP growth this year have only recently been reduced from 7.5% to 5%. And while the Brazilian finance ministry expects GDP growth to reach 6.5% in 2013 and 2014, local economists would knock a point or so off those forecasts. Part of this economic growth will come simply from the changing population demographic. According to research from Brazil's Federal University of Minas Gerais (a Brazilian state—literally 'general mines', named after its heritage industry), the shift in the demographic 'pyramid' will increase the proportion of 'active' population year by year until 2022. This alone should add 2.5% to GDP growth!

Onshore is the best shore

Despite the fact that Brazilian IT industry association, Brasscom, is trying hard to promote Brazil as an offshore alternative to the likes of India and China, frankly the real opportunity for 'foreign' IT players is in Brazil's domestic market (I hope to write about Brazil as an 'offshore' centre in a future note). The country certainly has a time-zone advantage for US and Europe over India and China. But it must be said that economic growth has been whittling away at its

labour arbitrage benefit. In any event, Brazil – and for that matter China – simply does not have an offshore services industry 'machine' anywhere as well developed – both in sophistication and scale – as India.

As many readers will know, I am a regular visitor to Brazil (wife's family and all that!) and I try to take the pulse of the local IT services scene whenever I get the chance. My first opportunity was a couple of years ago, when I visited **TCS** Brazil (see TCS brings a touch of India to Brazil). That was a real eye-opener for me for all sorts of reasons, not least of which was the fact the vast majority of its business derived from the domestic market, serving both local enterprises as well as Brazilian subsidiaries of overseas clients. The other big surprise was that virtually no work was offshored to India! At the time I was very optimistic about TCS' growth prospects in Brazil, and indeed for the rest of the Brazilian IT services market. So, imagine my surprise when on my return visit (see Page 2) I found a much smaller organisation, trying to regain a foothold on growth.

I also met up with the local CEOs of two other players in the Brazilian IT services market: **Logica**, and **CPM Braxis**, the 'local hero', control of which was acquired by Capgemini last September (see Capgemini has a Brazilian).

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Both Logica and CPM Braxis had been battered about a bit by the downturn and, like TCS, are now hoping for a return to growth.

They also all share a common challenge. They can't get enough good staff! With demand for IT services increasing, and the pool of skills relatively small, attrition rates are more like those in India (above 20%). This, perhaps more than any other factor, will determine whether the likes of TCS, Logica and CPM Braxis will achieve the sorts of growth rates they are aiming for over the next few years.

Where can the UK play?

So where does this leave UK players interested in getting a slice of the action in the Brazilian IT market?

Based on what I've seen so far, frankly I think the IT services market is pretty much tied up by the global 'usual suspects' – mainly **IBM**, **Accenture** and **HP** – with a host of local players (like CPM Braxis) and other international firms (like TCS, Logica) hoovering up much of the rest.

If there is opportunity for the UK industry in Brazil, I suspect it will be more on the software side, and even then, by partnering with IT services players already in the market. To be honest, I don't have any sense yet of the potential scope and scale of the opportunity, but I will be back in Brazil in June and hope to find out more.

TCS Brazil puts difficult times behind

I t's been a couple of years since my first visit to **TCS**' operations in Sao Paulo and I was keen to hear how things had moved along. At that time (December 2008), TCS Brazil employed some 1,300 people and had revenues of around $100m p.a. Brazil itself had yet to feel any substantial impact from the global downturn, though economists had downgraded GDP growth forecasts to 'only' 4%.

TCS Brazil essentially serves the domestic market, rather than being an offshore/nearshore delivery centre for TCS' other geographies. Its biggest customer was Banco Santander, as a result of the Spanish bank's acquisition of ABN Amro's Brazilian operations in 2007 (our very own Royal Bank of Scotland acquired a fair chunk of ABN Amro too). A rigorous reassessment of headcount requirements saw TCS Brazil slim down to some 800 employees, but the business is now growing again.

The other big change at TCS Brazil was at the top. Now running TCS' Brazilian operation is Andre Fossa, who was brought in from Columbia Business School in July 2010 (where he was completing an MBA course) and promoted to country manager in November. Prior, Fossa had spent a number of years with Brazil Telecom and, before that, in consulting.

Three by three

"We've put the difficult times behind us," Fossa explained. "This was a one-off hit and we grew in other parts of the business." According to Fossa, TCS expects the Latin American region to grow threefold over the next three years – and Brazil even faster. That seems rather a tall order even for a fast growing market like Brazil. But Fossa seemed confident. "We are refocusing our efforts on our key clients so that we can take full advantage of our global delivery network and service delivery processes."

The shape of the business hadn't changed much in the past couple of years. TCS Brazil still relies on a 50/50 mix of staff augmentation and managed services, with most of the work being in application development and management (AD&M). "Enterprise application services is the really hot area for us," Fossa said, "but we also have a growing business in infrastructure management."

The competitive scene looks much the same, too, with Accenture, IBM and HP (via EDS) still the dominant players. "We really don't see much of our India-based peers," Fossa mused. But one thing TCS Brazil shares with all its peers is the shortage of good people to employ. "The market perceives TCS in a really positive light here in Brazil," Fossa noted. "That stands us in good stead when we're competing to hire the best staff." We hope so, as in the world of IT services, three times growth in revenues usually means three times growth in headcount. That's perhaps Fossa's real challenge!

"It's not Brazil's goal to become another India!"

That was the strident statement that caught my attention early in my conversation with **CPM Braxis** CEO, Jose Luiz Rossi, when we met up just after Christmas. And straight away it reset my perception as to what the Brazilian IT services industry is really all about. And the answer is it's pretty much all about Brazil – by which I mean the domestic market, rather than as an offshore/nearshore delivery centre for other geographies.

CPM Braxis was arguably the largest Brazilian-owned IT services player. I say 'arguably' because archrival Stefanini also makes that claim, but I understand that although Stefanini has more employees (12,000), their revenues are lower than those of CPM Braxis, (a little under $R1b, i.e. one billion Reals, c. €440m). And I also say 'was' because in September 2010, Capgemini acquired control of CPM Braxis through an offer which valued the company at around 1x revenues. Existing investors retained a 45% share, led by third-ranked Brazilian bank, Bradesco.

The story so far ...

CPM started business in 1985 as a communication equipment (and later, mainframe) importer for Bradesco. Over the years CPM diversified into services and reduced its dependency on the Bank. In 2006, a group of Brazilian entrepreneurs founded Braxis. Braxis was merged with CPM with the aim to adopt the rigorous, industrialised service delivery and operational management processes that had become the trademark of the by then famous Indian brands. Indeed, the plan was to create a big Brazilian IT services exporter that could provide a viable alternative to the Indian players. However, management soon realised that the real opportunity for CPM Braxis lay in its own domestic market, which then became the main focus for its business.

In 2009, CPM Braxis' investors hired Rossi from IBM to lead the next stage of the company's growth. The plan was to raise funding, looking for potential private equity investors both in Brazil and in the US. In early 2010, JP Morgan were appointed as advisors and soon returned with news of interest not only from potential investors, but also from prospective buyers. These were mainly high profile global IT services companies keen to expand their presence in Latin America, including Capgemini.

At that time, Capgemini only had a small operation in Brazil, with some 160 employees in traditional IT services roles and another 600 in BPO (F&A services). Capgemini was very keen to exploit the fast-growing local IT services market as well as wishing to create a far more substantial local presence to service the Brazilian subsidiaries of its international clients. CPM Braxis, with its 6,100-strong headcount, looked like the ideal solution. It seemed a great fit, with some 60% of its revenues coming from financial services firms and 20% from telecoms companies.

CPM Braxis' investors were initially reluctant to consider a trade sale. But it seems that Capgemini CEO, Paul Hermelin's charms (and of course his business proposition) were compelling enough to cement a deal with little more than three months discussion. The acquisition completed in October 2010, with Capgemini taking a 55% interest in CPM Braxis along with a 'call' option on the balance between 3 and 5 years hence.

More local than remote

Although Capgemini's aspirations are still mainly focused on the Brazilian domestic IT services market, CPM Braxis also has a fledgling remote infrastructure management (RIM) operation which services the US market. RIM only accounts for about 5% of CPM Braxis' revenues, though they derive a further 20% in domestic infrastructure-related services. But RIM is seen by both CPM Braxis and by Capgemini as a growth segment – as do the India-based pure-plays. But Rossi feels that CPM Braxis has an edge. Part of this is down to time zones, though Rossi feels that CPM Braxis also has much better 'cultural alignment'. In summer, Sao Paulo is just three hours ahead of New York (and, for that matter, three hours behind Paris). "We're competing with the Indian night-shift," he explained. "For us, it's a normal day's work".

But it is the domestic market that will be the engine of growth for Capgemini in Brazil. Around 80% of CPM Braxis' clients are headquartered in Brazil, of which about half are major international companies in their own right. "Our customers' business growth plans really are quite aggressive," mused Rossi. "This is creating a huge demand for IT services which is frankly outstripping supply". Indeed, recruitment and retention are among Rossi's biggest challenges. "Like other IT services providers in Brazil, we just can't get enough good staff".

Logica Brazil breaks out!

Although **Logica** opened its first office in Brazil back in 1999, it really wasn't until they acquired Edinfor, the IT captive of Portugal's electricity supplier, EDP, that it truly became the cornerstone of Logica's South American operations. Even so, the business traded as Edinfor until 2007, when it was finally rebadged as Logica Brazil.

Today, Logica Brazil employees 600 professionals, and is led by CEO Edson Ferreira Leite. To give him his full title, Leite is CEO and COO of Logica South America, a role he assumed in October 2009. Leite joined Logica in October 2009 after in effect co-founding **Tivit**, one of Brazil's leading IT/BPO players. UK-based private equity firm, **Apax**, acquired control of Tivit in May 2010 in a deal that valued the Brazilian firm at around $1b. Prior to Tivit, Leite spent 21 years with EDS, latterly running their Latin American IT outsourcing operations.

Turnaround time

It has to be said that Logica Brazil was not in great shape when Leite came on board. Not only was it losing money but, as Leite saw it, the company had somewhat of a 'neutral' brand – Logica was barely known outside of its core Energy & Utilities sector. This also made it difficult to attract talent, in a market where demand for skilled IT professionals far outstrips supply.

Today, although pretty much all of Logica Brazil's revenues derive from the E&U sector, Leite has reduced the company's dependence on EDP, which now accounts for about a third of the business. "We used 2010 to reshape the Logica Brazil and now see 2011 as a growth year," Leite explained. "We would like to break out from being an energy and utilities player. We want to diversify the business to the point where 30-40% of our revenues come from clients in other sectors."

To this end, Leite is turning his attention to the booming financial services sector, where many of Logica's traditional competitors are already well entrenched. Leite understands that Brazil's big banks would be tough to crack: "We're targeting medium-size banks because they have yet to integrate their core applications – Logica has a banking solution we think can help."

Beyond Financial Services, Leite has set his sights on Logica's other 'strong suits', notably 'IDT' (Industry, Distribution, Transport) – where they have already been shortlisted for a major deal competing against HP and IBM – and Telecoms. "Even despite the restructuring we did last year we still managed high single digit growth," Leite said. "This year we should double that." If so, that should really help Logica's brand in Brazil become a lot more visible!