



BMW AND BRAZILIAN FEDERAL GOVERNMENT: ENHANCING THE AUTOMOTIVE INDUSTRY REGULATORY ENVIRONMENT

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This paper presents a descriptive case study regarding the negotiations between the German automotive company *Bayerische Motoren Werke* (BMW) and Brazilian Federal Government (BFG) with the purpose to implement the company's first automotive factory in Latin America. BMW announced on March 2011 to the BFG the intention to start manufacturing in the country. However, on September of the same year, BFG launched measures aiming to foster productive investments and protect the internal market, which included a 30 percentage points excise tax increase on non-locally manufactured cars. This significant change on the regulatory environment impacted directly BMW's market access strategies under development at that time. Such governmental measures gave birth: (a) to a new automotive regime called *Inovar-Auto* and (b) the need for BMW to negotiate its strategic interests with BFG. The negotiations were successfully concluded on October 2012 with positive outcomes to all parties involved. This study throws more light on the strategic importance of Government Relations as a core competence for companies operating on strongly regulated business environments.

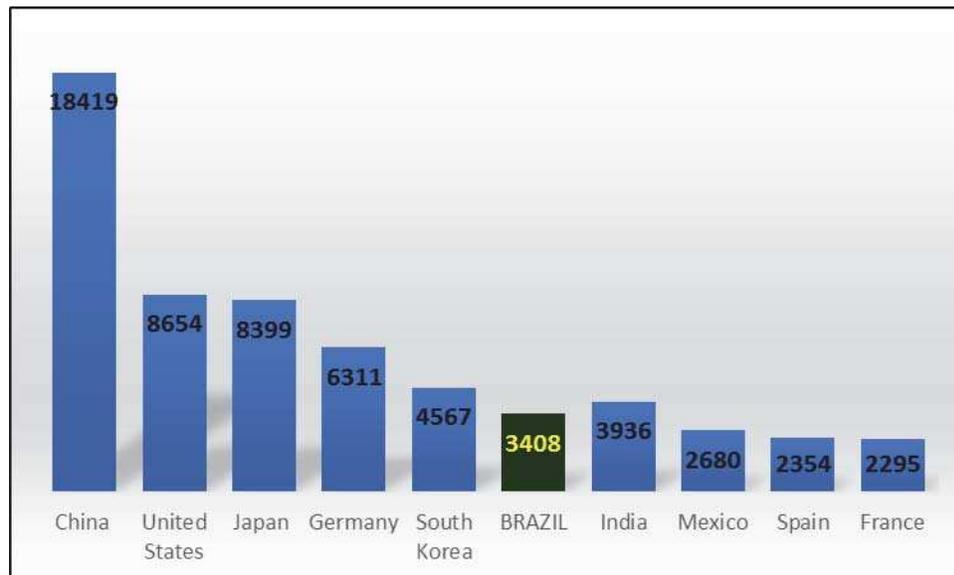
Keywords: Brazilian Government, Institutional Relations, BMW, Negotiation, Inovar-Auto.

Background

The Brazilian automotive industry in 2012 encompassed 53 industrial units in 9 states and 39 municipalities, 26 assemblers, 500 autoparts makers and 4,809 dealers in the whole country, employing 1.5 million people, a GDP (Gross Domestic Product) share in 2011 of 21% - including autoparts, 5% of the total Brazilian GDP. Revenues reached \$ 121.3 billion, exporting \$ 24.8 billion and importing \$ 34.7 billion in 2011, with a production capacity of 109 thousand agricultural machines and 4.3 million vehicles (ANFAVEA¹, 2012, p.15).

Despite these numbers, Brazil was the 6th country in worldwide vehicle production in 2011 (see table 1 below) and the United States had at that time eight times more vehicles circulating in the whole country than Brazil (ANFAVEA, 2012).

¹ ANFAVEA – *Associação Nacional dos Fabricantes de Veículos Automotores* (Vehicle Manufacturer's National Association). See ANFAVEA (2012) *Brazilian Automotive Industry*. Brazil: ANFAVEA, available at <http://www.anfavea.com.br/anuario.html>, cited on 03/14/13.

Table 1. Worldwide vehicle production 2011.

Notes: (a) units in thousands of vehicles. Source: Anfavea, 2012, p.147.

Brazilian automotive industry history is very recent, 57 years-old only. On August of 1956, former Brazilian president Juscelino Kubistchek has created, by Decree, GEIA², as part of the Brazilian *Plano de Metas*³. GEIA's responsibility was to 'Establishing standards for building principals Brazilian Automotive Industry' (Brazil, Decreee 39412, Article I). The focus of GEIA, therefore, was the automotive sector, to define the basic guidelines regarding the implementation of this industry in Brazil. The intention was to stimulate the production of utilitarian cars, not luxury or sports models.

On February 1957, through Decree 41.028 the BFG instituted the National Automotive Industry, with specific goals: according to Article IV, by July 1st, 1957, a nationalization index of 50% was imposed to any industry interested in investing in the newly created Brazilian Automotive Market, vehicles would not be sportive but utilitarian with minimum of four seats each (Brazil, Decree 41.028/57, Article IV).

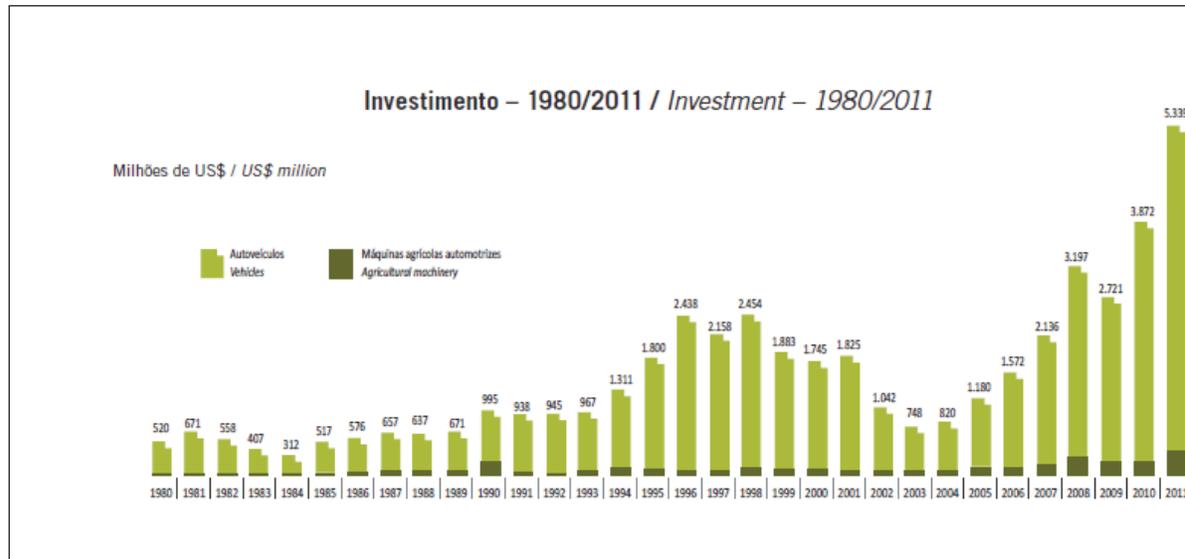
Curiously, BMW was one of the interested companies. The first BMW's goal was to produce, in a joint venture with the Brazilian Romi, 5,000 units. BMW would manufacture Model E: Romi-BMW 600, four passengers, 350 kg of workload, two doors and maximum speed of 95 km/h⁴. Unfortunately, BMW aborted the project due to financial losses regarding World War II (1939-1945).

Brazilian automotive market investments has evolved as seen in table 2, as follows:

² GEIA - *Grupo Executivo da Indústria Automobilística* (Automobilistic Industry Executive Group)

³ *Plano de Metas* - Goal's Plan. Brazilian Governmental Developments' Policy at 1956.

⁴ See Romi Foundation. Retrieved from http://www.fundacaoromi.org.br/fundacao/cultura.php?foto=isetta&area=cultura&p1=3&p2=21&p3=23&p4=132&id_is_historia=12, cited on 03/14/13.

Table 2. Brazilian Automotive Industry – Investment 1980/2011

Source: Anfavea. *Brazilian Automotive Industry Yearbook*, 2012, p.40. Reprinted under permission.

In 1995, BMW acquired the operation of its authorized importer in Brazil and established a national sales company (BMW do Brasil Ltda). In 1999, the company received the approval of Brazilian Central Bank to start its financial services operation, which included leasing operations.

In 2004, BMW Brazil moved its headquarters to the city of São Paulo, in order to manage its 25 points of sale (total volume reached only 1,291 cars).

During the 2008 International Motor Show (*Salão do Automóvel*), the company announced its plan to bring to the country the commercialization of the brand Mini and also to manufacture one of its motorcycles models in the Manaus Free Trade Zone, using the industrial facilities of a third party. At his point, the group had 30 points of sales (including motorcycles). This way, during the year of 2009 the Mini brand was launched in Brazil and the first motorcycle (model G650GS) was manufactured in the country.

With the expansion of its sales structure in Brazil, the BMW group delivered 9,886 cars (BMW and Mini) and 3,507 motorcycles in 2010 through 61 points of sale, establishing a record of sales and consolidating as leader on the *premium* automotive segment according to the European Union (EU) classification⁵.

The next step, clear to BMW executives, should be to expand its operations, with a plant construction, manufacturing and sales within Brazilian territory.

This research is focused on the negotiations that resulted with the possibility to BMW's entrance in Brazilian *premium* automotive segment.

⁵ Category **M1** (carriage of passengers not exceeding 8 seats in addition to the driver's seat), segment **F** (Luxury cars), according to Commission Directive 2001/116/EC of 20 December 2001, adapting to technical progress Council Directive 70/156/EEC. For further information: Vehicle Category (2013). Retrieved from http://en.wikipedia.org/wiki/Vehicle_category.

Methodology

This multiple-method, interpretive research combines descriptive case study method (Yin, 1988), in-depth interview, first hand observation, direct participation and action research (Silverman, 2011). Data were collected through documentation, first hand participant interviews, influenced by Goffman's (1959, 1961) dramaturgical theory. *Inovar-Auto* described earlier is the research's unit of analysis (Yin, 1988), due to the fact that its first configuration and then reconfiguration by the BFG is critical to the whole research and the tangible outcome of the negotiations occurred between BMW and BFG. One of the authors has participated directly on the mentioned negotiations and is here interviewed and quoted. Also, four in-depth key qualitative interviews were conducted (100 per cent response rate) through the usage of semi-structured questionnaires sent by e-mail. Three out of four respondents were invited by phone call and e-mail, and the other is one of the authors. Primary data were collected by email statements. All respondents answered one hundred percent out of three questions posed. Three out of four interviews were conducted in Portuguese and then translated into English and the last one conducted directly in English. All interviewees allowed to be quoted with no restrictions on disclosing information. Data gathered were transcribed and coded through descriptive and In Vivo coding, the latter selected in order to preserve the narrative's vividness and first hand observation, to 'honor the participant's voice' (Saldaña, 2013, p. 91). Primary data were then analyzed through text analysis and hermeneutics circle. Secondary data were gathered through literature review. Findings are discussed further. Once parts of data related to past events were collected through interviews, relying on memory could be deceitful (Myers, 2007). The interview is not a natural situation, according to Hermanns (2004) – it involves a parlance between two strangers. This study is limited to three phases already mentioned or turning points, based on direct observations, which could be interpreted differently by others. All negotiations, however culminated with *Inovar-Auto* BFG's policy, benefitted other automotive industries and therefore should be investigated in future researches.

March 2011: BMW and the Intention to Enter the Brazilian Automotive Market

The year of 2011 was President Dilma Rousseff's first. At the same time, she was showing her own personality and will to implement her style, with care not to confront with the charisma of former President Luiz Inácio Lula da Silva.

President Dilma indicated Ministers of her personal confidence to control key areas, such as Civil House, Industry & Commerce and Justice, and maintained some names from previous Government, such as the Finance Minister, Mr. Guido Mantega, to show stability.

Brazil's 2010 GDP (Gross Domestic Product) showed a record of 7.5% and investments were growing⁶, but due to a concern on inflation control, measures such as credit constrains and interest rate increases were being implemented.

There were also great concerns regarding the balance of trade, that generated a commitment from several areas within the BFG to promote innovation, exports and improve competitiveness of Brazilian products (e.g. avoid Chinese products "invasion").

Many foreign companies were approaching Brazil, especially considering market opportunities and upcoming events such as the 2014 Soccer World Cup and the 2016 Olympics in Rio de Janeiro State.

⁶ See: Instituto Brasileiro de Geografia e Estatística – IBGE. www.ibge.gov.br. Retrieved on May 2013.

Considering all the previous background, there was an optimism atmosphere, with the necessary care to maintain a desirable sustainable growth within BFG targets on inflation, currency and GDP.

In this context, fostered by the increasing local sales results, especially since 2008, a series of studies conducted internally at BMW headquarters in Munich indicated by the end of 2010 that the company should evaluate the inclusion of Brazil in the strategic investments to be made in manufacturing facilities on selected markets, as stated by Dr. Thomas Becker, BMW's Vice President of Government Affairs:

(...) BMW already in 2011 started to examine possible locations for a plant in Brazil, driven by the strong market potential Brazil is offering also for a *premium* manufacturer like BMW. Yet it was clear from the outset that the industrial structure of the Brazilian automotive sector has been shaped by large volume manufacturers and their specific approach to the market, namely offering derivatives of European or US-products modified for Brazil. As BMW in all markets worldwide offers the very same products at the same state of the art level of technology, here strategically has a different approach which puts higher demands on the supply sector as well as on employees.

These investments initially used the Semi Knocked Down (SKD⁷) approach, which consists in the importation of subassemblies, followed by final assembling and testing operations. After proving that the market was well responding, the manufacturing operation could be further developed, to a Complete Knocked Down (CKD⁸) level, where several parts are included in the process, until it reaches the so called "full factory" category, with painting cabins and other manufacturing operations. This same "step-by-step" strategy was successfully implemented by BMW in other emerging markets, such as India in 2007.

A local team was then assembled in early 2011 to conduct the analysis and to start the planning of the institutional approach to the Brazilian Federal Government and other selected key stakeholders.

Due to the highly strategic content of the project, the team was comprised by only a few members of the company in Brazil and at headquarters in Germany, including the President of BMW Brazil at the time, Mr. Henning Dornbusch, and the BMW Vice-President of Government Affairs, Dr. Thomas Becker. To complete the team, an external consultant with expertise in the areas of Government Relations and Market Access Strategies, Mr. Rodrigo Navarro, was hired and joined the task force that led the initiatives with the BFG.

After a series of meetings to discuss the main ideas, possible strategies and desired outcomes, a detailed stakeholder mapping and a concise explanatory material about the planning initiative were produced. On March 24th, 2011 the first announcement of the BMW intention to study the feasibility of a local plant was made officially to the BFG during a meeting in Brasilia at the Industry & Commerce Ministry (MDIC) for Minister Fernando Pimentel, which was selected by the BMW team as a political focal point on the BFG for the Project study.

The news were very well received by MDIC, and as BMW asked for a technical support for the Project study, the Minister indicated the Production Development Secretary (SDP), led by Secretary Heloisa Menezes, to interact with the BMW team. In particular, the MDIC/SDP Automotive Sector Director, Mr. Paulo Bedran, was selected as a technical focal point.

⁷ SKD is a full parts' kit exported from one country to another in order to parts be assembled on final destination. See: SKD (2013). Retrieved from <http://en.wikipedia.org/wiki/SKD>.

⁸ CKD is a full parts' kit exported from one country to another in order to parts be assembled on final destination. The difference between CKD and SKD is: while CKD is totally disassembled exported parts, the SKD comes assembled in small groups of parts. See: SKD (2013). Retrieved from <http://pt.wikipedia.org/wiki/CKD>.

The next meeting occurred in April 2011 with the President of the National Development Bank (BNDES), Mr. Luciano Coutinho, in Rio de Janeiro, with the objective of analyzing possible available BFG's project financing possibilities.

The institutional meetings also occurred in parallel at State Government levels, to probe possible candidates to receive the investments, trying to evaluate technical aspects like the quality and availability of infrastructure, manpower, fiscal incentives, among other factors. This way, a series of meetings were scheduled during the following months that included representatives from the States of Rio de Janeiro, Minas Gerais, São Paulo, Paraná, Rio Grande do Sul and Santa Catarina.

BMW knew that it should approach not only Government officials, but also needed to expand the stakeholders contacts to other active key players on the industry. Because of that, a meeting with the President of Sindipeças (Auto Parts National Manufacturers Association), Mr. Paulo Butori, was performed in São Paulo to present the company's intentions.

Meanwhile these series of institutional meetings were conducted, in August 2nd, 2011 the Provisional Measure (MP) 540/11 launched the "Greater Brazil Plan" ("*Plano Brasil Maior*"), an initiative called "the new Brazilian Industrial Policy", planned and justified by BFG as a response to the global economic crisis, currency fluctuation threats and to the necessity to foster and attract new direct investments in the country. It included the automotive sector as one of the targets, but no details were disclosed at this point. The BFG created an official website since then that contains updated information on all measures part of this initiative⁹.

This new policy was outlined by BFG as a new industrial, technological, service and foreign trade policy for Brazil. Its core was the "innovation to improve competitiveness and development", through a series of preferential policies to encourage and promote technological innovation and increased value-added products, while strengthening anti-dumping and other measures to protect the domestic industrial market and the Brazilian national industry development.

Among the announced measures, (i) the reduction of the 20% welfare tax to zero for sectors that are sensitive to the exchange rate and international competition and which are labor intensive: apparel, footwear, furniture and software; (ii) a series of actions for tax breaks on exports; (iii) the creation of the "Reintegra" Program (which pays back to manufactured goods exporters 3% of their export revenue as an Income Tax rebate); (iv) a Government Purchasing Law, containing up to 25% price preference for locally manufactured goods; and (v) the strengthening of commercial defenses.

Also, this new industrial policy made the National Economic and Social Development Bank (BNDES) responsible for financing innovation and investment. One of the main measures in this area was a R\$ 2 billion (aprox. US\$ 1 billion) credit line provided by Financing of Studies and Projects (FINEP), which comes under the Ministry of Science and Technology, to expand the bank's innovation portfolio.

Specifically for the automotive sector, at that time it was stated by the BFG only that "there would be fiscal incentives for the industry in place until 2016", reducing the excise tax (IPI) in a proportional way to the value add, with rules and definitions to be detailed.

According to Mrs. Heloisa Menezes, Production Development Secretary of MDIC, the issue was to

(...) harmonize the various interests and development stages of the actors involved in the automotive industry (automakers already installed in Brazil of all sizes, potential "newcomers" in different segments, importers,

⁹ For further reference, see: Brasil Maior (2013). Retrieved from <http://www.brasilmaior.mdic.gov.br>

suppliers, employees and the federal government) to get the results with gains for all, by leveraging the potential of our market and our production facilities in support of economic, social and technological development.

The BMW team – as well as other industry players – had to wait for the details (expected then to be announced shortly) on the specific measures for the sector in order to analyze the potential impacts on the ongoing market access study. So far, it was known that BFG was trying to provide higher competitiveness for local manufacturers *via-a-vis* importers (mainly from China and Korea), using fiscal incentives (like excise tax reductions) in a yet-to-be-defined increase on local value add and investments on innovations and Research and Development (R&D) requirements.

A great part of the Brazilian industrial community supported the announced measures, but some sectors were still waiting for more concrete actions to protect their internal market from imports, considered a strong menace at that moment by them.

After this announcement, technical meetings were also conducted by the BMW team, like the ones made with the Brazilian Douane's General Coordinator, Mr. Dario Brayner, the MDIC International Trade Negotiations (DEINT) Secretary, Mrs. Maruska Aguiar, and the aforementioned focal points at MDIC/SDP.

Some feedbacks received from these technical meetings, plus the fact that the BFG announced “specific measures for the automotive sector to be detailed” based on MP 540/11, and also strong market rumors that in fact Brazil was preparing some “market protective measures” against the high level of imports at the time, engaged the collective thinking of the BMW team that something could change the regulatory environment that may cause impacts on the study under development. The challenge then was to understand BFG’s interests and what should be the next step.

September 2011: A Restrictive Regulatory Framework Emerges and a Long Negotiation Process Starts

The answer to this question came on September 15th, 2011 with the publication by the BFG of the Decree 7567/11, regulated by MP (Provisory Measure) 540/11.

In summary, this new regulatory milestone increased in 30 percentage points the excise tax (IPI – *Imposto sobre Produtos Industrializados*) on all imported cars: from 13% to 37% for cars between 1000 and 2000 cc; and from 25% to 55% in the case of cars above 2000 cc. This way, some imported cars that was already paying a 35% duty rate started to pay not a 25% IPI anymore, but 55% instead.

The Decree, that entered in effect immediately being valid until December 2012, included an exception for this extra IPI taxation, i.e. bringing IPI to previous levels, but only for current manufacturers installed in the country that (i) showed at least 65% of local (and/or Mercosur) product content in 80% of its portfolio; (ii) proved Research and Development (R&D) investments of at least 0.5% of total company revenue; (iii) and performed a set of minimum pre-defined manufacturing operations (e.g. welding, plastic injection, assembling, painting) in at least 80% of its local production.

According to Coelho:

(...) the government ...implemented stricter measures to control content, inverting the formula for national participation, which privileged the imported parts for a minimum of 65% of local content that can boost a rapid revolution in the current model of productive activity from automakers, sensitive to developments in the industry and auto parts supplier. (Coelho, 2012, p. 64).

The companies would have to be certified to be included in the new regime by the BFG, and would be periodically audited. Initially, all manufacturers were automatically certified for the next 45 days; during this period, BFG would validate the ones that meet the above described requirements to further continue using the IPI reduction (if a company during this period was proved to have not met the requirements, it would have to pay the IPI difference).

In the case of imported cars, brought directly by an already certified company in Brazil or by its request, of the same brand, originated of countries that Brazil has international trade agreements (i.e. Mercosur members and Mexico), the IPI reduction would also apply.

In practical terms, it sounded as a showstopper not only for the BMW ongoing study, but for all importers that were operating in this sector in Brazil. In effect, Chinese and Korean automotive companies among others, had a strong negative reaction to the measure due to the tax increase *per se* – that would impact its sales, headcount, and dealers investments – and also to the manner that the BFG implemented it, i.e. in a considered sudden move, without exchanging relevant information with the importers, and seeming to surrender to a high pressure coming from the installed manufacturers, that were suffering a huge competition from high volume/low cost importers, mainly from Asia.

The problem increased due to the fact that the measure affected all imported cars in the same way, not only the already mentioned high volume/low cost models, but also the *premium* segment, with completely different characteristics, occupied by – besides BMW – Mercedes Benz, Audi, Jaguar, Land Rover, Porsche, Ferrari, among others.

Reactions against the measure started to appear. A strong antagonism grew between the importers association (ABEIVA – *Associação Brasileira das Empresas Importadoras de Veículos Automotores* – Automotive Vehicles Importers' Brazilian Association) and the manufacturers association (ANFAVEA – *Associação Nacional dos Fabricantes de Veículos Automotores* - Automotive Vehicles Manufacturers National Association). Manifestations against the measure also came from Uruguay President, Mr. José Mujica, since imports from the country (that had no specific agreement on the automotive sector like Argentina or Mexico) were subjected to the IPI increase. FECOMERCIO São Paulo (*Federação das Indústria de Comércio* - State of São Paulo Federation of Commerce) also showed publicly its disagreement with the measure through the press. Former São Paulo Governor and candidate that ran for Presidency on the last two elections, Mr. Jose Serra, published an article against the measure.

Another technical point was that the mentioned Decree was intended to enter in effect on the same day it was published on the Official Diary¹⁰. As known, in Brazil taxes like IPI cannot be increased without a minimum waiver period of 90 days. Proof of this was that the Justice of Espírito Santo State, right after after the publishing of the Decree, granted a legal injunction to the Chinese company Chery that postponed the IPI increase for 90 days.

BMW immediately sought a meeting with MDIC Minister Fernando Pimentel, which occurred on September 22nd in São Paulo, during an ABEIVA meeting, i.e. together with other importers. While this meeting was taking place, on this same day a legal injunction (ADI – *Ação Direta de Inconstitucionalidade* – *Inconstitutional Direct Action*) – number 4661/11 – was filed by a Government opposition political party (*Democratas* – Democrats) against Decree 7567/11, since it was considered unconstitutional due to the raising of excise tax without respecting a minimum 90-days period.

¹⁰ Brazilian Federal Government Report, published on daily basis with deliberations of the three Powers: Executive, Legislative and Judiciary.

Another meeting was set by BMW with MDIC Minister on October 13th, this time to discuss the impacts of the announced measures on the study in detail, and to seek for alternatives. The importance of another key player in the scenario arose – the Finance Ministry, led by Minister Guido Mantega.

As stated by Dr. Thomas Becker: (...) BMW had to face two big political challenges: first the Government responded to the massive pressure on the competitiveness of the established manufacturers by putting in place a modified tax regime for imported vehicle (increase in IPI); secondly, Brazil embarked on a pathway towards higher efficiency of vehicles in order to reduce fuel-consumption and CO₂-emissions. Both decisions were taken right in the middle of BMW's planning process and therefore required a full reassessment of the project: It was imperative for BMW to seek a new pathway for its presence in Brazil combining a setup of local production and supply that meets the expectation of the government, while being realistic in terms of the locally available level of technology competence and on the other hand ensuring that the future product portfolio would comply with the upcoming CO₂-regulation.

It was clear that MDIC recognized the new measures as strong ones, but also considered them necessary, in the context of the “Brazil Greater Plan” goals. Furthermore, it was also clear that this was a BFG decision made not only by MDIC and its technical staff, but also by the Finance Ministry with the support from President Dilma Rousseff, which – after several interactions with ANFAVEA – preferred a quick impact measure (raising IPI) rather than a more elaborated plan for the industry, as MDIC originally was defending.

As BMW Brazil President, Mr. Henning Dornbusch, noted at the time: (...) From all the parties involved, the Ministry of Finance was the most skeptical one...during the course of negotiations, it came to a point that no incentives were given to bridge the actual high excise tax structure for those which signed a letter of intention to invest in the country until the start of manufacturing.

However, this fact was minimized as BFG stated repeatedly whenever questioned on this point – even during international events by representatives of South Korea, Japan, Australia, USA and EU – that this measure was valid only until December 2012, and other actions regarding the sector would be taken until then. The problem was: what the importers could do in this 15-month period? Suffer with the immediate effect of the significant cost increase that would impact the final price of its products?

In reality, as pointed out by the external consultant, Mr. Rodrigo Navarro: (...) several factors impacted the process. Among the most relevant ones, the multiplicity of actors involved – both from the government representatives side (MDIC, Science & Technology Ministry, Finance Ministry, Civil House, Presidency, State Governors, Congress members) as well as from the private sector (ANFAVEA, ABEIVA, SINDIPEÇAS, media). This multiplicity of actors contributed to a constantly changing regulatory environment, with many opinions, ideas, intentions and interests. This also resulted in another important challenge during the process, which was to assure a “place on the negotiation table” for the BMW team.

On October 20th 2011, the Brazilian Supreme Court (STF – *Supremo Tribunal Federal*) decided on ADI 4661/11, declaring that the Decree 7567/11 was indeed violating Constitution and granted a 90-day period to raise the IPI (i.e. only after December 16th). On November 10th Decree 7604/11 was published, altering the date of effect as determined by STF, and thus giving a little relief for the importers.

A series of meetings in October and November took place between several companies (manufacturers and importers) and the MDIC/SDP technical team. These meetings were conducted separately, and this way BMW had the chance to continue its own constructive

approach, bringing proposals, discussing ideas, defending arguments, sharing international benchmarks and making strategic and technical comments, always in a transparent way, to the various BFG representatives, in a coherent way. The objective was to show in a collaborative manner that a common goal between the company and the BFG was being together pursued, focusing on the intentions, not positions, showed by the different parties involved.

On one side, BMW wanted to proceed and conclude favorably with the plan to invest and install in Brazil its first Latin American automotive factory; on the other side, BFG intended to favor the growing Brazilian market to those companies that were willing to invest in the country and “create roots”, not only to explore a business opportunity. It was clear that these objectives could only be achieved by a sound and stable regulatory framework. For sure, not a simple task, but a complex one.

As Mr. Henning Dornbusch noted: (...) There were several challenges throughout the whole process. The negotiation surpassed the expected timeframe due to several reasons. The change in legislation regarding the excise tax on imported vehicles, the announcement of a new Automotive Regime, uncertainties in the regime itself, legislation in regard to environmental hazards, between others. Nevertheless, the creation of a new Automotive Regime brought major challenges since the Government himself did not paint a clear picture of all the parameters of a brand new Regime. Although having automotive experts in the Ministries related to the New Regime, there was a lack of empirical experience. However, this missing experience also created a close relation to newcomers since best practices observed in other markets in regards to legislation were shared. At the end, we noticed that the Brazilian Government was in a learning curve that cost the investors precious time. Another point was the pressure from the already established manufacturers (some for more than 40 years) to establish new rules which should not jeopardized their achieved status and so called domination of the market. This created a political environment in which from one side the newcomers were ready to arrive aiming at a potential market for their products and at the other side the local manufacturers trying to protect their market share and past investments. In between, the government was trying to accommodate both interests.

Besides the continuity of extensive working meetings with BFG representatives from MDIC/SDP, Finance, and Science, Technology & Innovation (MCTI) Ministries, BMW also looked in parallel for support on additional potential allies, during discussions as the ones conducted with the Head of the European Union Commission in Brazil, Mrs. Ana Paula Zacarias, the German Ambassador in Brazil, Mr. Wilfried Grolig, the Economic Counselor of the British Embassy, Mr. Jonathan Dunn, and the Operations Director of the National Industry Confederation (CNI), Mr. Carlos Abijaodi.

Some key meetings on the subject were then conducted on December, 2011. They included the Finance Minister, Mr. Guido Mantega; the Finance Ministry Executive Secretary, Mr. Nelson Barbosa; the President of the Brazilian Industrial Development Agency (ABDI), Mr. Mauro Borges; the MDIC/SDP Automotive Sector Director, Mr. Paulo Bedran; and the Civil House Chief Minister, Mrs. Gleisi Hoffmann.

According to Mr. Nelson Barbosa, the biggest challenges in the whole process were (...) to establish control mechanisms so that the incentives results in the desired goals. The main objective is to increase the technological content in the country, and this requires clear goals and objectives, which can be reported by the companies and verified by the government. The goals should also be staggered so as to facilitate the transition to the new regime. As the situation of each player in the market is different, for example newcomers versus consolidated

manufacturers, the government had to prepare an intermediate proposal to enable the investments of all.

On these meeting opportunities, BMW sought the recognition by the BFG of a specific market niche, with special characteristics of low volume and high prices (known as *premium* segment), to be considered in future alterations of the current regime and/or on implementations of a new regime starting in 2013, since according to the actual framework it would be valid only until December 2012.

The company evaluated several options and was able to alter, if conditions were met, its original SKD plan for the factory and accelerate some implementation steps, increasing the number of models originally planned to be manufactured in the country, now on a “full factory” model plant, which would imply in a significant increase on the investments if compared to the original study.

Also, besides the above described effort to accelerate and increase the scope and size of the project, BMW were able to offer (i) clear project milestones (so the BFG could track the implementation real progress); (ii) a detailed project description (to maintain the transparency); and (iii) written commitments on all key points (to increase confidence).

The above set of arguments and ideas were very well received by BFG representatives (and later incorporated on the requests made to all players on the final version of the regime). The negotiation started to finally move in a favorable direction.

October 2012: *Inovar-Auto*, Final Negotiations and the Reaching of an Important Agreement

The year of 2012 started and the meetings toward a feasible and enhanced regulatory framework for the automotive sector continued: the MDIC Minister, MDIC/SDP technical team, MCTI Executive Secretary and SDP Secretary were all contacted during the period between January and March.

On April 3rd another Provisional Measure (MP) 563/12 was then published by the BFG containing general guidelines for a new Brazilian automotive regime (called *Inovar-Auto*), to be valid on the 2013-2017 period (the timeframe for the previous regime was maintained, i.e. until December, 2012).

The following day, Decree 7716/12 was published bringing details of the Brazilian new automotive regime, with specific topics for the inclusion of newcomers in the new regime and transition rules to attract investments for production of new models in Brazil, such as:

- New conditions to become eligible to the new regime

Vehicles energy efficiency and CO₂ emission reduction requirements

- Transition rules to attract new investments

During the construction of the factory, the IPI on imports will generate credits to be used after the start of production, with a limit of 50% of the production capacity forecasted on the approved project

Habilitation rules applied gradually, starting with 60% of the rules for the companies already installed, up to 3 years to reach general conditions of the regime

Import quota without additional 30 percentage points of IPI

- New benefits

Additional reduction up to 2 percentage points on IPI for companies that meet targets on R&D investment and Engineering

Regional content measurement using the acquisition of parts and strategic inputs, that also generate IPI credit to be used by the company, i.e. the higher the local purchases, the higher the benefit up to the limit of 30 percentage points of IPI

In order to discuss in detail the implications of the new regime, another set of “fine tuning” meetings were conducted by the BMW team between May and July, including the MDIC/SDP technical team, Finance Ministry representatives, and the MCTI Executive Secretary.

According to Mr. Nelson Barbosa,

(...) the BMW team had a crucial participation, due to the objectivity and seriousness of the proposal presented. The BMW case served as reference for the government to analyze the peculiarities and needs of new players in high income segments, with small production volume in relation to automakers already installed in Brazil. As this is a new segment in Brazil, the information from BMW helped the government to improve the design of the Inovar-Auto program.

Meanwhile, the formal process at Congress to approve the MP started. It had to be approved first at the House of Representatives, and then at Senate. After that, it would follow for the President sanction. On July 17th the House of Representatives discussed on plenary the approval of MP 563/12. A meeting to discuss this positive impact and the approval of the project by BMW headquarters (pending on all formal approvals) was settled with MDIC Minister on July 19th.

Almost one month later, on August 7th, MP 563/12 was approved at Senate, this way concluding successfully the process at Congress.

On September 18th Law 12715/12 (conversion of MP 563/12) was sanctioned and published on the Official Diary (DOU), which includes the new Brazilian automotive regime (articles 40 to 44).

On October 4th Decree 7819/12 was published, regulating in detail the Brazilian new automotive regime, bringing in particular more flexible rules for newcomers, and comparative advantages for the *premium* segment, defined by the BFG (on article 12, §5, III) as “companies established in the country, in accordance with the terms of the Decree, with an investment project for the installation of a single plant with a production capacity up to 35,000 units of vehicles, and with specific investments of at least R\$ 17,000.00 per produced vehicle”.

Not coincidentally, these parameters were set by BFG using as basis the BMW project, thus setting the rules for all newcomers on the segment.

Dr. Thomas Becker pointed out: (...) Clearly, the definite decisions on land purchase and all the ensuing administrative logistical and legal issues at provincial and local could only be taken, after the issuing of the Inovar-Auto scheme in 2012 had laid a sound foundation for a plant-setup in line with the federal legislation. Therefore the constructive dialogue with the Federal Government Ministries during 2011 and 2012,...and the strong supportive attitude towards BMW’s plans in Brazil at all levels were the crucial success factors for the decision taken in the end.

The official announcement of the installation of the first BMW automotive plant in Brazil took place at BMW’s with the presence of President Dilma Rousseff, MDIC Minister Fernando

Pimentel, and Finance Minister Guido Mantega, on an event scheduled for October 22nd, that received a great coverage by local press and general media.

The mission of that small – but brave – team was considered accomplished, with all involved parts having gains – BMW, the BFG and all players to come to the Brazilian *premium* segment.

And, this way, the BMW Project started in Brazil, once the regulatory environment was finally enhanced, according to Fig. 1, as follows. In the words of Mrs. Heloiza Menezes, (...) the BMW team was guided throughout the negotiation process with the government with professionalism, ethics and transparency. The team demonstrated to the government, in a reliable way, its possibilities and limits of compliance with the requirements that were being built by the government, being an important reference for adjustments in the regulatory framework that enabled the implementation of the project in Brazil for production of high-end vehicles. The team showed no impracticable claims, but realistic ones, being agile on the responses and on the compliance with the requirements of the project.



Figure 1. Official communication of the BMW plant to the BFG.

Notes: From left to right: Brazilian president, Mrs. Dilma Roussef, Santa Catarina State Governor, Mr. Raimundo Colombo, and Mr. Ian Robertson, Vice President and Member of the BMW Board of Management. Source: MDIC – Ministério do Desenvolvimento, Indústria e Comércio Exterior (2013). Retrieved from: <http://www2.planalto.gov.br/multimedia/galeria-de-fotos/ian-robertson-vice-presidente-e-membro-do-conselho-de-administracao-da-bmw-ag-vendas-e-marketing>, on Jun 11th.

Discussion

The present case study reflect one negotiation between BMW and BFG that culminated in a new automotive regime that can be generalized to any other company (external validation) in the

same situation as BMW and with same strategic objectives, meanwhile, the negotiation of Inovar-Auto is here considered the case's unit of analysis. In this sense, BMW's efforts helped to create a new framework that can be replicated and generalized, as a new approach to accommodate new business models regarding the Brazilian automotive market segment. Inovar-Auto is the correct operational measure for the concepts here analyzed (Yin, 1988). Future studies, however, could deepen multi-party negotiations and strategic alliances' among parties' synergy.

Some important observation derives from the analysis of the steps, processes and results described in this article that can be considered in similar situations, i.e. when dealing with a high complex - and sometimes volatile - regulatory environment, especially in developing countries. As a matter of fact, a final contribution to future negotiations regarding to success critical factors, cornerstones of the case reported here:

1. **Be resilient.** In cases like the one described in this article, odds are that the regulatory environment will change – maybe after the engagement with Government is made, during the development of the business case, or even when preparing for the first meeting. Anyway, the point here is to support the initial pressure and reactions, maintain calm and keep working without losing sight of the ultimate goals that have been set. A strategic thinking and planning process using different possible scenarios may help the involved team to be prepared for the almost certain changes that will happen.
2. **Keep transparency.** This is valid whenever approaching Government representatives in any hierarchy. The very common practice of constant information exchange between the several areas involved (e.g. in this case, MDIC, Finance, MCTI, Civil House, ABDI) can easily detect any kind of tentative of promoting specific points to different *liaisons*, and this can jeopardize the mutual confidence that is a key element during all negotiating process.
3. **Have a focal point.** As this case have shown, the selection of a focal point helps to maintain an updated and expedite flow of key information from one side of the table to the other. Moreover, this case also showed that is valid to have, in reality, two focal points: one in the political area (such as the MDIC Minister), as well as, at the same time – ideally appointed or supported by the first – another one on the technical area (such as SDP). If during the process you feel that other important stakeholders arose (like the Finance Minister), do not hesitate to contact them, but keep close the focal point(s) you started with.
4. **Focus on interests, not positions** (Fisher, Ury and Patton, 1981). This advice is particularly useful when dealing with multiple Government stakeholders as seen here with – at first sight – different positions. After separate interactions, once they are all under the same “roof”, and being considered as “the BFG”, the higher level interest has more chance to prevail over some particular – and understandable – positions of one particular area. For instance, the desire to protect investments made by companies present in the sector for decades (from Finance), the intent to foster new investments (from MDIC) and to promote innovation (from MCTI) were all combined and considered on the final outcome of the new automotive industry's regime (Inovar-Auto).
5. **Have strong, sustainable technical arguments.** This facilitated the negotiations during all the described case, as it promoted the exchange of helpful information between the involved parties and served as a guide to shape certain portions of the new optimized regulatory framework, such as the need to differentiate the *premium* automotive market from others in the same sector, due to its unique characteristics.

6. **Prepare properly.** This may include international benchmarks and illustrative related facts from the same (or similar) sector in other countries. The energy efficiency targets used in the EU automotive sector illustrate this, as they were considered as a reference during the discussion of this topic in Brazil. Even examples from other sectors that faced similar situations may help to illustrate potential solutions and generate creative alternatives.
7. **Have a partnership spirit, do not engage confrontation.** A constructive approach is valued by Government representatives in general. As Sun Tzu already advised in his classic Art of War, never battle uphill¹¹. The confrontation option taken by some importers after the rushed IPI increase measure initially made by the BFG, not only was widely related on the media creating institutional image friction, but also brought no advantageous position for them on the negotiation table during the whole development of the process. In sum, work on strategic alliances (Das & Bing-Sheng, 2000).
8. **Perform a comprehensive key stakeholder mapping.** Considering the multiplicity of areas and levels within the complex structure of the BFG, this was one of the first crucial steps, and can be considered as a critical one in any similar process. After electing the key “heads” and “arms” to work with, besides the “supporters” and “conflict makers”, a proactive engagement with them can produce good results, as shown in this case. Do not forget also other stakeholders that can help you in the constructive dialogue process, as in this case played an important role the German ambassador in Brazil and the EU Commission head in the country.
9. **Generate options and mutual gains approach.** As in every negotiation process, this case showed the importance of having alternatives to offer - and also to accept - during the conversations with Government. The different options would consider good or possible results, not only the ideal or utopic ones. As popular wisdom says, “optimum is the enemy of good”. Keep this in mind when considering several potential alternatives and implications (Fisher, Ury and Patton, 1981, Susskind, 1987, Lax and Sebenius, 1986 and 2006, Lax 1985, Mnookin, 1999).
10. **Intense communication.** Finally, be prepared to properly use intensive ways of communication such as white papers, official letters, e-mails, conference calls, executive summaries, video conferences and technical reports, seeking value co-creation with other involved parties to enhance their effects towards your objectives.

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