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DELL'S DILEMMA IN BRAZIL: NEGOTIATING AT THE STATE LEVEL

In mid-March 1999, Keith Maxwell, Senior Vice President for Worldwide Operations, Dell Computer Corporation, looked out the window of his office at Dell's headquarters in Round Rock, Texas, and pondered the frustrating situation he faced in Brazil, where Dell had decided to locate its first manufacturing plant in Latin America.

In early 1998, Maxwell led the site selection team that visited five different states in Brazil in order to decide where Dell should locate its manufacturing plant.¹ In June 1998, after the team confirmed its initial findings and concluded its negotiations, Maxwell made the final recommendation to Michael Dell: the plant should be built in Brazil's southernmost state, Rio Grande do Sul. By mid-March 1999, Dell had already signed agreements with the local state government on the terms of the investment, the process of hiring local personnel to manage the plant had begun, and construction on the plant itself was scheduled to start soon.

Suddenly, however, the political climate in Rio Grande do Sul changed. A new governor, Olivio Dutra of the Partido dos Trabalhadores (Workers' Party),² took office in Rio Grande do Sul on January 1, 1999 and appeared likely to rescind the entire agreement. This was a setback, and Maxwell had to decide on a course of action to recommend: (1) leave Brazil entirely; (2) move the plant to another state; or (3) try to renegotiate with Governor Dutra.

Dell and the Brazilian Computer Market

As Maxwell considered the options, he reflected on the events that had led to this situation. Dell had begun the process of selecting a site for its manufacturing plant in Brazil in 1998, after the company had experienced a long period of astonishing growth. Founded in 1984 by Michael Dell in his University of Texas dorm room, by 1999 Dell Computer Corporation had annual revenue of over \$23 billion and a market capitalization of \$98 billion. In just 15 years, the revenues Dell generated were the second largest in the world for personal computer manufacturers, just behind Compaq, and the company was still one of the fastest growing PC makers in the industry.

Most of Dell's success could be attributed to its revolutionary business approach, which had become known as the Direct Model. Following the Direct Model, Dell shipped its products to its

¹ The principal members of the initial team, in addition to Maxwell, included Daryl Robertson, Vice President, Dell Latin America; Tom Armstrong, Vice President, Tax and Administration; Kip Thompson, Vice President, Worldwide Facilities Management and Corporate Real Estate; and Charlene Coor, Director of International Tax.

² Brazil's Partido dos Trabalhadores (PT), the Workers' Party, is a leftist political party with a socialist ideology.

customers directly from the factory, without any intermediary retailers. Dell also set up its supply chain of parts and components using the latest just-in-time (JIT) methods, which allowed the company to maintain minimal inventory. These highly efficient practices enabled Dell not only to get its products to customers faster than its competitors could, but also to reduce its costs substantially. The resulting ability to pass on these savings directly to customers created a tremendous competitive edge that enabled the company to control 25% of the U.S. market for personal computers, and 11% of the market worldwide.³

In order to maintain its rapid growth, Dell adopted a strategy of emphasizing international expansion. From its headquarters in Round Rock, Texas, the company expanded its operations to the point that by the late 1990s, it had offices in 34 countries around the world, sales in over 170 countries and territories, and manufacturing facilities in five countries, including Ireland and China. Although the company outsourced some of its manufacturing to contract manufacturers in Mexico, it did not have any manufacturing facilities of its own in Latin America when, in early 1998, it began evaluating possible sites for the construction of its own manufacturing plant in Brazil.

Brazil was a logical place for a manufacturing plant. In the late 1990s, sales of personal computers were growing faster in Latin America than anywhere else in the world and Brazil, the largest Latin American country with a population of over 170 million, was a very attractive market for the company. Despite the maxi-devaluation of the Brazilian currency, the *real*, in January 1999, Dell had decided to continue with its plans to invest in Brazil as part of its long-term strategy. Dell executives realized that having a plant in Brazil would be essential if the company were to enter the Brazilian market successfully. Although in 1992 the Brazilian government had abandoned its market reserve policy of allowing only domestic manufacturers to make computers in the country, Brazil's protectionist barriers for imports were still high. Moreover, Brazil was a member of Mercado Común do Sul (Mercosul), the South American customs union that included Argentina, Uruguay, and Paraguay, with Chile and Bolivia as associate members. The benefit of Mercosul was that any company that produced at least 60% of a given product in any of the Mercosul countries would, with some exceptions, be able to export the product to any of the other Mercosul countries at zero tariffs. Clearly, Brazil's Mercosul membership was another plus for putting the plant in Brazil.

Once Dell had selected Brazil, however, the question remained as to exactly where the manufacturing plant would be located. Brazil had a federal system, with 26 separate states—each with its own governor and state legislature, as well as a federal district, and many of these states eagerly sought Dell's investment. Having chosen Brazil as the site for the new manufacturing plant in Latin America, Dell's executives would have still another decision to make.

Maxwell and the others on Dell's site selection team visited five different states in Brazil: São Paulo, Minas Gerais, Rio de Janeiro, Paraná, and Rio Grande do Sul. All of these states essentially met the requirements for levels of education and sufficient numbers of qualified personnel, adequate supply of electrical energy, and quality of telecommunications and transportation infrastructure. The main differences of interest to the Dell team were the special financial incentives each state offered, and the nature of the agency with which the company interacted when making the investment decision.

Competition Between the States

The Guerra Fiscal

In their exuberance during Brazil's transition to democracy, politicians elected to Brazil's Constituent Assembly approved a constitution in 1988 that gave states considerably more power than before. Among other things, states were authorized to collect state sales taxes, or Impostos sobre a Circulação de

³ "IDC Results Show Compaq Finished 1999 as Number One in Worldwide PC Market, but Dell Heads into Millennium Leading in the US," *PR Newswire*, January 24, 2000.

Mercadorias e Serviços (ICMS). Although the current average for these taxes was 12%, states had some leeway to reduce these taxes in order to attract investment.

In theory, individual states could not change their ICMS tax rates unless all states agreed to do so within the Conselho Nacional de Política Fazendária (CONFAZ), the representative body for the states on finance and taxation policy. Nevertheless, from the beginning, states made such changes without CONFAZ approval. Since the early 1990s, the competition between the states to lower their taxes and attract investment had become so fierce that journalists called it the “guerra fiscal,” or taxation war.

Taxation rates mattered to large transnational corporations trying to decide where to invest. Competition among these companies was fierce, and a difference in sales tax meant that companies could offer their products at reduced costs without passing on the tax burden to consumers. Such incentives also compensated for extra costs associated with investing outside of the more industrialized and heavily populated locations of Brazil, especially the state of São Paulo, which traditionally received, by far, the greatest proportion of Brazil’s foreign investment. Significantly, São Paulo itself did not offer this particular incentive—it did not need to do so.

But many in Brazil saw this policy as detrimental to the country’s overall interests. Critics of the *guerra fiscal* argued that transnational corporations (TNCs) could use it to play one state against another for their own benefit, without concern for the welfare of the country as a whole. Poor Brazilian states, these critics maintained, were in no position to be giving tax concessions to large, wealthy transnational corporations.⁴ Supporters of the policy, on the other hand, argued that without such incentives, the TNCs would not invest at all in states far from the more industrialized regions.⁵ And as one supporter of the policy put it, “12% [the full taxation rate] of nothing is still nothing.”⁶

The incentives Brazil’s states could offer to attract foreign investment went beyond reductions in the ICMS. State governments could (and did, in many cases) also offer to provide free land on which to build infrastructure (usually roads or port facilities), and to provide government loans on highly concessional terms, including lengthy grace periods and low interest rates. As with the ICMS tax reductions, these incentives also came under harsh attack from critics. This was the environment that Maxwell and the Dell team had entered when they began their site selection process in Brazil.

Financial Incentives and Contrasting Approaches to Investment Promotion

During the site selection process, one of the team’s chief concerns had been to investigate the prospects for obtaining financial incentives in each state. Upon actually visiting each state, however, the site selection team’s initial and most important contacts were with the agency responsible for investment promotion. The nature of the working relationships Maxwell and the rest of the team established with these agencies also turned out to play a major role in the decision-making process.

Each state in Brazil that the Dell executives visited had a unique approach to promoting foreign investment; and in every state, the investment promotion organization responsible for meeting with the Dell team had a slightly different organizational structure and style. With the sole exception of Pólo-RS, Agência de Desenvolvimento (Pólo), the independent, private, nonprofit investment promotion agency that collaborated with the state government of Rio Grande do Sul, all of the state agencies the Dell executives encountered were government agencies. This made a difference in how these agencies inter-

⁴ Talita Moreira, “Business Leaders Praise Responses to Incentives Dispute,” *Gazeta Mercantil Invest News*, <<http://lexis-nexis.com/universe>>, January 11, 2000; Denise Neumann et al., “Guerra Fiscal Abala Finanças dos Estados,” *Estado do São Paulo*, July 13, 1997, p. 31; and Maria Quadros, “Governors Fail to Find Consensus on Fiscal War,” *Gazeta Mercantil Invest News*, <<http://lexis-nexis.com/universe>>, January 28, 2000.

⁵ Ricardo Caldeira, “Os Incentivos Fiscal Gera Desenvolvimento,” *Gazeta Mercantil*, March 23, 1999, p. 2.

⁶ Interview with Ricardo Hinkelman, Former Technical Adviser, SEDAI, Porto Alegre, November 10, 1999.

acted with Dell. While other states such as Minas Gerais offered Dell similar financial incentives, only in Rio Grande do Sul did the Dell executives, working with Pólo as an intermediary, encounter an investment promotion agency that they felt had made a concerted effort to understand Dell's specific needs. In other states, in contrast, Dell executives perceived that the government officials they were dealing with either did not sufficiently understand Dell's unique requirements, or were not sufficiently committed to attracting high-technology investment.

São Paulo, for example, was a state that initially attracted Dell. It had a large pool of skilled labor and, because of its large, relatively prosperous population, it was the principal market for computers in Brazil. São Paulo's sheer market size was the main reason that in the final selection process, two possible sites in the state, one in the city of São Jose dos Campos and the other in Campinas, were ranked high on the list, although still below Rio Grande do Sul.⁷ But the Dell site selection team formed a negative impression of São Paulo when harried state government officials appeared to be somewhat indifferent to Dell's specific concerns.⁸ Moreover, the state, which already had significant investment, had a policy of not offering special financial incentives.⁹

In Rio de Janeiro, the team encountered a different situation. The head of the Companhia de Desenvolvimento Industrial do Estado do Rio de Janeiro (CODIN), Rio de Janeiro's investment promotion agency, was accustomed to long drawn-out negotiations with automobile firms that sometimes lasted for a year or more. Consequently, he made a very low initial offer for financial incentives to Dell, expecting the company to come back with a counter offer. He was stunned when the Dell executives, accustomed to making decisions on a much speedier basis, never returned.¹⁰

In Paraná, the state government was not able to offer Dell the same financial incentives that Rio Grande do Sul offered.¹¹ In addition to that, Maxwell and others on the Dell team also perceived that the state was giving the same sort of presentation to them that it gave to all companies, regardless of the specific sector the company represented.¹²

Other than São Paulo, which was ranked high principally because of the size of its market rather than its investment promotion efforts, only Minas Gerais came close to winning the competition with Rio Grande do Sul for Dell's investment. In Minas, the Dell executives met with state government officials from various agencies, as well as with *técnicos* from the Instituto de Desenvolvimento Industrial de Minas Gerais (INDI).

Created in 1968, INDI had a unique structure. It was financed partly by the Companhia Energética de Minas Gerais (CEMIG), the state energy company—a mixed enterprise, 70% state-owned, 30% private—and partly by the Banco de Desenvolvimento de Minas Gerais (BDMG), the state-owned Minas Gerais Development Bank. While INDI was a government institution, then, the partially private ownership of one of INDI's supporting institutions, CEMIG, gave INDI more flexibility in hiring personnel than it would have had if it were purely a state-owned institution.¹³ As a result, at least some of INDI's staff also received salaries that were considerably higher than those working in regular govern-

⁷ Interview with Keith Maxwell, Senior Vice President, Dell Computer Corporation, Round Rock, Texas, March 20, 2000.

⁸ *Ibid.*

⁹ Interview with Jorge Funaro, Chief of Staff, Secretariat of Science, Technology and Economic Development, São Paulo, November 15, 1999.

¹⁰ Interview with Enrique Weber, President of CODIN, Rio de Janeiro, March 13, 2000.

¹¹ Interviews with Fernando Sicuro, Technical Adviser of State Government of Paraná, and Clemente Simião, Coordinator, Secretariat of Industry, Commerce and Economic Development, State Government of Paraná, Curitiba, Parana, November 23, 1999.

¹² Maxwell, March 20, 2000.

¹³ In fact, strictly speaking INDI did not have its own staff because all of INDI's personnel worked either for CEMIG, BDMG, or were outsourced from other agencies, and were technically on loan from these other institutions, Khoury Rolim Dias 2001, 2002.

ment agencies.¹⁴ In this way, INDI was able to recruit highly qualified staff that specialized in at least six broadly diversified industrial sectors—mining and metallurgy; chemicals and nonchemical materials; industry and tourism; agroindustries; textiles, garments, leather, footwear, furniture, and publishing; and mechanics, electroelectronics and computers—who might otherwise have taken jobs in the private sector.¹⁵

It is a testament to INDI's effectiveness that members of Dell's site selection team made three separate visits to Minas Gerais to meet with state government officials. The final proposal that INDI prepared was only slightly less favorable than that of Rio Grande do Sul—the state that ultimately won Dell's investment. Minas Gerais was able to offer Dell a 70% reduction in the ICMS tax for 10 years; a loan for R\$20 million (20 million *reais*), with a four-year grace period and a four-year repayment period; and free land for the plant site.¹⁶ But in the end, Dell chose Rio Grande do Sul.

INDI was in some ways a victim of its own success. The agency's past achievements in attracting companies from the mining, steel, and automobile sectors had made such an impact on the state that when the Dell site selection team arrived, they had the impression that this was the primary focus of the government's activities. Historically, of course, Minas Gerais had always had a strong mining sector. (Minas Gerais itself means "General Mines" in Portuguese.) INDI's later success in attracting foreign investment from companies in the heavy capital equipment and automobile sectors further contributed to the state's industrial development. Observing the results of this prior industrialization, however, the Dell executives came away with the impression that Minas Gerais, especially in the vicinity of the Fiat plant and the greater metropolitan region of Belo Horizonte, was a heavy-industry, rust-belt region. This reinforced their sense that the government officials they were dealing with in Minas had grown accustomed to working with the large, capital-intensive, heavy-industry firms that were common in the mining and automobile industries, and would not fully be able to appreciate Dell's specific needs as a fast-paced, just-in-time-oriented, knowledge-intensive company.¹⁷ Fair impression or not, the INDI staff were unable to change this view during the Dell executives' time in Minas Gerais, and it had a strong influence on the company's decision not to invest there.

Rio Grande do Sul, the Ultimate Choice

Rio Grande do Sul had not even been on Dell's short list when representatives from Pólo and the state government visited the company in early 1998 and convinced Dell's senior executives that the state deserved a closer look. But by June 1998—less than six months after that initial visit—Maxwell and the team had made the recommendation that Dell should establish a plant in Rio Grande do Sul.

Certainly, Rio Grande do Sul had a lot to offer. It had a well-developed, modern infrastructure; and as the first state to privatize its telecommunications company, its telecommunications infrastructure was among the more efficient in the country. In fact, a quick analysis indicated that, even before factoring in any incentives the state government might offer, lower costs in Rio Grande do Sul for the plant's overall facilities would already compensate for the additional expense associated with shipping computers to customers elsewhere in Brazil.¹⁸ And although customers in São Paulo, for example, would have to wait a day longer to receive their computers from a plant in Rio Grande do Sul than they would if the plant were located in São Paulo itself, previous studies had indicated that this would not be a serious problem.¹⁹

¹⁴ Interview with Romulo Ronan Fontes, Manager of Technical and Economic Studies Department, INDI, Belo Horizonte, November 26, 1999.

¹⁵ INDI, <<http://www.indi.mg.gov> 2001>, January 23, 2002. Clearly, INDI, an older, larger, more established institution with a wider range of investment promotion activities, did not have what Pólo was able to develop in a very short time: a specific focus on attracting high-technology industries.

¹⁶ Governo de Minas Gerais, Dell Proposal, Belo Horizonte, 1998.

¹⁷ Maxwell, March 20, 2000.

¹⁸ All computers were to be shipped by truck. This service was to be outsourced to local shipping companies.

¹⁹ Telephone interview with Keith Maxwell, August 4, 2003.

Security was another factor. In terms of security from hijackings and robbery, the main road from Rio Grande do Sul to São Paulo, Dell's principal market, appeared to be considerably safer than many of the roads within the state of São Paulo itself. In addition, the Dell executives felt personally safe in and around the vicinity of Porto Alegre, Rio Grande do Sul's capital, where the plant would be located. Expatriate executives and suppliers from out of town might not know which areas to avoid in a large, unfamiliar city, but this was not really a serious problem in the greater metropolitan region of Porto Alegre, where the crime rate was relatively low.

Home to a number of well-regarded universities, Rio Grande do Sul had a well-educated population. It was one of the most prosperous of Brazil's states, with a standard of living that some rated as the highest in Brazil. In the end, too, the Rio Grande do Sul state government was able to offer very generous terms: a 75% reduction in the ICMS tax for 12 years, plus a R\$20 million loan (over USD \$16 million at the prevailing exchange rate), with a five-year grace period, to be paid back over a 10-year period.²⁰

While offering generous incentives, the state government made sure that Dell would be providing benefits to Rio Grande do Sul as well. In the contract that the government signed with the company, Dell promised to develop joint research and development projects with local universities, such as the Universidade Federal de Rio Grande do Sul (UFRGS) and the Pontifícia Universidade Católica (PUC).²¹ In addition to the company's R\$128 million investment in its plant (USD \$108.5 million), which alone would create beneficial linkage effects in the local economy in its construction and continued operation, Dell also promised to hire 260 direct employees in the first year and 700 employees within five years. If it did not, the contract would be nullified.²²

These potential benefits help to explain why so many states in Brazil considered Dell's investment to be such a prize, and why Rio Grande do Sul was willing to offer such attractive incentives. Nevertheless, without Pólo's intervention Dell would not even have considered the state. Because Pólo played such an instrumental role in this outcome, further background on the agency itself is in order.

The Creation of Pólo

Pólo originated in the early 1990s within the Federação das Associações do Rio Grande do Sul (FEDERASUL), which represented commercial enterprises in the state, and the Federação das Indústrias do Rio Grande do Sul (FIERGS), which represented industries. Leaders within these two organizations proposed creating an independent, private agency to promote foreign investment that would be more flexible and nimble than a government entity. Funding for the agency would come from the private sector, but Pólo would work in conjunction with the state government to promote economic development in Rio Grande do Sul by attracting direct foreign investment in the state. Representatives from FEDERASUL and FIERGS presented it to the two candidates for governor in the 1994 election: Olívio Dutra, a socialist from the Partido dos Trabalhadores (PT), and Antonio Britto, a pro-business moderate from the relatively centrist Partido do Movimento Democrático Brasileiro (PMDB). Although holding

²⁰ Guilherme Diefenthaler, "O Dedo da Dell," *Amanha*, November, 1999, p. 39.

²¹ Of course, in order to qualify for a tax incentive, the federal government gave to the computer industry known as the Processo Produtivo Básico (PPB), which included a reduction of up to 50% of corporate income tax, companies such as Dell had to invest 5% of their total revenue in Brazil on research and development (R&D) within the country. At the time, at least 2% of this had to be invested in universities or other government-approved institutions; the rest could be invested inside the company. (Renato Bastos, "Computer Hardware and Peripherals," US Department of Commerce Industry Sector Analysis for Brazil, São Paulo, Brazil, 1998, p. 15.) As a result of these provisions, Dell would have to spend some money in Brazil on R&D in any case. The federal law, however, did not specify where in Brazil this expenditure on R&D would have to be made.

²² "Alvorada Instala Pólo Tecnológico Com A Dell," *Jornal do Comércio*, August 21, 1998, p. 8; and Paulo Ricardo Fontoura, "Empresa Receberá Mais de 25 Anos de Incentivos Fiscais," *Gazeta Mercantil* August 26, 1998, p. 4.

widely divergent political views, both candidates endorsed the idea, and thus Pólo was formally created in December 1995.

Pólo's founders sought to maintain a connection with the government by allowing the governor a key role in selecting the agency's president. This was done to ensure that the governor would maintain a close working relationship with the agency.²³ Ideally, both the government and the agency would work in concert to attract foreign investment that would contribute to the development of the state. However, this rule was changed in 1999, and the Board of Directors became solely responsible for selecting Pólo's president.²⁴

The New High-Technology Emphasis

Antonio Britto, the pro-business moderate, won the 1994 gubernatorial campaign and took office in January 1995. Having campaigned on a promise to promote foreign investment in areas that would bring jobs and economic development to Rio Grande do Sul, Britto was, for the most part, able to follow through with his plans. Using tax and other incentives aggressively, he was able to land large investments.²⁵ In order to convince General Motors (GM) to establish a plant in the state, for example, Britto had offered substantial reductions in the ICMS state sales tax and generous loans at low interest rates, totalling hundreds of millions of dollars.²⁶

José Cesar Martins, who became president of Pólo midway through Britto's administration in 1997, collaborated closely with the state government in an aggressive effort to attract more foreign investment like the GM plant. The agency maintained close contacts with several of what it called its "virtual" representatives: expatriate business people from Rio Grande do Sul working in New York City and San Francisco, who helped the agency by keeping tabs on investment trends and providing advice about how to deal with foreign investors. Martins also made sure that Pólo's staff participated in frequent investment forums and road shows around the world, in order to make contacts with potential investors and persuade them of the merits of investing in Rio Grande do Sul.

On one of these visits, Martins and other representatives from Pólo accompanied Governor Britto himself, as well as Nelson Proença, head of the Secretaria do Desenvolvimento e dos Assuntos Internacionais (SEDAI)—the state agency charged with attracting foreign investment to Rio Grande do Sul—to New York City for a series of meetings with potential investors. Marcelo Cabral, U.S. Managing Director for Banco Fator (a Brazilian investment bank) in New York City and one of Pólo's virtual agents in the U.S., had a substantial role in arranging this event.

A former equity analyst for Morgan Stanley, Cabral had extensive experience dealing with U.S. institutional investors who invested in Latin America, such as Scudder and Alliance Capital, and knew something about what made them tick. As an informal (virtual) advisor to Pólo, he explained to Martins that such investors would want to hear only briefly from the Governor and from Proença before speaking directly with managers of local companies looking for investment capital. To Cabral's surprise, Martins, a businessman himself, understood immediately and followed his suggestion.²⁷

At the meeting, one of the investors that Cabral had invited argued that Rio Grande do Sul should seek to attract high-technology companies. Although Governor Britto was at first resistant to this idea, Nelson Proença, who had been an executive for IBM in Brazil for 10 years before working in the Britto

²³ Interview with Telmo Magadan, former President of Pólo, Porto Alegre, December 17, 1999.

²⁴ Pólo-RS, Agência de Desenvolvimento, <<http://www.polors.com.br>>, January 11, 2000.

²⁵ "Portas Abertas Para Novos Investimentos," *Zero Hora*, December 30, 1998, p. 11.

²⁶ Darcy Oliveira, "A Qualquer Custo," *Istoé*, April 14, 1997, pp. 34-6.

²⁷ Interviews with Marcelo Cabral, Former Managing Director of Banco Fator, Porto Alegre, December 17, 1999 and José Cesar Martins, former president of Pólo, Porto Alegre, November 11, 1999 and December 15, 1999.

government, was intrigued by this possibility. He reasoned that focusing on high-technology investment made a lot of sense given Rio Grande do Sul's unique characteristics: the large number of universities in the state already offering degrees in Computer Science and Electrical Engineering, and the overall high levels of education in the state's population as a whole.²⁸

José Cesar Martins also thought the idea was worth pursuing. After discussing it further with Proença, Martins asked Cabral to help Pólo find a consultant in the area of high technology. From his extensive contacts in the financial community, Cabral knew the person to call was Duane Kirkpatrick, head of international operations for Robertson Stephens in San Francisco, one of the leading investment banks in the world in financing for high-technology businesses. Kirkpatrick agreed to serve as an outside consultant to Pólo to assess Rio Grande do Sul's prospects for attracting investment from high-technology companies.

After an extended visit to Rio Grande do Sul, Kirkpatrick came to the conclusion that high-technology investment would provide the state with high-wage jobs, in addition to linkages to the local economy. He also provided a number of suggestions about how Pólo and the state government of Rio Grande do Sul could attract such firms. Impressed, Pólo—in collaboration with Nelson Proença and Governor Britto—decided to focus future investment promotion efforts in this area.²⁹

Rio Grande do Sul Makes the Short List: An Exchange of Visits

As part of the new strategy, in February 1998, José Cesar Martins and a number of representatives from Pólo flew to San Francisco to attend a symposium for high-technology industries sponsored by Robertson Stephens bank. By this time, Pólo, with the help of Kirkpatrick and its virtual agents at Banco Fator (Marcelo Cabral and Dennis Rodrigues), had already identified a list of high-technology companies that it would like to attract to Rio Grande do Sul. One of these was Dell Computer Corporation.

During the conference, Marcelo Cabral came upon an article in *América Económica* magazine about Dell's interest in building a manufacturing plant in Brazil, and he showed it to Martins. Demonstrating just how quick and flexible Pólo could be, Martins and his staff immediately left the conference, went back to their hotel and put in a call to Dell. When they got through to Tom Armstrong, Dell's Vice President of Tax and Administration, Armstrong told him that the company's preliminary site selection team, reporting to Keith Maxwell, had already been to Brazil three times and was closing its short list of potential sites in Brazil. "You are going to lose a big opportunity," Armstrong said. Martins protested, "But we are fast!" Martins told Armstrong that he, his staff, and Nelson Proença (who was in New York at the time) could be at Dell's headquarters the next day. They packed up, left the hotel, and were on a plane to Texas that night.

At Dell headquarters, the group was to be received by some of Dell's senior executives, including Daryl Robertson, Vice President of Dell Latin America, Tom Armstrong, and Keith Maxwell. But before the meeting at which Proença and Martins would make their pitch to Dell, they were given a tour of Dell's facilities and manufacturing plant in Round Rock. During this tour, something fortuitous happened. One of the workers in the plant, a skilled technician, happened to be Brazilian. The group stopped briefly to speak with him in Portuguese.

"I'll tell you how to win the hearts of Dell management," he told José Cesar Martins. "Tell them that Pólo is like the Irish Development Authority."³⁰ He explained that Dell's executives had had an excellent experience working with that organization. The Irish Development Authority (IDA) was Ireland's

²⁸ Interview with Nelson Proença, Congressman, Chamber of Deputies, National Congress of Brazil, Brasília, December 5, 1999.

²⁹ Interviews with José Cesar Martins, November 11, 1999 and December 15, 1999; and Nelson Proença, December 5, 1999.

³⁰ Martins, November 11, 1999, and December 15, 1999.

investment promotion agency. Dell executives had returned from a site selection trip to Ireland raving about how professional and helpful the IDA had been. Dell's experience with the IDA was an important factor in its decision to build a plant in Ireland.

Significantly, although Pólo had not consciously modelled itself after the IDA, it had many of the same characteristics. Pólo was entirely private, but worked in close collaboration with the government. It also had a targeted investment promotion strategy: it selected specific industries, and then focused on attracting investment from specific companies in those industries. Similarly, IDA's targeted investment promotion strategy allowed it to research an industry and specific companies thoroughly to anticipate any questions that site selection teams might have and address questions, concerns, or potential problems in advance, before the team even raised them. This is what made the organization so effective.

In its effort to focus on high-technology companies, Pólo clearly was pursuing a strategy similar to IDA's. In the meeting with Dell's senior management, then, José Cesar Martins did emphasize that Pólo was like the IDA. He noticed that this comment definitely caught their attention. The Dell executives listened attentively to presentations from Proença and Martins, and asked a number of penetrating questions about Rio Grande do Sul's level of education, rules regarding unions, and infrastructure. The Dell executives told the visitors that members of the site selection team had already visited São Paulo, Paraná, and Minas Gerais, but would like to return to Brazil to visit Rio Grande do Sul.

The site selection team came to Rio Grande do Sul sooner than expected, only about a week after that first meeting. Nevertheless, with only a short advance notice of the visit, Pólo called upon all its speed and agility. Notified over the weekend that the Dell executives were arriving Monday, Martins immediately called his staff and explained that they would have to make some urgent preparations for the meeting: charts would have to be prepared, statistics ready; in short, everything that would be relevant to Dell's concerns. Martins also called Proença, who convinced the governor to cancel meetings that Monday in order to give a presentation to the visiting Dell team. Thinking ahead, Martins made sure to hold the Monday meeting with Dell in a hotel, rather than in Pólo's offices, in order to avoid unwanted press attention at this delicate stage of the negotiations process.

It helped Pólo's case considerably that Martins was able to use his contacts in the business community to arrange private interviews for the Dell team with important business leaders in the state. These included high-level executives from three local companies: Gerdau, a steel conglomerate; Ipiranga, a gasoline distribution firm; and Rede Brasil Sul de Comunicações (RBS), a media company. Also present was one U.S. multinational, Coca-Cola, with which everyone on Dell's team would be familiar. A businessman himself, Martins was sensitive to the concerns of business executives. He knew that the Dell team would want to talk privately with local business executives in order to gain a perspective that was independent of Pólo and the state government officials.

The Pólo officials also made sure, on the first night the Dell executives were in town, to take them to visit a very popular local microbrewery called Dado Bier. They knew that the ambience of this popular local restaurant and bar would make a favorable impression on the Dell executives, and it did. To the visitors from Dell, the obviously well-educated, high-energy young clientele at Dado Bier seemed very similar to the kind of crowd that frequented such places in Austin, Texas.³¹ This seemed to be just another indication that Dell would be able to find the kinds of employees it needed in Rio Grande do Sul. In addition to executives, engineers, and technicians, Dell's new plant in Brazil (which would also become its headquarters there) would need a large staff of personable, articulate, and technically proficient employees to take orders and handle technical questions over the telephone.

All of Pólo's quick, highly focused preparations worked. After listening to the presentations, speaking privately with business executives already in the state, and touring greater Porto Alegre for possible manufacturing sites, the Dell team said that they were interested.³² They would send more teams later to

³¹ Telephone Interview with Keith Maxwell, August 4, 2003.

examine potential sites more carefully, to ask additional questions, and to negotiate financial incentives. The Dell executives made clear that they would continue to negotiate with other states, but that they had decided that Rio Grande do Sul was definitely one of the leading candidates. To that extent, then, Pólo had been successful. Rio Grande do Sul would now just have to win against the other competing states.

In the end, of course, this was what happened. Tom Armstrong and Charlene Coor, as well as others at Dell whose job it was to confirm the site selection team's initial findings, made more visits and continued negotiations. Ultimately, determined to win high-technology investment for the state, the Britto government offered Dell the best terms for its investment. Less than six months after beginning negotiations with Pólo and the state government, Maxwell recommended to Michael Dell that the company should build its manufacturing plant in Rio Grande do Sul.

The Change in Government

Michael Dell agreed with this recommendation, and the company's plans to build its plant finally appeared to be set. But then the time came for another round of gubernatorial elections in 1998. Unfortunately, Britto's challenger—Olivio Dutra, once again—did not approve of the deal that Britto had negotiated with Dell. A member of Brazil's socialist Partido dos Trabalhadores, the Workers' Party, Dutra was against the government's granting of benefits to foreign transnational corporations. One of the main charges he had raised against Britto in his last campaign for governor was that "excessive" concessions granted to foreign transnational corporations would have to stop.

Dutra had served as mayor of Porto Alegre, where both he and the PT had a reputation for honest and effective government. Moreover, the Workers' Party was popular in 1998 as Brazil's financial crisis deepened and the federal government attempted to solve it with higher interest rates and other austerity measures. Perhaps not too surprisingly, then, Dutra won the 1998 election.

Since during his campaign Dutra had talked so much about the excessive benefits given to TNCs, once he was in office he had to take action. During the first several weeks, he argued that the tax incentives granted to Dell, and also to Ford, which planned to build a multimillion dollar plant in the state and had been offered millions in incentives, would have to be renegotiated.³³

Ford's attempts to negotiate with Dutra were futile. The new governor held fast to his position regarding the incentives by suspending the payment of loans the Britto government had promised the company.³⁴ Realizing that other states would offer the same incentives, and with minimal capital sunk into the project, Ford investigated its opportunities elsewhere. The state government of Bahia was quick to offer incentives identical to those the Britto administration had offered. Additionally, by locating its plant in Bahia, Ford would receive special incentives from the federal government for automobile manufacturers investing in the poorer northeastern states of Brazil.³⁵

It helped Bahia's case considerably, of course, that the federal government was more than willing to intervene to make Bahia an attractive alternative to Rio Grande do Sul. Antonio Carlos Magalhães (ACM), President of the Brazilian Senate at the time, was an enormously influential politician from Bahia who was a key member of President Cardoso's governing coalition. It was ACM who pushed through the Congress a modification of the legislation on incentives for manufacturing automobiles in

³² Interviews with Miguelangelo Azário, Former Investment Analyst, Pólo, November 19, 1999, and November 1, 2001; Alex Martins, Former Director of Investments, Pólo, December 16, 1999, and Maxwell, March 20, 2000.

³³ Rosane de Oliveira, "A Opção e Seu Risco," *Zero Hora*, March 22, 1999, p. 10.

³⁴ Peter Fritsch, "Ford and GM Clash with Brazilian State—Dispute Over Incentives, Tax Breaks May Hurt Investment," *Wall Street Journal*, April 9, 1999, p. A11.

³⁵ Nelson Silveira, "Ford Promove Festa Política na Bahia," *Jornal do Brasil*, June 29, 1999, p. 16.

the northeast, so that Ford could still take advantage of it—even though the deadline for additional companies to do this had passed.³⁶ The federal government even approved additional incentives in order to make up for the extra costs Ford would face by putting its plant in Bahia rather than the more conveniently located Rio Grande do Sul. It was also significant that Brazil's national development bank, Banco Nacional de Desenvolvimento Econômico e Social (BNDES), provided a low interest loan of over US\$300 million to Ford, more than it had planned to give for Ford's investment in Rio Grande do Sul. Again, the justification was that the additional amount was needed to make up for the extra costs associated with locating the plant in Bahia.³⁷ Realizing that Ford was now likely to withdraw from its plan to invest in Rio Grande do Sul, Dutra tried to negotiate with the company. But he was too late. Ford had already made its decision, and soon signed a contract with the Bahian state government.

The loss of Ford's investment was politically disastrous for Dutra. Residents of the town where the plant was to have been located protested.³⁸ The press lambasted the governor. And, of course, the political opposition had a field day lamenting the jobs that had been lost.

Nevertheless, Dutra had made his views very clear. It was at this point, by mid-March 1999, that Maxwell realized something had to be done.

Dell's Options

Maxwell considered his options again:

1. *Dell could simply leave Brazil altogether.* After all, the country had just experienced a massive devaluation in January 1999. Dell had continued with its plans in the immediate aftermath of the devaluation, demonstrating its faith in Brazil's long-term prospects. But the country clearly had a significant degree of economic volatility, and even a fair amount of political volatility, or at least policy uncertainty, as Governor Dutra's recent actions indicated.
2. *Dell could stay in Brazil but go to another state, such as Ford had done in Bahia.* Certainly, the other states on the list that the site selection team had considered offered some interesting possibilities. Bahia would not be an option for Dell, but Minas Gerais might be. Minas met Dell's basic selection criteria and had offered an incentives package that was very similar to what Dell had received in Rio Grande do Sul.

Minas Gerais had other benefits also. It did not have the same level of partisan differences, at least with regard to attracting foreign direct investment, that Rio Grande do Sul seemed currently to be experiencing. INDI, the state government's investment promotion agency, had seemed interested in working with Dell and knowledgeable about Dell's needs, if not quite to the same extent that Pólo had been. Perhaps the impression that members of the site selection team had—that Minas Gerais was too oriented toward the mining and automobile industries—had been misleading. After all, that did not mean that the state could not also develop a niche in high-technology investment as well.

Dell had not yet begun construction on the plant in Rio Grande do Sul. As of yet, it really had no sunk costs that would make it difficult to leave the state and go elsewhere. Going to Minas was definitely still a possibility.

3. *Dell could stay put and try to negotiate with the new governor.* Fernando Loureiro was a talented Brazilian executive whom Dell had already hired to serve as its new Corporate Affairs Director in

³⁶ Denise Madueño, "Governo Muda Lei Para Beneficiar Ford," *Folha de São Paulo*, June 30, 1999, p. 1.

³⁷ Denise Chrispim Marin, "Receita e Ford Já Negociam Incentivos à Fábrica da BA," *Folha de São Paulo*, July 14, 1999, p. 1.

³⁸ "Guiaba, De Luto, Grita 'Fica, Fica'; Prefeito Chora," *Folha de São Paulo*, April 30, 1999, p. 5.

Brazil. He proposed that Dell could attempt to negotiate with the governor by showing how keeping Dell in the state could help him, or at least would not be inconsistent with his own goals and agenda.

Loureiro's idea was that Dell executives could reason with the new governor by pointing out the harmony between the governor's objectives and Dell's. After all, Loureiro's argument went, Dell was a very different company from Ford. Unlike an automobile company, Dell did not manufacture something that damaged the environment; it manufactured computers. Computers provided people with access to the Internet. The Internet provided even people in poor slum areas access to information. This had a democratizing effect on society. Giving people everywhere access to information in this way could potentially create the conditions for a more just and egalitarian social order. Thus, Dell's goal to provide people with computers was in harmony with the governor's goal of working to create a more just and egalitarian society!




This last option seemed somewhat dubious to Maxwell. But, it was true that the governor had suffered a major political blow when Ford left. It would be very bad for him indeed if another major U.S. company decided to move to another state.

With such logic, perhaps the governor could be persuaded to let Dell keep all of its incentives. Loureiro had suggested this might be possible, provided that Dell offered to donate some computers to poor areas as a gesture of goodwill.

Should Dell take a chance on this last option or follow one of the others? Maxwell realized that there were risks either way. But he would be the one making the final recommendation to Michael Dell, and the decision would have to be made quickly.

Appendix 1 Brazilian States



Appendix 2 Principal Site Options		Rio Grande do Sul	Minas Gerais	São Paulo
				
General				
Population		10.2 Million	17.8 Million	37 Million
Area		281,749 Sq. Km	586,528 Sq. Km	1,522,000 Sq. Km
Demographic density		36.1 inhabitants / Sq. Km	30.5 inhabitants / Sq. Km	149.2 inhabitants / Sq. Km
Capital (population)		Porto Alegre (1.3 M)	Belo Horizonte (2.2M)	São Paulo (10.4M)
Economic Active population		53.5%	49.7%	47.6%
Life expectancy		71.7 years	70.4 years	70 years
Population Annual Growth		1.2%	1.4%	1.8%
Population distribution		Urban: 81.6%; Rural: 18.4%	Urban: 82%; Rural: 18%	Urban: 93.4%; Rural: 6.6%
Economic Indicators				
Total GDP		US\$41.7 Billion	US\$51.9 Billion	US\$188.3 Billion
GDP per capita		US\$ 4130	US\$ 2928	US\$ 5148
Commercial Balance		+ US\$2.8 M	+ US\$3.8 M	+ US\$253 M
Principal Industries		Tobacco, Chemicals, Automobiles, Steel, Footwear, Foodstuffs	Metallurgy, General Engineering, Agribusiness, Minerals, Automobiles	Metallurgy, Automobiles, Foodstuffs, Engineering, Electronics
Infrastructure				
Homes with fixed telephone lines		67.9%	57.5%	77.9%
Paved roads		10,332 km	19,234 km	26,377 km
Incentives				
ICMS		75% reduction for 12 years	70% reduction for 10 years	N/A
Free land		no	Free land for plant site	N/A
Loan Agreements				
Amount		R\$ 20 Million	R\$ 20 Million	N/A
Grace period		5 year	4 year	N/A
Repayment period		10 year program	4 year program	N/A
Nature of Investment Agency				
		Pólo	INDI	Secretaria da Ciência e Tecnologia (SCT)
		Private, nonprofit agency	70% state-owned; 30% private	State institution
Source: Instituto Brasileiro de Geografia e Estatística (IBGE)				