



CEO agenda for Germany's economic cooperation with Latin America and the Caribbean

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Introduction

Today, Latin America and the Caribbean offer some of the biggest opportunities in the world for German companies. Markets throughout the region are eager for German products, services, investment, and know-how, but economic engagement and business partnerships remain far below their potential.

This has to change. Surprisingly, although Germany and its offers have a good reputation in the region, Germany's exports are developing only gradually while the U.S., China, and other countries are gaining momentum.¹ Many observers believe that German companies export relatively little because they have invested substantially in production facilities in the area to meet local demand. The reality, however, is that Germany makes only 2.6% of its foreign direct investments there, only a quarter of the OECD average.² Its engagement in Latin America and the Caribbean simply does not reflect how many German companies are well-suited to thrive there.

Companies and investors face significant long-term risks in the region, of course, including overall low growth rates driven by relatively slow advances in labor productivity and declines in fertility rates; the strong influence of government, which includes potential changes in political conditions and

challenging institutional and regulatory environments in several countries; and macroeconomic volatility, particularly driven by public debt and inflation.

Recent changes in the region, however, have significantly improved the environment for economic engagement. Political and economic stability are rising, labor costs remain low, the highly digital middle class is growing, and most governments are more supportive than ever, unlocking major opportunities across industries from mining to healthcare. Companies are more profitable in the area, for example, than in Asia,³ even though overall economic growth is slower.

German firms have natural advantages in the region, including cultural synergies, a strong expat community in several markets, and positive views of Germany and its industries and politics. To succeed in the long term in a marketplace with many other foreign competitors and strong local players, German firms will need to tailor their approaches to each market and provide products and services that meet local needs and preferences. Getting it right can yield many benefits: in addition to profits, for example, success in the region can provide a valuable hedge against economic risks in other emerging markets.



In this report, based on research by the Latin America Committee of German Business (Lateinamerika-Ausschuss der Deutschen Wirtschaft-LADW) and McKinsey & Company, we explain Germany's current economic engagement in the region, describe some of the biggest opportunities, and suggest three basic strategies and five success factors that can help German companies compete and win there for years to come.

1 Based on data from the United Nations Conference on Trade and Development and McKinsey analysis

2 Based on OECD figures and McKinsey analysis

3 Based on data from an analysis of firms with revenue over \$100 million per year, World Bank development indicators, the McKinsey Corporate Performance Analytics, and the McKinsey Global Institute



German economic engagement does not reflect opportunities in Latin America and the Caribbean

German companies are missing major opportunities in the region today

Germany trails many other countries in its exports to the region, as shown in Exhibit 1. Growth in exports has been slow, especially compared to the U.S., China, and other countries and considering Latin Americans' high regard for German products. The U.S. dominates in regional exports, mainly profiting from its vicinity. Mexico alone accounts for 62% of U.S. exports. What's more surprising is the depth and breadth of China's exports to the area – nearly half a world away.

China is now the most important trading partner for four of the six largest Latin American economies, and second only to the U.S. in overall exports to the region. China's most important markets there are Mexico, Brazil, Chile, and Argentina.

In all, those four countries imported more than \$700 billion in goods and services in 2017 and exported \$754 billion, mostly to and from the U.S. (all financial figures in U.S. dollars). Besides Mexico, Germany's export volume was in the single digits.⁴

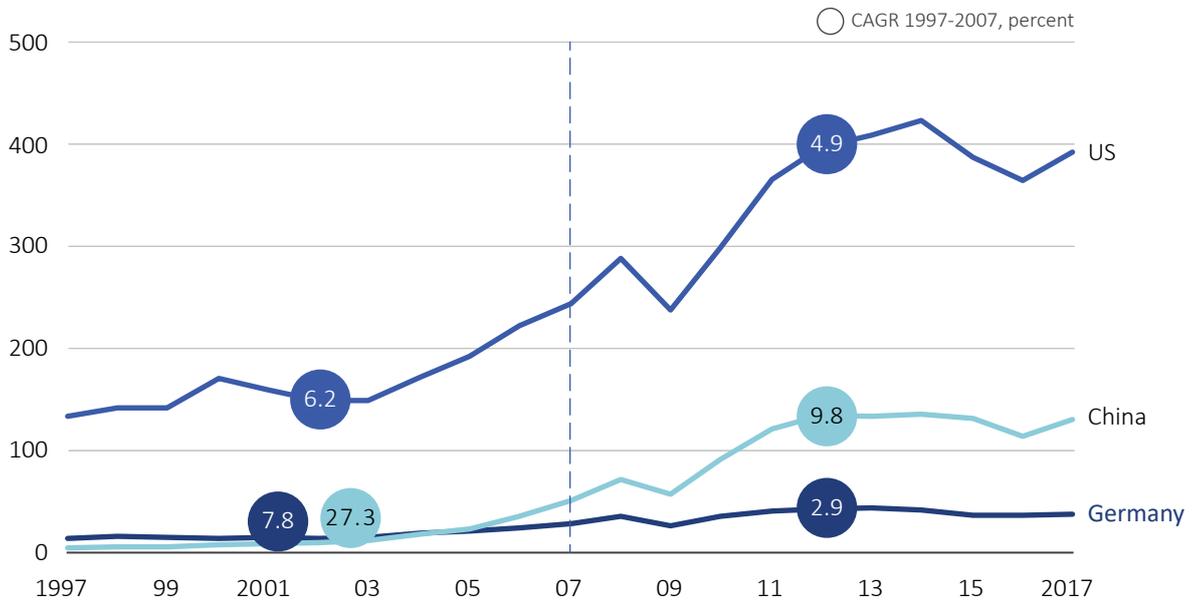
China is now the most important trading partner for four of the six largest Latin American economies.

In 2017, China extended its global “Belt and Road” investment and trade project to Latin America to strengthen its long-term strategic cooperation with the region. The initiative is gaining momentum. More than a dozen countries in the region, including Bolivia, Chile, Uruguay, and Venezuela, have joined the project so far, and China's progress is very tangible: Latin America is now the fourth-largest international market for Chinese construction companies.⁵

EXHIBIT 1: GERMAN EXPORTS TO THE REGION ARE LAGGING

Exports from the U.S., China, and Germany to the region, 1997-2017

USD billions



Source: UNCTAD; McKinsey

From 2007 to 2017, China’s loans in the region grew by about 6% per year, totaling approximately \$150 billion now,⁶ mainly for sorely needed infrastructure and energy development. In the same decade, Chinese greenfield investments grew to around \$73 billion, and China has increased its exports by an average of 9.8% annually, reaching \$130 billion in 2017.⁷

With its persistent and strategic “commercial diplomacy,” China is forging new relationships and gaining access to strategic maritime corridors, critical commodities, and new markets – especially for its technologically advanced products. As shown in Exhibit 2, it is shifting its investments in the region from metals and mining as well as traditional energy towards alternative energy, technology, finance, and transport.⁸

In all of these industries, Germany has first-rate products, services, and know-how, but its exports to the area declined by about 3% per year between 2012 and 2017, mainly because of a roughly 4.4% annual drop in exports to Brazil.

4 Based on data from UN Comtrade and McKinsey analysis

5 Based on data from Bloomberg, press search, fDi Markets, World Investment Report 2018, The Dialogue, World Bank, FAO, IPAT 3.0, CEPAL, and McKinsey analyses

6 Based on data from The Dialogue

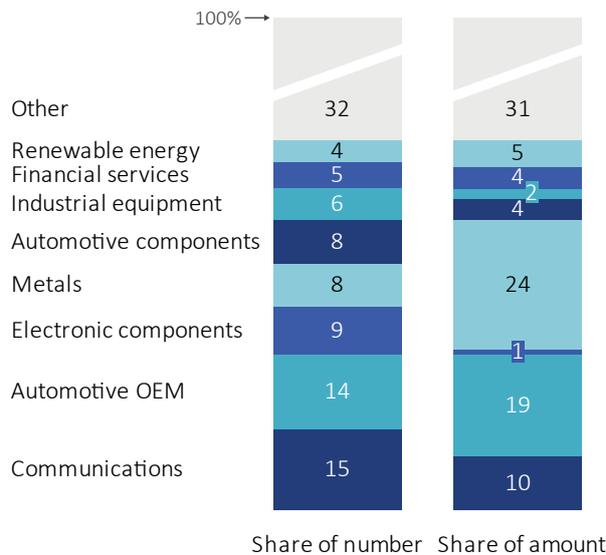
7 Based on data from the United Nations Conference on Trade and Development, fDi Markets, World Investment Report 2018, and McKinsey analysis

8 Based on data from fDi Markets, World Investment Report 2018, press search, and McKinsey analysis

EXHIBIT 2: CHINESE GREENFIELD INVESTMENTS TARGET TECHNOLOGICALLY ADVANCED INDUSTRIES

Chinese investments, 2012-17

Percent (deviation from 100% due to rounding)



Source: fDi Markets; World Investment Report 2018; press search; McKinsey analysis

On the positive side of the ledger, the value of German exports to Mexico rose by about 2% annually over the same period, driven largely by German companies' relocating to Mexico to service the U.S. market, which also increased demand for imports of German machinery and components, including spare parts.⁹

Some observers assume that German companies export little to the region because they have built a large local production footprint over decades. German direct investment in Latin America and the Caribbean is far below average among developed countries, however, as shown in Exhibit 3. Spain leads the field, given its linguistic and cultural connections to the region, but even the Netherlands, Italy, and the U.K. far outpace Germany in their distribution of investments.

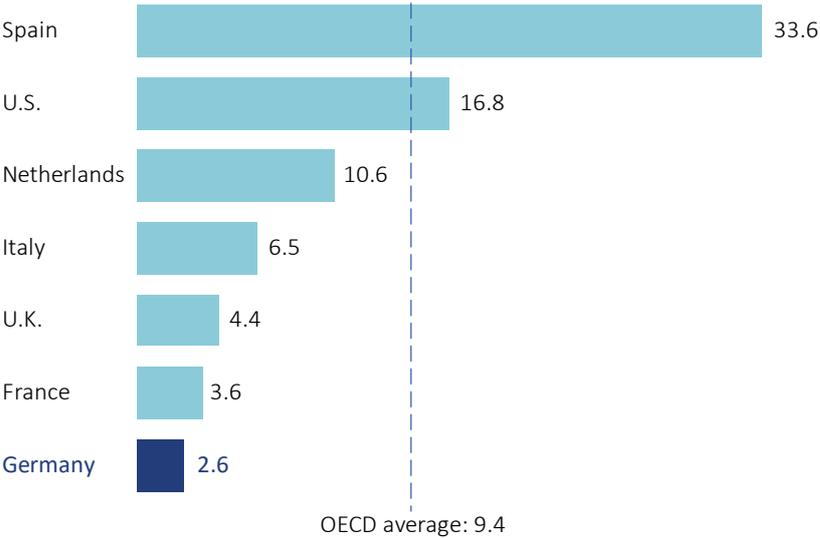
The longer Germany waits to seek new opportunities in Latin America and the Caribbean, the steeper its climb will be.

⁹ Based on data from the United Nations Conference on Trade and Development and McKinsey analysis

EXHIBIT 3: THE SHARE OF GERMAN DIRECT INVESTMENT IN THE REGION IS FAR BELOW THE OECD AVERAGE

Share of worldwide FDI stock in Latin America and the Caribbean by origin, 2017

Percent



Source: OECD; McKinsey analysis

Overall, Germany lags behind many other countries in terms of exports to and investments in Latin America and the Caribbean. The longer Germany waits to seek new opportunities there, the steeper its climb will be.

The region’s economic potential is substantial and slightly rising again

Economic and social stability are on the rise across the area, presenting German enterprises with many promising new opportunities. Although some analysts have recently lowered their growth expectations for Brazil, most expect the region’s overall output to grow faster after a brief slowdown, as shown in Exhibit 4, helping millions of people join the middle classes and raising private consumption.¹⁰

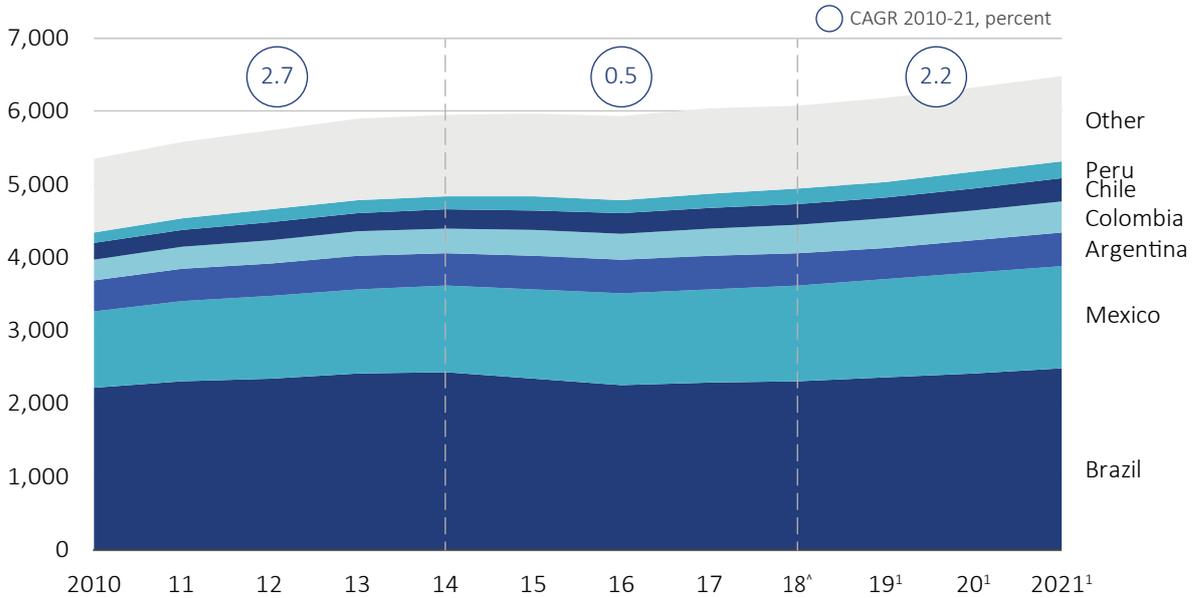


10 Based on World Bank figures and McKinsey analysis

EXHIBIT 4: AFTER A BRIEF SLOWDOWN, GDP GROWTH IS PICKING UP SLIGHTLY

Real GDP in Latin America and the Caribbean (2010 price levels), 2010-17

USD billions



1 Forecast based on World Bank data. For very small countries representing 4% of GDP in the region, future growth was assumed as average growth of last 5 years
Source: World Bank; McKinsey analysis

“Brazil’s economy is still relatively closed to foreign trade. Changing that is one of my administration’s major commitments.”

President Jair Messias Bolsonaro
January 22, 2019

After recent elections, many governments across the region are now working harder to stimulate the economy and introducing reforms to help businesses succeed. The new administration in Brazil, for example, has announced plans to privatize some state-owned companies, simplify the tax system, reduce bureaucracy, and raise the retirement age to save

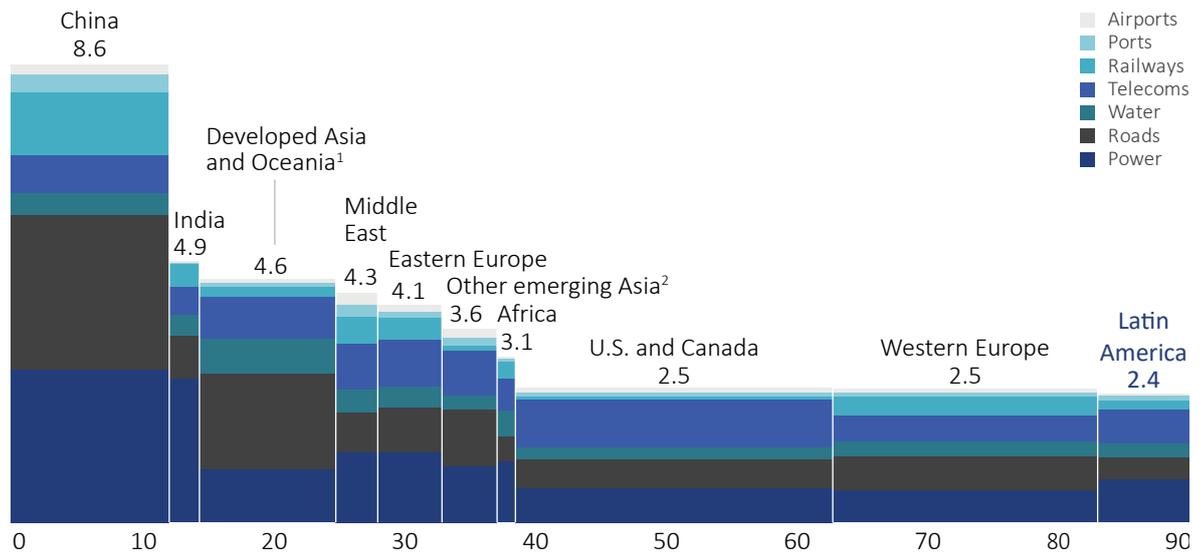
as much as \$350 billion in the next decade. Among many other countries, Brazil already has strategic initiatives in place to promote mobile broadband, cloud computing, and IoT and to help universities, government, and industry join forces to advance research in digitizing production processes and supporting Industry 4.0.

Many governments also acknowledge the strong need to increase investments in infrastructure. For decades, the region’s infrastructure investments have lagged behind those in China and other developing countries by wide margins, as shown in Exhibit 5.

EXHIBIT 5: LATIN AMERICA HAS HUGE INFRASTRUCTURE NEEDS

Infrastructure spending, 1992-2013

Annual average as percent of GDP



¹ Includes Australia, Hong Kong, Japan, New Zealand, and Singapore

² Includes Bangladesh, Indonesia, Malaysia, Pakistan, Philippines, Sri Lanka, Taiwan, Thailand, and Vietnam

³ Percent of world GDP generated by 75 countries in analysis for 2013

Source: IHS Global Insight; ITF; GWI; National Statistics; McKinsey Global Institute analysis

Companies in the region are highly profitable despite low economic growth

Overall growth rates in Latin America and the Caribbean are far behind those of other developing countries and will most likely remain below benchmarks, despite the recent political ambitions. McKinsey research proves, however, that achieving high profitability in the region does not require the high economic growth common in other developing countries. Compared to other emerging markets, markups in Latin America and the Caribbean have been strong and stable since 1980,¹¹ as shown in Exhibit 6.

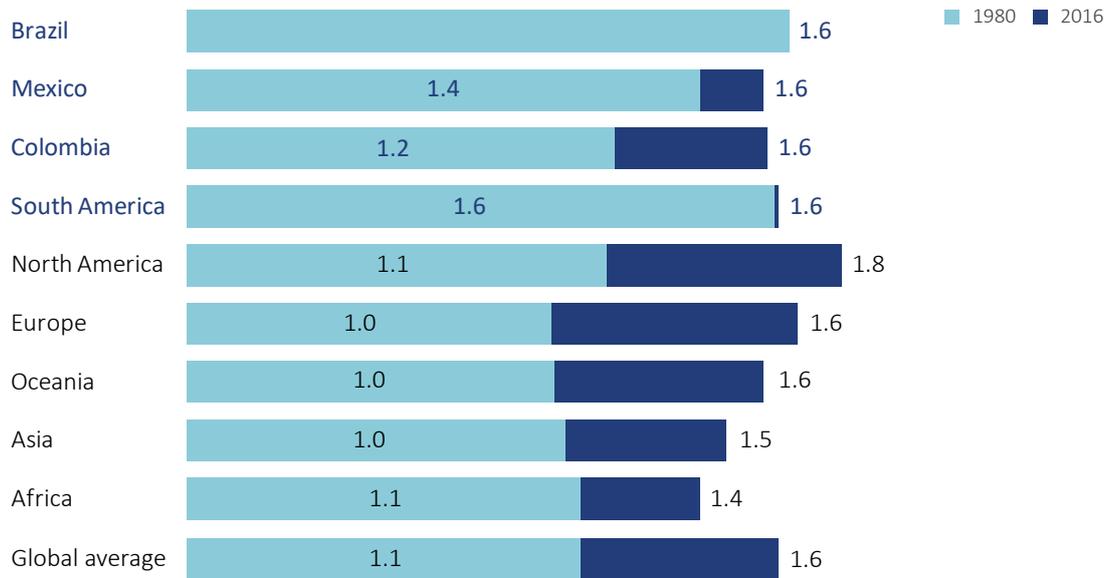


¹¹ Based on figures from Global Market Power (Eeckhout, De Loecker) and McKinsey Global Institute analysis

EXHIBIT 6: THE REGION HAS LONG BEEN KNOWN FOR STABLE, HEALTHY MARGINS

Markup¹

Ratio, 1980



¹ Sales minus costs of goods sold for 70,000 companies

Source: IHS Global Insight; ITF; GWI; National Statistics; McKinsey Global Institute analysis

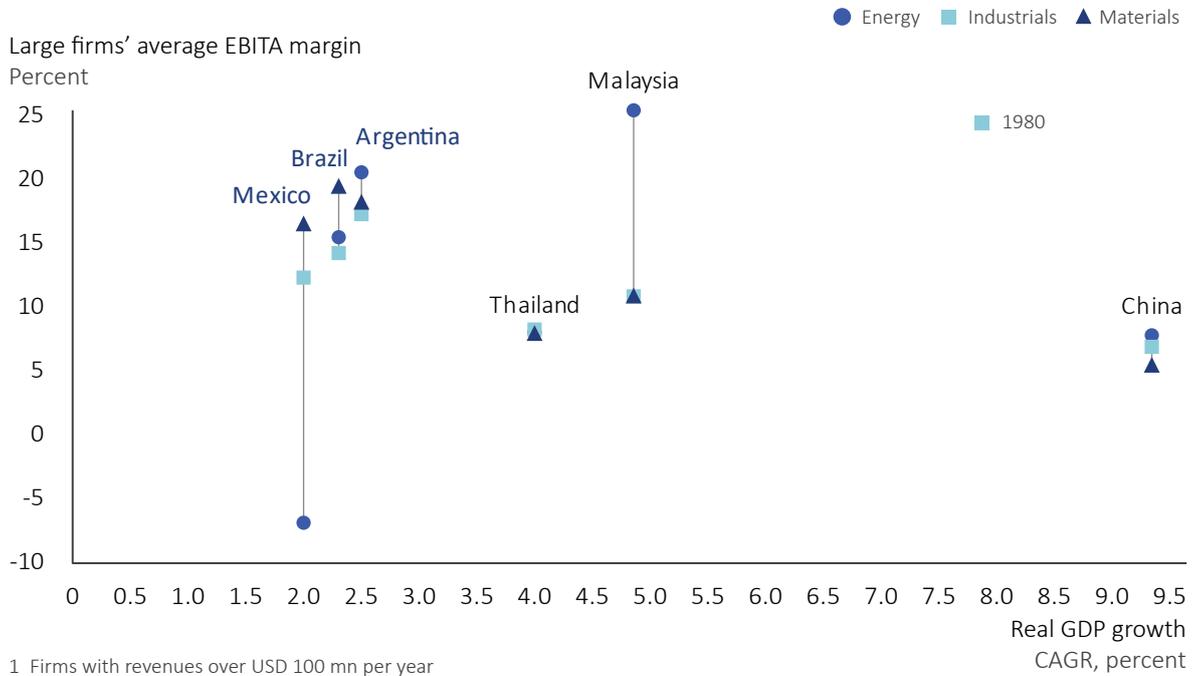
Companies across industries tend to be more profitable in the region than in other developing markets, including those in Asia. This is especially true for firms with at least \$100 million in annual revenue. For close to a decade, they have been more profitable in the area, on average, than in Asian markets, even though economies have grown more slowly than those in Asia, as shown in Exhibit 7.¹²

There is also plenty of evidence that German companies can build a major presence and succeed in the region – and that it is still possible to enter and win in those emerging markets. Many of the large German companies that built local production facilities in the 1950s or 1960s continue to invest billions today, proving the importance and viability of the area.

¹² Based on data from McKinsey's Corporate Performance Analytics database, World Bank development indicators, and McKinsey Global Institute analysis; firms are included only if their financial data is available

EXHIBIT 7: MANY LARGE COMPANIES MAKE MORE PROFIT IN LATIN AMERICA THAN IN ASIA

Latin America and outperforming benchmarks by sector, 2000-17



1 Firms with revenues over USD 100 mn per year
Source: McKinsey Corporate Performance Analytics database; WB WDI; McKinsey Global Institute analysis





Obstacles could emerge to hamper business success

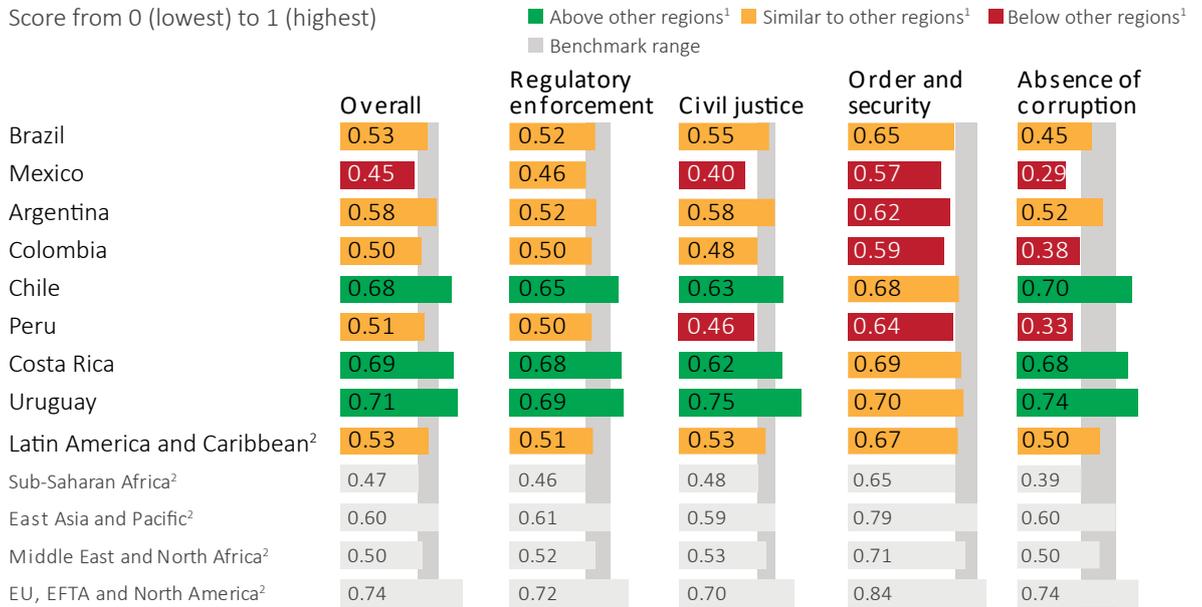
These and other successful German firms have learned to navigate cultural and economic environments across the region. They understand that obstacles emerge there from time to time, especially regarding the three main risks noted in the introduction: the strong influence of government, macroeconomic volatility associated with the threat of crises, and overall low economic growth.

Challenging institutional and regulatory environments reduce investment security in many countries. For example, in its 2019 report, the World Justice Project Rule of Law Index revealed a mixed picture, ranking some countries in the region low in important categories, such as civil justice, order, security, and the absence of corruption, as shown in Exhibit 8.

EXHIBIT 8: ONLY SOME COUNTRIES IN THE REGION RANK HIGHLY IN THE RULE OF LAW

Selected dimensions of Rule of Law Index, 2019

Score from 0 (lowest) to 1 (highest)



1 All regions except EU, EFTA and North America

2 Unweighted average of all countries in region, according to World Justice Project classification

Source: The World Justice Project Rule of Law Index 2019; McKinsey

That said, many of the countries offer relatively good regulations to protect foreign direct investments. For example, Germany has bilateral investment treaties with most of the large countries in the region except Brazil and Colombia. And with the exception of Brazil, the largest economies are members of the International Center for Settlement of Investment Disputes, and all the large economies are members of the Multilateral Investment Guarantee Agency. Investment regulation is getting stronger in some countries, although others frequently shift their tax regimes.

Economic and business challenges can arise in any developing country, of course, and even the most developed nations are not immune to deep and sudden economic downturns. Compared to many other emerging countries, the economic development in Latin America and the Caribbean has been volatile, and as noted, overall growth is relatively low.

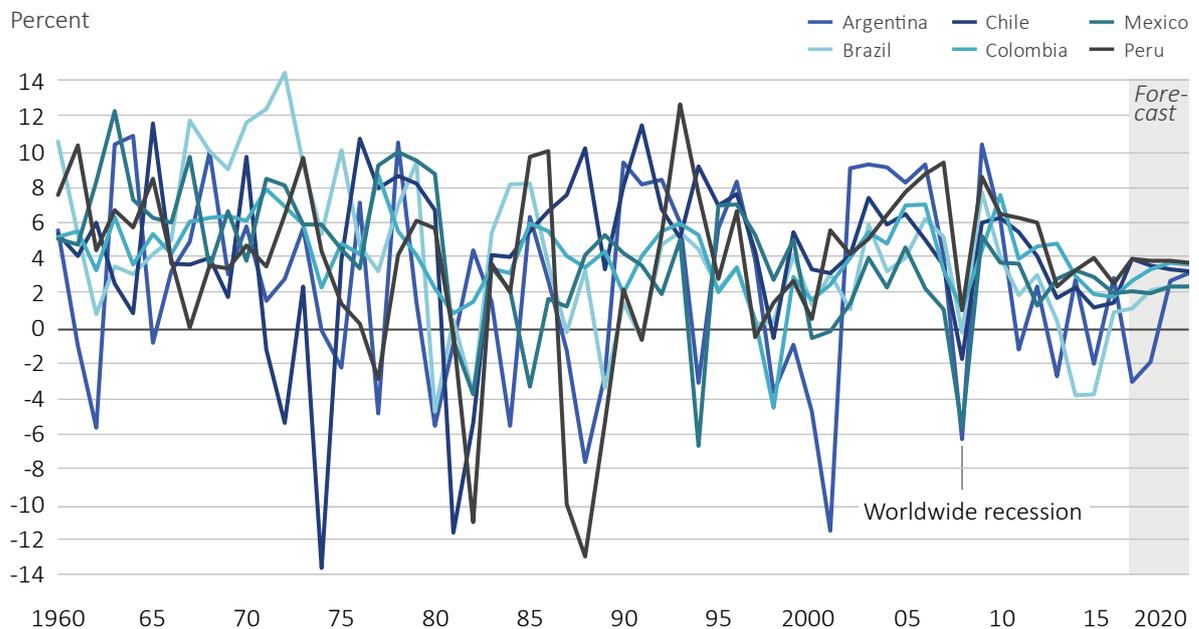
As shown in Exhibit 9, economic cycles tend to vary widely among countries in the region – and overall variations have declined in recent years. The economic cycles are strongly driven by political influences. Brazil, Mexico, and some other countries have shifted back and forth between demand- and supply-driven approaches since 1990, without establishing a stable virtuous cycle of improved productivity and the

expansion of middle-class income and consumption. Only a few countries, such as Chile, Colombia, and Peru, have had more stable macroeconomic and political conditions and steady growth.

The good news for investors is that each national economy in the region is independent. Even strong economic fluctuations have tended to counterbalance each other over time, giving companies that operate in several countries relatively steady growth opportunities overall, year after year.

EXHIBIT 9: ECONOMIC CYCLES VARY ACROSS COUNTRIES IN THE REGION

Annual change of real GDP in selected countries (2010 USD price levels), 1960-2020



Source: World Bank; McKinsey analysis

Productivity has contributed only 22% of GDP growth in Latin America since 2000, compared to 86% in Asia.¹³ Declining birth rates in the region will make productivity growth increases even more imperative in the decades ahead. By 2050, the average woman is expected to have 1.77 children, down from 2.64 in 2000.¹⁴

To avoid a roughly 40% decline in GDP growth over the next 15 years due to a shrinking labor force, the region will need to sharply improve labor productivity. Many governments are becoming increasingly aware of this issue. German companies, perhaps more than any other firms in the world, are in a good position to help the area tackle this huge challenge by providing technology and know-how to increase efficiency.

Supranational organizations such as the United Nations Economic Commission for Latin America and the Caribbean urge high-quality foreign direct investment that has positive effects on the economy and is sustainable over the long term to overcome challenges in the region – especially to increase productivity and reduce poverty. The European Union is considered the key source of quality foreign direct investment in the area.

To avoid a roughly 40% decline in GDP growth over the next 15 years, the region will need to sharply improve labor productivity. German companies are in a good position to help.

13 Based on data from the Conference Board Total Economy Database 2017 and McKinsey Global Institute analysis

14 Based on figures from the World Bank, UN World Population Prospects, and McKinsey Global Institute analysis



German companies have many opportunities in the region

German companies are well-suited to succeed across sectors

Many German firms are in a good position to succeed in the region. Their strengths are a good fit for local needs and offer competitive advantages. Many will benefit from a natural cultural affinity and positive perceptions of Germany and its companies, products, and politics.

The German government has embassies or consulates in 32 countries in the region – more than the U.K., Spain, the U.S., or China. As a central source of support for the German business community, the diplomatic corps allows close alignment and support of German business.

In addition, German Chambers of Commerce Abroad support German business by providing valuable information and services in all major countries on-site.

Our research shows that the region's opportunities in some sectors rank among the largest in the world, and that German companies are well-matched to tap the potential in major industries:¹⁵

Mining, oil and gas

The region is rich in natural resources, but the oil and gas sector is dominated by large and inefficient state-owned enterprises with low digitization. Mining represents substantial shares of the GDP in Argentina (3%), Chile (4%), and Colombia (9%) and has grown quickly in some countries in the last decade – by 5.4% in Peru, for example, and by 5.2% in Brazil.

German companies lead the world in exporting process technology, including for oil and gas operations, with a market share of 13.5% market in 2016 – ahead of the U.S. (13.2%) and China (12.8%).

¹⁵ Based on data from VDMA, MAKE, OECD, IHS Markit, Federal Statistical Office Germany, IFR World Robotics, SPECTARIS, Phillips McDougall, and McKinsey

Germany is also a major provider of high-tech pumps, valves, compressors, turbines, and instrumentation for mining, oil and gas, and refining. It exported \$4.7 billion worth of industrial valves in 2018, for example, and specialized players lead the industry in innovative products.

Utilities and renewable energy

Latin America's renewable energy share, at 27%, is already 50% higher than the global average of 18%, and many countries in the region aim to speed the transition to renewables. In the last five years alone renewable energy investments topped \$50 billion in major markets such as Brazil, Chile, and Mexico.

With the third-largest installed base of wind capacity, Germany has exceptional domain knowledge in installation, operation, maintenance, and grid infrastructure. Four German OEMs are among the top ten wind turbine manufacturers in the world, representing a third of the market in 2017 with installations and facilities.

Transport

The sector has been growing at more than 4% in all major markets except Brazil since 2000, and experts expect annual growth of 3% for the next 15 years, especially as infrastructure megaprojects unfold. Transport has one of the biggest digitization gaps across all regional sectors.

The two largest German players, Daimler and TRATON, cover 16% of the global market in truck and bus manufacturing and already have strong production footprints in Latin America. In addition, German firms are leading experts in digitizing rail systems, with national investments of about \$1.6 billion per year until 2040.

Manufacturing

The sector contributes a major share of value added in many countries – 19% in Argentina and Brazil and 14-15% in Colombia and Peru. Industry observers expect growth to remain stable at 2 to

3% in major markets over the next 15 years. Rising labor costs across the region have spurred most big manufacturing players to adopt more automation and digital technologies.

Germany has much to offer in this realm. As a part of the nation's long-term Industry 4.0 strategy, more than 150 members are pursuing digitization and other productivity improvements.

Germany is a global leader in manufacturing industrial robots, for example KUKA, one of the top four robotics OEMs worldwide, is originally from there. Germany exported about 25,000 robots in 2017 and has the largest installed base in Europe with about 190,000, or 10% of the global installed base, and the fifth-largest base in the world. It has the highest density in manufacturing after South Korea and Singapore, with more than 32 robots per thousand employees.

The German machinery industry is huge and growing, with revenue of more than \$290 billion in 2017 and an average annual growth of 3.6% over the last 20 years. The German manufacturing industry alone spends about 1.7% of the overall German GDP on research and development compared to an OECD average of 1.1%. Altogether, Germany invests 3.0% of its GDP in research and development (OECD average of 2.4%).

Healthcare

Annual growth exceeded 4% from 2000 to 2017 in markets such as Argentina and Peru and should accelerate to 4% in Chile and Colombia over the next 15 years. Major markets across the region are implementing nationwide digital medical records, providing opportunities for digital healthcare leaders.

Germany is a global leader in medical technology. The national industry generated gross revenue of more than \$33 billion in 2017, 65% of which was earned outside Germany. The country is home to Fresenius Medical Care and Siemens Healthineers, two of the world's top ten medical device companies.

Agriculture

The agriculture sector is vital in most countries in the region and enjoys robust annual growth – 3.9% in Peru, 2.6% in Colombia, 2.5% in Brazil, and 2.2% in Argentina over the last seven years. Automation rates vary widely; some agricultural companies have adopted highly advanced technologies, such as large drone fleets in Brazil and Argentina, while small farmers tend to rely on manual labor, especially in Mexico and Peru.

Global leaders from Germany, including Bayer and BASF, drive a wide range of agricultural innovations and already serve 25 to 30% of the Latin American market in crop protection and seeds.



German firms can pursue three main strategies to tap regional opportunities

Based on the strengths of German companies, their success in the area so far, and experience in other developing markets around the world, three main strategies appear to be promising for those seeking to enter and thrive in Latin American and Caribbean markets.

1. B2C strategy

Benefit from increasing purchasing power in the region and trends in certain areas, such as aging populations and online buying behavior

In the decade ahead, the consuming middle classes – those with incomes of \$20,000 to \$70,000 – is expected to grow by more than 12%, from 64 to 72 million citizens. Indeed, Latin Americans, including the growing ranks of “global” consumers with more than \$70,000 annual income, are one of nine groups set to generate about 75% of global consumption

growth through 2030. Over the last seven years, annual growth in private consumption has averaged 2.7% in Brazil, 2.9% in Argentina, and about 5% in Chile and Peru.

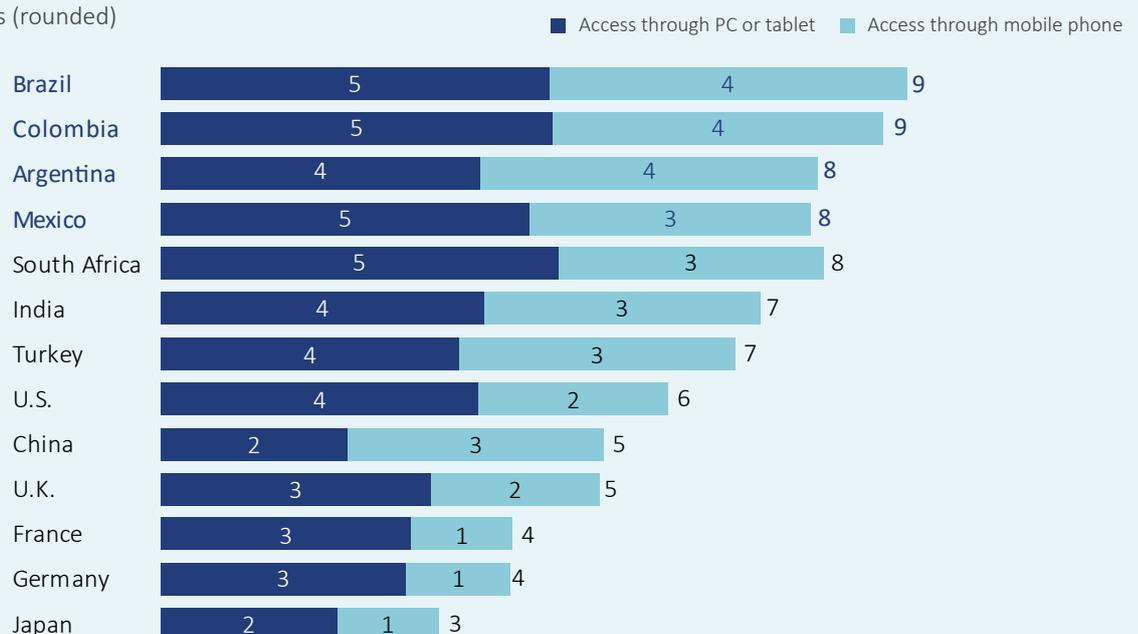
Although Latin America has strongly reduced income inequality in the last few decades, large gaps remain, meaning that the region has one of the most uneven distributions of income in the world. Among the 20 countries with the most unequal family earnings, eight are in Latin America and the Caribbean; the others are in sub-Saharan Africa. German firms can help address this issue in the long term by creating well-paying jobs, driving more inclusive growth, and thereby expanding the middle classes.

The Latin American electric mobility market offers many opportunities, for example. The national governments of the major countries in the region and many local governments are promoting the industry. Three large vehicle producers operate in Argentina,

EXHIBIT 10: PEOPLE IN THE REGION SPEND MORE TIME ONLINE THAN THOSE IN MANY DEVELOPING AND EVEN DEVELOPED COUNTRIES

Time spend online per day, 2018

Hours (rounded)



Source: World Bank; ‘Digital 2019: Global Internet Use Accelerates’ Report; GlobalWebIndex; McKinsey analysis

Brazil, and Mexico, while Argentina, Bolivia, and Chile have substantial lithium reserves – critical for electric vehicle batteries. Nevertheless, the market is still very small and neglected by major international players in the area of electric mobility, presenting opportunities for German OEMs.

Consumers in the area are among the most digital on earth. Mobile subscription rates are comparable to those in the U.S. and other developed markets, and the time people spend online is among the highest in the world, as shown in Exhibit 10.

As millions of the region’s residents reach retirement age, they will need many of the products and services German firms can provide, including advanced healthcare. And as birth rates decline to about 1.77 children per woman by 2050, productivity will need to rise sharply, as noted.

2. B2B productivity strategy

Supply businesses with technology to increase productivity, mainly in the areas of robotics and automation, artificial intelligence, big data analytics, IoT, and digitization

Across the region, people understand the productivity imperative, and governments and decision makers see German companies as experts in the field. The region’s productivity growth is among the lowest in the world, as shown in Exhibit 11, posing major challenges. As noted, about 78% of GDP growth has been generated by employment growth, and only 22% by productivity improvements. That said, some countries have made advances more quickly, including Peru, where productivity has accounted for 48% of GDP growth, Panama (48%), and Costa Rica (54%).

Average productivity is about 20% of German and 17% of U.S. productivity. The region invests only around 0.8% of GDP in R&D activities today, far below the 2.4% OECD average.

Every sector needs to make advances in productivity, as shown in Exhibit 12.

Supplying businesses with technology to increase productivity is a massive B2B opportunity that spans countries and industries. As outlined, German companies have key opportunities across sectors, including mining, oil and gas, utilities and renewable energy, transport, manufacturing, healthcare, and agriculture. They also have competitive advantages in those sectors.

Despite widespread poverty, the area already has some of the developing world’s highest Internet distribution and IoT adaption. People in the region in general and Brazilians in particular are interested in IoT. Research shows that the potential for smart home adoption is higher in Brazil than in many developed markets, and Mexicans and Argentinians are close behind. The annual growth of IoT revenues through 2025 should range between 14 and 16% in most countries.

The long-term potential of IoT can hardly be overstated: it may transform entire national infrastructures, from transportation and public safety to energy generation and distribution. It can help local industries such as manufacturing, banking, and retail to become globally competitive, and allow government agencies to serve citizens more efficiently and reliably.

Many German companies have the resources they need to contribute to the utilization of this productivity-enhancing technology in the region – especially the funding and talent that are in short supply and that Latin American CIOs say are the keys to digital transformation.

EXHIBIT 11: EMPLOYMENT HAS GENERATED ABOUT 80% OF PRODUCTIVITY GROWTH

Contribution of productivity and labor input to GDP growth, 2000-17



1 Higher labor input reflects increased population and changes in participation and employment rates; calculated as a residual

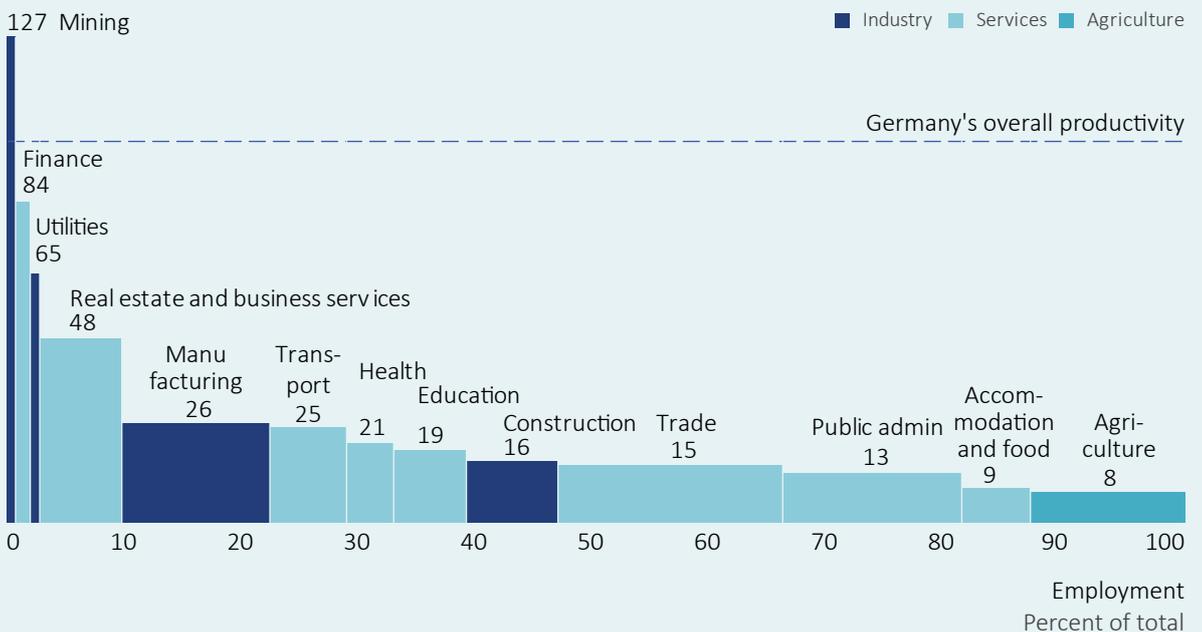
2 Labor productivity growth is measured as real GDP per employee

Source: Conference Board Total Economy Database 2017; McKinsey Global Institute analysis

EXHIBIT 12: PRODUCTIVITY INCREASES ARE NEEDED ACROSS SECTORS

Relative real productivity in Latin America (GDP per employee) by sector, 2018

Index; 100 = Germany's overall productivity



Source: IHS; ILO; McKinsey Global Institute analysis

3. Export strategy

Manufacture products and materials in the region for export, taking advantage of low labor costs and vast natural resources; export digital services and outsource knowledge-intensive processes

As displayed in Exhibit 13, the cost of manufacturing labor is more than 80% lower in Latin America and the Caribbean than in Germany. In addition, the region benefits from abundant natural resources across several countries, especially in mining, oil and gas, agriculture, and forestry. Productivity is relatively low, however, given the poor quality of education and automation.

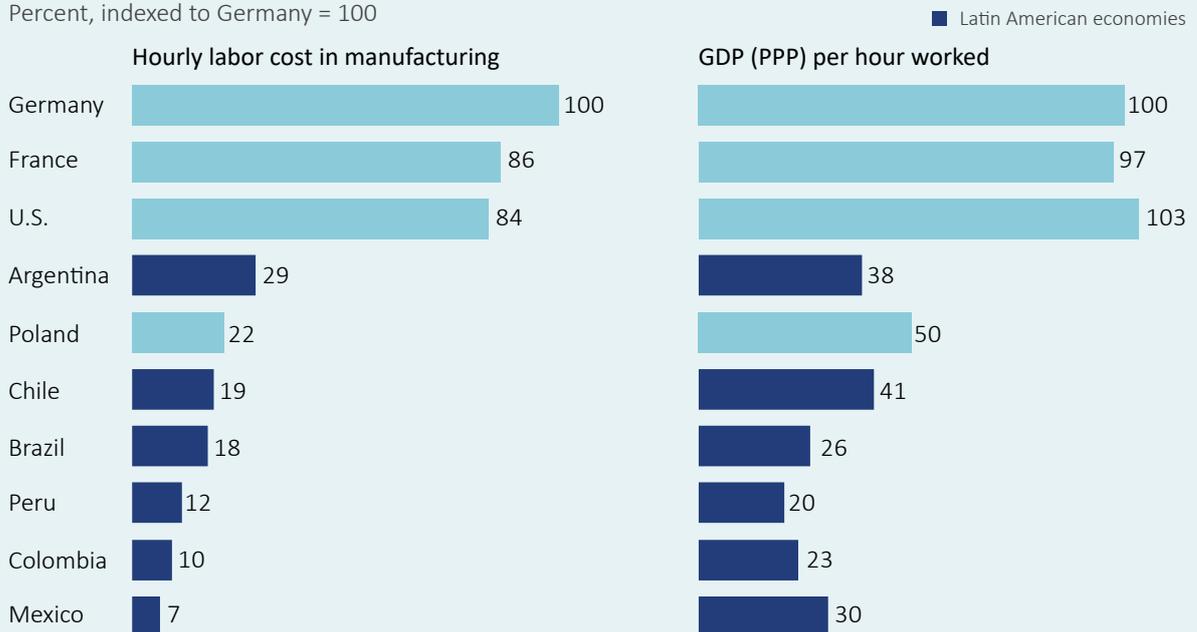
German companies can benefit in this environment by producing for export – especially to the nearby U.S. market – offering high-quality products, digital services abroad, and outsourcing knowledge-intensive processes, for example.

German companies could also help raise worker productivity. McKinsey research shows that about two-thirds of work could be automated. New training programs, perhaps in collaboration with universities, could help workers learn new skills to add more value and thrive in 21st-century industries.

EXHIBIT 13: LABOR COSTS ARE FAR BELOW THEN THOSE IN DEVELOPED COUNTRIES

Labor cost and GDP per hour, 2018

Percent, indexed to Germany = 100



Source: Conference Board; EIU Viewswire; McKinsey analysis



German companies can now take advantage of the opportunities

Five key success factors can help German companies to thrive in the region

Latin American and Caribbean countries share some common features and heritage, but each one is unique. The more than 600 million people in the area belong to a dazzling array of cultures, some of them thousands of years old, with a huge range of tastes and preferences. Mexico has at least seven distinct cuisines, for example, and speak more than 65 indigenous languages. Many people prefer the products and services of local and national businesses, and many of these home-grown companies are large and sophisticated, even if they have little or no presence abroad.

In other words, companies, products, and practices that succeed in Europe, the U.S., or developing countries may not work in specific Latin American or Caribbean marketplaces. Based on interviews with German CEOs and experts, we believe that the most successful German companies in the region pay attention to five key success factors:

1. Adapt products and services to local market needs

Like consumers around the world, Latin Americans and Caribbeans tend to buy products and services that are tailored closely to their preferences and budgets and that meet local conditions well. For example, most car buyers in the region care much more about shock absorbers and low prices than paint colors or the latest technological features. Most of the companies that succeed in the area offer products with the features local consumers value most without bells and whistles, which allows them to better compete on costs. Several German companies that have aimed to sell their unchanged German products in regional markets have encountered major challenges.

2. Understand the broader market environment and plan for the long term

It goes without saying that foreign companies have to understand the economic market context in each country they operate in or they intend to enter. In Latin America and the Caribbean, the most successful firms also have a deep and up-to-date understanding of political perspectives to anticipate and navigate economic cycles. They need to prepare for occasional downturns and have the stamina to endure them with a long-term view of growth.

3. Network with local companies and academic and political institutions

Many German companies can succeed by partnering with local businesses to enter markets, and some can forge even larger partnerships with local and foreign companies to create entire ecosystems.

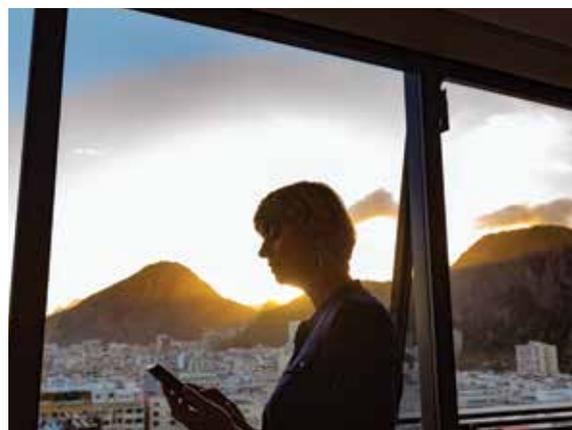
As noted, several of the most successful companies work with universities to establish dual-education systems and provide their workers with world-class skills.

Companies should take advantage of national development plans and incentive systems and even help governments develop strategies to pursue certain future-oriented technologies. German companies in particular are a good fit for these types of alliances that serve mutual interests – especially productivity improvements. Given Germany’s leadership in many measures of productivity, governments across the region have an interest in forging strong relationships with German companies.

4. Empower and retain highly qualified local employees

German companies and staff cannot expect to navigate the region’s highly complex marketplaces quickly or without local help. The most successful firms get long-term commitments from their executive managers in the area and give local business units and managers plenty of independence and autonomy. With the long-term involvement of European experts, they can transfer valuable knowledge to managers and workers in the region.

Successful firms choose their local workforces very carefully, hiring and retaining the most capable and committed workers rather than large numbers of poorly trained people.



5. Harness the unique advantages that differentiate German companies

As noted, German firms have natural competitive advantages in the area, including cultural synergies not available to firms from other regions and positive views of Germany and its industries and politics.

German companies should continue to distinguish themselves with world-class environmental protection standards, data privacy for customers, fair treatment of employees, and adherence to their commitments to vendors, consumers, public interest groups, legislators, regulators, and other key stakeholders. The pursuit of credible corporate social responsibility strategies can therefore emerge as a key differentiating factor compared to other foreign companies, including those that make massive investments in the region.

The LADW recommends consistent political engagement for long-term business success

High-ranking diplomats can provide private-sector leaders with privileged access to local CEOs, policy makers, bureaucrats, and elites. Diplomats often have more credibility than business leaders and can get media attention more easily, and embassy researchers can provide economic intelligence available nowhere else.

In the LADW's view, political support is therefore required to strengthen the business relationship between Latin America and the Caribbean and Germany. The recommendations include five factors:

1. Pursue a clear and long-term agenda

Sustainable business success requires long-term mutual political support in Latin America and the Caribbean as well as in Germany. Partnerships like these have to be built on joint agendas. The aims of the business and the government should be articulated clearly and remain constant over the long term to guide decision making in the marketplace and in legislative and regulatory bodies.

2. Establish a favorable and fair environment

Wherever they operate, companies seek favorable and fair environments to do business. In Latin America and the Caribbean, this includes increasing free trade, establishing double-tax agreements, and easing and protecting investment. Level playing fields require an absence of corruption, limited bureaucracy, and fair and simple tax systems. In addition, long-term stable and low input costs and costs of capital, including attractive financing solutions, will be required to raise the volume of investments in the region.

3. Support education systems in the region

Governments in the area and in Germany need to work together to support education systems for children, college students, and workers. In particular, a dual-education system could bring lots of advantages for foreign investors. This will create a virtuous circle: as more capable workers become available, more investments will flow into the region, raising wages, lowering unemployment, providing more funds for education – and driving productivity.

4. Align on strategic topics

Working together closely, governments and industry can advance strategic topics such as industrial standards to make it easier to do business in the region. They can also agree on other strategic topics such as sustainability, digitization, data protection, infrastructure, and logistics. This will help the area address local challenges, avoid some of the consequences of economic growth, and become more competitive. For this purpose, stakeholders can come together using a range of existing or new platforms, such as intergovernmental consultation, mixed commissions, and bilateral cooperation.

5. Support concrete projects

Finally, governments in both Latin America and the Caribbean and in Germany can support concrete projects such as IoT and smart cities, digitization, and sustainability, all of which could help German companies build on their strengths and export technology to the region. In addition, governments should support planned and ongoing investments in solution-oriented ways.



Next steps

Navigating the complex and diverse marketplaces in Latin America and the Caribbean requires extensive local knowledge and talent, cultural sensitivity, political acumen, and competitive intelligence. It also needs courage. In fact, successful German companies require stamina in this fluctuating business environment, and they must take risks due to weak regulative enforcement and changing political conditions.

Nevertheless, for many German companies, Latin America and the Caribbean can offer rich opportunities for profitable growth. Those firms can provide products, services, tools, talent, and insights that the people of the region value highly. And from Argentina to Mexico, German companies and investors receive consistently warm welcomes from customers, suppliers, workers, lenders, civic and academic leaders, and government officials.

Based on our research, we believe that many German companies can succeed by moving carefully but vigorously into specific markets in the region. Firms have to be aware of the risks, but they should not neglect the opportunities that this area provides.



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