

**THE ENTRY MODE OF FOREIGN INFRASTRUCTURE PLAYERS IN BRAZIL -
UNDERSTANDING THE CASE OF AIRPORTS**

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INTRODUCTION

As opposed to manufacturing, infrastructure sectors suffer from the “market failure” problem by which competition does not promote the maximum social welfare and State intervention is thus justified under an economic efficiency criteria (RAMAMURTI; DOH, 2004). Government regulation as well as the control of entry in certain monopolistic markets like airports is justified although it brings with it the “obsolescing bargain” risk. Studies of market regulation and controls of entry are highly industry-specific due to the very idiosyncratic market failures that are present in each infrastructure activity or segment (RAMAMURTI; DOH, 2004; TUROLLA, 2013). In addition, the institutional environment of host countries is also idiosyncratic, and even more in developing countries. Against that background, studies of market entry in specific infrastructure industries in emerging countries are relevant because theory is not sufficiently general to account for both the specific market failure of the industry concerned and the host country institutions. This paper contributes to the literature by presenting a specific case of entry in a particular infrastructure industry in an emerging country, and by identifying the role of host country institutions in attracting FDI – which is difficult to attract in emerging markets as supported by Sader (2000) and the problems arising after entry are significant (GUASCH; LAFFONT; STRAUB, 2005).

Infrastructure’s foreign direct investment (FDI) has been for many years a challenging contractual endeavor to new entrants in their internationalization process and to government agencies in attracting resources and knowledge to overcome country’s infrastructure asymmetries (SADER, 2000; VAN DEN HURK, 2016). After a long period of deterioration in public accounts, services and infrastructure and limited financial resources for infrastructure investments in emerging economies, many governments decided to pursue initiatives of various forms of private sector participation in order to boost investments amid binding fiscal constraints (GILLEN; MANTIN, 2014).

That was the case of Brazil which by the late 90`s and 2000`s launched a program of privatization of state-owned companies, in addition to public-private partnerships (PPPs) in regulated services such as, but not limited to transport, energy, water and telecommunications. In this paper, we focus specifically on the developments that took place with initiatives in the airport sector, a key element of country`s infrastructure development that gives support to the exchange of business passengers both in domestic and cross-border flows, tourism activities and cargo logistics which play a key role in competitiveness.

The Brazilian air transportation sector posted a significant growth record over the preceding

years increasing from 37.7 million passengers in 2000 to over 109.6 million passengers in 2017, a growth of approximately 7% per annum (ANAC 2017, 2000). That growth had put pressure on existing assets thus requiring substantial investments in airports and terminals capacity, as well as upgrades to improved levels of service as demanded by new passengers (INFRAERO, 2016). Brazilian airports were then fully owned and managed by state-owned enterprise (SOE) Infraero with limited investment and improvement capacity, as well as politically oriented management strategies, in line with literature that shows public corporations less efficient than private ones (VASIGH; HOWARD, 2012). Early in the years 2010, while Brazil was already chosen as host of both the FIFA Cup 2014 and the Rio Olympic Games of 2016, there was a noticeable scarcity of government financial resources and the urgent need for increased capacity and service improvement. That scenario led the government to decide for the concession, in form of PPP, of some of the most important Brazilian airports to make it feasible and to streamline the necessary investments for the adequacy of the airport infrastructure, modernization of the facilities and introduction of technological innovations already seen in other countries.

The Brazilian is a particular one because the federal government made four successive rounds of airport concessions each one with a particular ruling. In addition, there was a major change between the period in which these rounds of concessions take place, namely the Car Wash operation. Corruption scandals and court decisions led incumbent infrastructure players to weaken. Those incumbents included contractors and new entrant operators typically derived from contractors' groups, being those which initially took over airport concessions. As a consequence, foreign new entrants have found a window of opportunity to enter the Brazilian market and to take concessions.

Before the Car Wash the bidding procurement requirements set by the Brazilian regulatory agency ANAC led the national contractors and entrant operators to associate with foreign groups to meet the minimum prior operation requirements; after the Car Wash operation the only round carried out resulted in the adjudication of all of the four concessions to foreign groups without any partnership with local companies – which did not even bid for the objects, showing a significant shift in this market. Other specific features of the competition for these concessions can also be isolated so that their effects can be evaluated under a relatively controlled institutional environment. These features include: in two out of the four rounds, the State-owned company Infraero was mandatorily included as a stockholder with 49% share; changes in bidding procurement rules; restrictions on cross-ownership of terminals among others. It is noteworthy that these changes are relatively constrained, thus allowing us to evaluate their impact.

Against that background, Brazil presents a particular institutional environment in which some specific changes can be studied in a controlled manner. When studying airport privatization in cross-country settings, the features are much less stable and therefore institutional aspects are much more difficult to control as compared to what is possible in the Brazilian context. This is a motivation for this study.

Literature on airport privatization has been focusing on several aspects of the process like design of competition (PEREIRA NETO et al., 2016), revenues (GILLEN; MANTIN, 2014) and on the performance differential and governance under public and private management (VASIGH; HOWARD, 2012) or in problems with concessions (GUASCH; STRAUB; LAFFONT, 2003). There is limited literature however on how institutions affect the entry mode of international operators in the airport sector in emerging countries.

In light of institutional theories, this research project endeavors to elicit the question: How Brazil's institutional environment affects the entry mode of FDI in the airport infrastructure sector?

Thereby, the general objective of this article is to examine the case of the concession of the Brazilian airports in which there were country-specific forms of contracts as well as mingled forms of concessions, including in the case of airports a consortium between MNEs and private nationals with Infraero participation in the equity profile. In such scenario, the specific object of this research project will be to analyze the contract advantages of MNEs entry mode in contrast to private local nationals in light of the costs of institutional rules of game taking into account the stake of Infraero, which has veto power over the investments in airports where it holds 49% of shares.

In the sequence, we discuss the theoretical and applied literature as applied to the subject followed by the methodology and by the discussion of the results. The study contributes to the strategy of international players in the infrastructure industry and specifically in the segment of airports as they can better understand institutional features of entry in emerging countries with idiosyncratic institutional environment and regulation. Regulatory staff can also benefit from the study as the paper clarifies rules that are relevant for new entrants given the existing local regulations.

THEORETICAL AND APPLIED LITERATURE

This paper intends to examine the impacts of Brazilian institutional environment in attracting MNEs to commit FDI in airport infrastructure compared to national enterprises, and their choices of entry mode in this sector.

Institutions, emerging economies and contracts

In his rethinking of foreign investment in developing countries, Ramamurti (2004) assesses that, opposed to manufacturing, infrastructure sectors, suffer from the market failure problem which can be remedied by government regulation. However, the latter carries obsolescing bargain risk, making investments even riskier when made in developing countries, characterized by weak institutions and political instability. Entry mode of MNEs in developing countries is, therefore, a function of choosing the appropriate capital structure to mitigate creeping expropriation from host governments (SAWANT, 2010). Notwithstanding, anticipated entry poses first mover advantages of ephemeral nature of windows of opportunity (TUROLLA, 2013).

Dunning (2008), upon incorporating institutions dimension in his eclectic paradigm outlined

the central role played by institutional analysis in understanding both the determinants of MNE behavior, and its effects on home and host countries. Much of institutions literature had dedicated attention to institutions as solutions to problems in a competitive environment and the role of institutions in economizing transaction costs (NORTH, 1991; WILLIAMSON, 1975, 1985). As applied to the international business field, the same literature provides insights on internationalization of firms. When firms decide to go to foreign countries to engage in a contract negotiation they are subject to transaction cost problems due to the constraints of achieving an agreement and enforcing and protecting goods and services bonded to the contract, in addition to the agency problems (NORTH, 1991). As in Ross (1973), the eldest and most common codified form of social interaction is the relationship of agency which is raised when one party acts for, on behalf of, or as representative agent for another party, in a particular dominion of decision problems.

According to North (1991), measurements, accounting units, exchange means, notaries, consuls, regulatory agencies, jurisdictions, and insurances, were posed due to negotiations and enforcement in foreign countries. In attempt to make transacting and engagement in long distance negotiations feasible, institutions, organizations, and instruments were created to reduce information costs and to incentive contracts fulfilment. In the context of long term public-private contracts, those characteristics are even more constraining (GUASCH; STRAUB; LAFFONT, 2003; KIRKPATRICK; PARKER; ZHANG, 2006).

Cantwell, Dunning, and Lundan (2010), in one of their propositions to link evolutionary and institutional views, ascertain that particularly from the emergence of knowledge-based economy and contemporary globalization, the aspects of institutional environment for international business are of uttermost importance to MNEs within the framework of North (1990, 2005), and that complex institutions emerge to deal with typical uncertainties arising from complex forms of exchange. Those institutions involve both market and non-markets actors. In their view “these institutional aspects have also become increasingly interconnected over geographical space, and MNEs both contribute to, and are affected by, the contagion effects from the external environment that are now capable of being transmitted more rapidly and effectively from one location to another” (CANTWELL; DUNNING; LUNDAN, 2010, p. 571).

Dacin, Kostova, and Roth (2008) in their review of literature challenge studies that embraced a view of institutions theory drawn from neo-institutionalism modeled by the DiMaggio and Powell (1983) paper in which supports the concepts of organizational field, isomorphism, and mechanisms of institutional pressures, to take a broader view of institution theory. As opposed to DiMaggio’s concept, Wood and Demirbag (2012, p. 30) argue that partially because institutions are not essentially homogenous within national business systems, institutions are amenable to small, incremental, and most of times invisible changes, significantly remolded by actors.

P1: Foreign direct investment in infrastructure in an emerging country is linked to host country institutions.

Infrastructure, internationalization and FDI

Turolla (2013), towards a theory of international production of infrastructure services, claims that the decision of internationalization by any infrastructure firm is not a trifling one. Opposed to most sectors, infrastructure is characterized by high level of fixed costs with highly specificity of capital. Investments have quite complex nature in particular those of greenfield type (SADER, 2000). Such peculiarities imply relatively low ex ante incentive to investment, exacting regulatory action from governments. In contrast to that context, the traditional infrastructure firm carries risks that are different and frequently higher than those born by other corporations (Turolla, 2013). Infrastructure FDI and the international production of infrastructure subject is exiguously addressed in the academic literature, albeit its increased importance. Limited works can be found on the internationalization of infrastructure firms. Sarkar, Cavusgil and Aulakh (1999), are of the view that mainstream theories of international business (IB) needs further development to adapt or unravel international production of infrastructure in academic

Even though infrastructure is a fundamental feature of economic development (CALDERÓN; SERVÉN, 2004), limited investment is a rather common situation, especially in developing countries. FDI, although not readily captive, may contribute to relieve the curbs related to poor infrastructure (TUROLLA, 2013, p. 42). The question raised by Sader (2000), as to why it is so difficult to attract FDI into infrastructure, a number of macroeconomy and institutional challenges faced by host countries were found.

Opposed to manufacturing, infrastructure sectors, suffer from the market failure problem which can be remedied by government regulation. However, the latter carries obsolescing bargain risk, making investments are even riskier when made in developing countries, characterized by weak institutions and political instability (RAMAMURTI; DOH, 2004).

With the event of rapid globalization in the 1990s, developing countries faced a major deficiency in infrastructure sectors such as transport, energy, water, and telecommunications (GUASCH,1996) in order to be able to attract FDI from MNEs, regardless the attractiveness of wages or other economic attributes (RAMAMURTI; DOH, 2004).

Although the fact that infrastructure sector risks of natural monopoly, non-tradable outputs, capital intensity, asset-specificity, asset immobility, and political salience in addition to developing country risks, Ramamurti and Doh (2004) raised the question: “Why FDI increased in emerging markets?” enlightening that FDI increase in late 1990’s were associated to: a) the decline of “natural monopoly” characteristics of infrastructure sectors which demands government regulation; b) to advantages of first-movers in globalization phenomena of infrastructure sectors; c) to novice mechanisms of finance that reduce risks for MNEs; d) to the qualitative improvement of climate for infrastructure FDI in developing countries; and e) to the

unlikely risk of expropriation of foreign infrastructure assets by host developing countries in current environment.

More recently, Sawant (2010) developed the theory of Project Finance (PF) mode of FDI as the alternative mechanism to minimize risk of capital intensive investment in developing countries by way of increased leverage and syndicated loans to mitigate creeping expropriation and to improve bargaining position of MNE's in ex post recontracting pitfalls emerged from asset specificity. In his work Sawant (2010) found that there are limited evidences that PF mitigate creeping expropriation in host countries however it does support the evidence that PF mitigates the risks of significant investments in infrastructure for MNE's in addition to mitigate transaction costs emerged from concentrated suppliers and buyers.

PF is however regulated in any local country context. In Brazil, regulation involves the law 8.987/1995 on concession and permission regime for public services and construction works and law 11.079/2004 on general rules for bidding and procurement of public-private partnership (PPP) in the context of public management. However, other institutions play a relevant role like the arrangements between players.

P2: Host country finance arrangements are determinant of entry modes of international operators in the local infrastructure market.

METHODOLOGY

This paper employs a qualitative research of a case study method based on available documents, with the core objective to explore the answers to the question: how Brazil's institutional environment affects the entry mode of FDI in the airport infrastructure sector?

Therefore, this term paper will observe three distinct moments: initially bibliographical research, which seeks to deepen the theoretical knowledge about the phenomena to be studied and thus pave the preparation of the second and third moments, which is the data collection and analysis of available documents including interviews with managers found in the press, regulatory reports by the regulator ANAC and the federal government. At a later stage there will be conducted field research with a small set of executives of airport consortiums through interviews, which will occur using the case study. We plan to do the interviews with a selected number of one to two executives of four airport groups that won the concessions in different rounds.

The purpose of this study is to elucidate how the phenomenon of entry mode of FDI in Brazil's airport infrastructure are influenced by the institutional environment considering the law 8.987/1995 on concession and permission regime for public services and construction works and law 11.079/2004 on general rules for bidding and procurement of public-private partnership (PPP) in the context of public management and also in the context of unfolding investigation on a web of corruption scheme, codenamed Lava-a-Jato (Car-wash), launched in March 2014 which uncovered a nationwide and international web of systemic fraud in Brazilian politics which deceived taxpayers and shareholders out of billions of dollars, to finance election

campaigns to keep the governing coalition in power (WATTS, 2017).

The importance of establishing a protocol for the execution of the research lies on the fact that it guides the researcher throughout the entire process and mainly establishes the scientific link between the procedures and the results found (YIN, 2006). For Yin (2006) the protocol must contain at least four different steps: overview, field procedures, search roadmap questions, and report. We will make at a later stage content analysis of the material mainly of interview transcriptions to be compared with other documents.

DISCUSSION

To be eligible for an airport concession, public tender requires at least one experienced operator in the partnership, thus far monopolized by Infraero. Because only MNE's own that specific advantage, national companies willing to participate in the tender are subject to partner with foreigner operators to compete in the process, initiated in 2011 (ANAC Tender Notice, 02/2011, 01/2013, and 01/2016)

The concession of Brazilian airports began with the privatization of Natal's airport alone. Then National Agency of Civil Aviation (ANAC), the aviation regulator agency, launched three batches of major airport privatization, in 2012, 2014, and 2017 respectively (INFRAERO, 2016). Table 1 below shows a gradual increase in participation of foreign MNE's in airport concession, an indicator of increased confidence, by foreign MNEs, in Brazilian institutional environment, evidenced by batch 3 of concessions in 2017, when airport concessions were fully adjudicated to foreign MNEs, a time when major infrastructure national enterprises and high caliber politicians were plunged into "Car-wash" corruption scandal at the same Brazil's economy were struggling to recoup from its long term recession.

Batch	Year	Location	Term		Value BRL	Invest BRL	Foreign			National		Infraero Share
			Years				Country	% share	% share	% share		
1	2012	Natal-RN	25		0,2 bi	0,7 bi	Corporación America	Argentina	50,0%	Infravix	50,0%	0,0%
2	2012	Brasília-DF	25		4,5 bi	2,8 bi	Corporación America	Argentina	25,5%	Infravix	25,5%	49,0%
2	2012	Guarulhos-SP	20		16,2 bi	4,6 bi	ACSA	South Africa	5,1%	Invepar/OAS	45,9%	49,0%
2	2012	Campinas-SP	30		3,8 bi	8,7 bi	Egis	France	5,1%	Triunfo UTC	23,0%	49,0%
3	2014	Galeão-RJ	25		19,0 bi	5,7 bi	Changi	Singapore	20,4%	Odebrecht	30,6%	49,0%
3	2014	Confins-MG	30		1,8 bi	3,5 bi	Flughafen Zürich Munich GMBH	Switzerland Germany	12,2% 0,5%	CCR	38,3%	49,0%
4	2017	Fortaleza-CE	30		1,5 bi	1,4 bi	Fraport	Germany	100,0%			0,0%
4	2017	Salvador-BA	30		1,6 bi	1,2 bi	Vinci	France	100,0%			0,0%
4	2017	Florianópolis-SC	30		0,2 bi	1,0 bi	Flughafen Zürich	Switzerland	100,0%			0,0%
4	2017	Porto Alegre-RS	25		0,4 bi	1,9 bi	Fraport	Germany	100,0%			0,0%

Table 1 – Sources: Infraero (2016); Alvarenga, D. (2012, 2013, 2017).

Brazil has disciplined, since mid-90s, a set of long term concession contracts, namely the so-called regular concessions ruled by law 8.987 of 1995, which main objective is to provide the necessary infrastructure for socio-economic development and the provision of services with distinctive quality allowing the public sector to harness the management potential of private entities while avoiding additional government expenditures (CABRAL; SILVA JR., 2009) and the administrative concessions and sponsored concessions both ruled by law 11.079 of 2004

being the first the service contract of which the Public Administration is the direct or indirect user and the latter when it involves, in addition to the tariff charged by the users, consideration from the public partner to the private partner. Before those laws, foreign entry in the Brazilian infrastructure markets was rare or very limited to the concession of three highways and bridges and some ports. The legislation gave support to the entry of foreign players in the Brazilian market for several infrastructure sectors and it is clear from the documents that such legislation was also the base for the design of the airport infrastructure concessions. In the case of the airport infrastructure, the government agency ANAC under an initiative led by the federal government issued the publicly tender notice for all the batches of airport privatization specifying the terms of the concession such as, but not limited to, requirements to be an operator, limitations of bidders, minimum investment required, documentation, auctioneer, local and foreigner and consortium participants and its limitations. (ANAC Tender Notices 02/2011, 01/2013, 01/2016). Brazilian government is also of the view that the country retrieved the quality of the projects presented in the novel modeling of infrastructure Partnership Program of Investment (PPI) (PERES, 2017)

Evidence from documents is limited and this will be further evaluated in interviews, but there are some indications that proposition #1 may be supported by these findings just presented. These laws and regulations have been giving legal certainty to foreign firms to commit long term FDI in Brazil's infrastructure sector where there is a clear set of rules of game.

Local market features are also relevant. The PF operations with the public sector were dominated by the local contractors (Odebrecht, a construction firm is as an example). Within that context, entry of foreigners only took place because it was mandated by minimum experience requirements mandated by ANAC (Tender Notices 02/2011, 01/2013, 01/2016), and foreign players such as Corporación America, ACSA, Egis, Changi, Flughafen Zürich, and pcontractors such as Engevix, OAS/Invepar, Triunfo, UTC, Odebrecht, and CCR (ALVARENGA 2012, 2013)

However, the anti-corruption car wash operation has dramatically changed the game and may provide analytical insights on the new situation.

As a result, local contractors, including those which participated in tendering batches one and two, were weakened in several senses by the operation, giving foreign players, such as airport operators Vinci, Flughafen Zürich, and Fraport, the conditions to enter, for the first time, without a local partner, nor SOE Infraero. with Fraport winning two concessions tenders in the same batch. Legislation did not prevent locals to keep taking most of the stake but the change is illustrative that weakened local players had opened the spectrum for FP entry modal without having to share management with any of the local players.

Although preliminarily, proposition #2 may be supported by these evidences in which the absence of main local contractors allowed international operators to determine the entry mode of full FDI. However further investigation needs to be performed in order to determine the finance arrangements set by those MNEs.

FINAL REMARKS

There is preliminary indication as shown in this paper (in progress) that host country institutions and regulations like the design of the procurement process actually have a direct effect on the foreign direct investment as an entry mode in airport infrastructure in Brazil and in the local markets. Furthermore, the perspective of effective laws aimed at rooting out systemic fraud might have signaled to a higher reliability of institutions in Brazil, in terms of contractual and regulatory environment, thus encouraging foreign firms to commit FDI in country's infrastructure (PERES, 2017).

This article has limitations like the limited number of cases studied and the fact that the study covers only Brazil as a host country – the idiosyncrasies may be very country specific. In addition, the concession process in Brazil is rather recent and further developments are yet to come as well as problems and challenges are yet to show up as the contracts evolve in time.

Future research directions include an enhanced qualitative methodology using interviews with executives from at least four different airport firms that have been granted the concession of a Brazilian airport.

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