Global Economy Sample Project

This project was submitted by a student group in Spring 2007. The content is average, but the layout and structure are excellent. The overall grade was 90 out of 100.

Analysis of Investment in Argentina

Executive Summary

In recent years, Argentina has been making considerable economic strides. Most notably, they have become well known for producing wine. As a developing country, the costs of doing business could be considerably less in Argentina. This report outlines and discusses the primary opportunities of the proposed venture to build a vineyard in Argentina, as compared two developed countries (United States and France) and two developing countries (Chile and South Africa. Our analysis considers several factors such as acquiring land, starting the business, employing a workforce and trading costs. We will further analyze the opportunities and challenges for this investment based on these factors.

Description of Major Opportunities and Challenges

The Argentinean economy has been highly unstable in the past, with a collapse in 2001 and government debt default in 2002. Although there has been progress made, not enough time has elapsed to make the economic climate as favorable as other Latin American countries.

From the World Bank data, we found Argentina to be a good place to acquire and register property. The time and number of procedures involved are considerably less than that of France, though a bit higher than the US. Please see Table 1.

Once the property has been acquired, we must consider that the time and effort to start a business in Argentina. The actual number of procedures, the duration and cost are considerably higher than that of the US or France. Please see Table 2.

With regard to employing a work force, we found that Argentina was better than France in most respects. A strong exception being, the Firing Costs are nearly 4 times that of France. We would have to ensure our employees are compensated for a little more than 2.5 years after termination. If our venture was not profitable and we were forced to pull out of Argentina, we would incur substantially greater losses for this fact alone. Please see Table 3.

The most notable concern for operating a vineyard in Argentina comes from the very high export costs. Nearly double that of the US and France. Every package of wine would cost us twice as much to export as our more popular and profitable California and French wines. Our primary concern is based on sustainability of profits and ability to recoup losses from our initial investment. Please see Table 4.

Comparison of Argentina with Other Developing Companies

The next step is to compare Argentina versus comparable countries in terms of the level of attractiveness for building a wine-making and exporting business. The first issue would be to select these “comparable countries”. Given that we are specifically looking to invest in a wine business, we would select developing economies, ideally in Latin America, that have some sort of recognized wine-making capability. According to the Food and Agricultural Organization of the United Nations, based on 2005 production data, the major South America wine-producing countries were[1]:

[1] Food and Agriculture Organization, United Nations, 2005 Data
http://faostat.fao.org/site/567/DesktopDefault.aspx?PageID=567

World Rank	Country	Wine Production (Tons)
5	Argentina	1,564,000
10	Chile	788,551
15	Brazil	320,000
24	Uruguay	112,559

We would also include South Africa, which in 2005 produced over 1.1mn tons of wine (9^{th} globally) and fits the "developing economy" that would provide a good comparison for Argentina. Given that Brazil and Uruguay have quite small wine-producing capabilities, we will select Chile and South Africa as the core competitors.

The next step is to select the key variables to compare setting up a wine-making and distribution business in Argentina versus Chile and South Africa. We will focus on three metrics: ease of starting a business, ease of hiring, and ease of trading across borders.

Ease of Starting a Business

The first core metric will be the ease of which a foreign company can start a business, as defined by the World Bank's "Doing Business" database as of 2006[2]. The World Bank breaks this metric down into four parts, as delineated in the Table 2.

This data indicates that Argentina, compared to Chile and Argentina, is a more difficult environment in which to start a business given that it takes more procedures, has higher costs and requires minimum capital. It is more of a difficult decision between Chile and South Africa, since Chile has lower duration of procedures and though South Africa has lower costs associated with starting a business.

Ease of Hiring

The World Bank defines the ease by which a company can hire and fire workers into the areas as defined Table 3.

According to this data, Argentina's most fundamental issue in terms of employment is the extremely high "firing costs", which are well above those in Chile and South Africa, and more importantly, these costs nullify that advantage of having a low "difficulty of firing" index number. In addition, its non-wage labor costs are an extremely high percentage of salary. Again, it is a closer decision between Chile and South Africa, with Chile having a low "difficulty of hiring" index number an a lower "difficulty of firing" index number, but higher firing costs would likely offset the latter advantage, perhaps making South Africa marginally more attractive in this regard.

Ease of Trading Across Borders

Finally, the ease with which the company can export its wine out of Argentina will be extremely important. The World Bank defines the ease with which one can export out of a country into the parameters laid out in Table 4, among others.

In this area, it seems to be a bit more of a mixed bag, as Argentina's "time for export" is low and the necessary documents are not well above Chile and South Africa, though "cost of export is extremely high. Chile seems to stand out a bit more in this area with a manageable "time for export" and low costs.

Conclusion

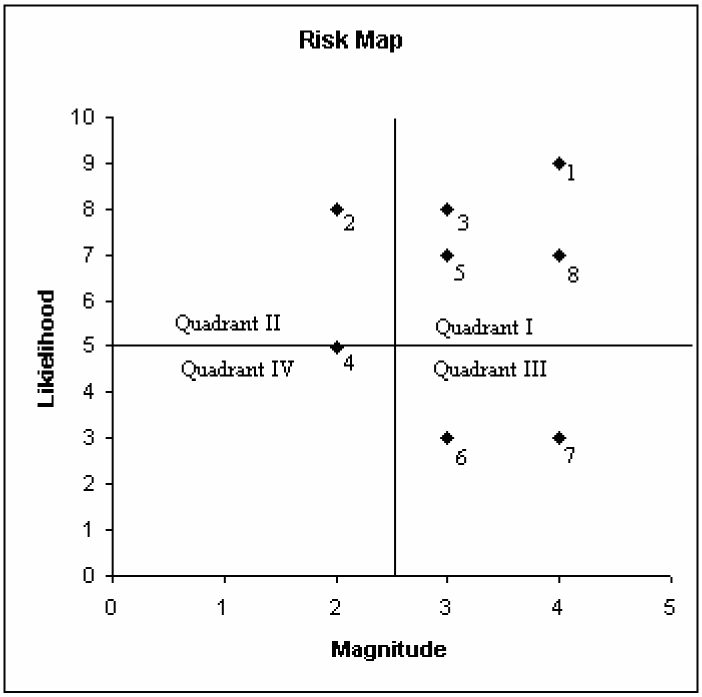
Unfortunately, in terms of the more qualitative aspects, Argentina does not seem to compare very well to Chile and South Africa, given that it is not the most attractive option in any of the three

[2] The World Bank, "Doing Business In" database, 2006.

core areas of measuring the attractiveness of starting a wine business. That said, it seems a much closer decision between Chile and South Africa

Risks and Mitigation Strategies

Finally, below are a Risk Map and associated table which provide a brief description of the risks our wine venture could face in Argentina as well as proposed solutions for mitigating those risks. The number for each risk in the Risk Map corresponds with the Risks described in the table below.



Quadrant I: Risks in this quadrant are classified as highly likely and are of “high” priority.

Quadrant II: Risks in this quadrant are significant, but less likely to occur.

Quadrant III: Risks in this quadrant are less significant but are likely to occur.

Quadrant IV: Risks in this quadrant are both unlikely insignificant.

Risks	Business Risk Description[3]	Mitigating Risk
1. Regulatory/Industry Environment	An antiquated and often overlapping regulatory structure creates a barrier on the national, provincial, and municipal levels, conserving anachronistic practices that create long delays for permits, reporting, approvals, and distorts competition, favoring those who function outside the legal domain.	Negotiate and partner directly with a province and municipality eager to remove regulatory barriers in exchange for employment and tax revenue guarantees. Establishing a lobbying arm would also allow us to be in full time contact with law makers, ensuring new laws and regulations are created that either favor our operation or do not adversely affect it.
2. Compliance With Laws & Regulations	Argentina has well established health and employment laws and regulations that are often on par with the United States’. However, compliance with these laws and regulation often results in added costs in manufacturing and	Again, negotiating and partnering with local municipalities may allow for efficient implementation of those regulations as well as reducing the potential for new regulations that may adversely affect our business.

[3] “Micro Lessons for Argentina”, The McKinsey Quarterly, 2002 Number 2

	reduces overall productivity by 10-30 percent relative to the U.S.	
3. Business Interruption/Service Failure	Although Argentina has relatively sophisticated infrastructures, the country's long history of tumultuous and unstable social and political institutions creates an uncertainty for the future, jeopardizing our capability to continue critical operations and processes that are dependent on availability of energy, information technologies, skilled labor and other resources.	It would be critical for us to import many critical tools such as for information technology and reduce our dependency on local sources. For energy needs, it would also be critical to contract with multiple and established suppliers that understand local business practices and have demonstrated a capacity to navigate established barriers. Regarding labor, offering salaries that are slightly higher than the local average as well a providing other services that are minimal in cost such as an extra day off may induce better performance and loyalty.
4. Information Technology/Processing	It is unclear how we will be able to integrate our information technology infrastructure (e.g., hardware, networks, software, people and processes) to effectively support the current and future needs of the business.	It would be necessary to complete a due diligence to determine current resources for IT in Argentina and how they integrate with ours. If we determine there is a shortage, it is critical that we establish our source for IT infrastructure and minimize our dependency on local sources.
5. Customer Satisfaction/Reputation	It is unclear how our customers would react to Argentinean produced wine. According to Sam Cooke, author and food critique for the Philadelphia Daily News - despite its illustrious history as a wine maker and status as the fifth largest wine producing country in the world, Argentina's wine quality is not always highly regarded. This may negatively affect our brand reputation.	Prior to committing to developing a wine manufacturing facility in Argentina, conducting a market research in our key markets for the perception of Argentinean wine, as well as the potential for customer demand may provide the insight we need.
6. Managing Change	Developing new operations in a foreign country is difficult. Language barriers, lack of cultural knowledge, and lack of relationship with local social and political organizations will create barriers. Our company also risks lacking the leadership and employees necessary to implement process and product/service improvements quickly enough to keep pace with changes in the marketplace.	Contracting a consulting firm with experience in developing and implementing operational plans in Argentina may mitigate this risk. We would also need to employ a liaison that speaks Spanish, understands the local customs and is able to learn our culture.
7. Commodity Pricing/Peso Value/ Contractual Commitments	The risk that fluctuations in prices of commodity-based materials or products (e.g., coal, oil, gas) may result in a shortfall from budgeted or projected earnings due to changes the in value of the Argentinean Peso. A de-valuing of the peso may result in contracted suppliers and service providers defaulting on their obligation. This can effectively halt all operations.	It is difficult to mitigate this risk as it depends on fiscal and monetary policy set by the Argentinean government. However, investing in hard assets and establishing a reserve of needed commodities may mitigate this risk to a certain extent.
8. Taxation	In Argentina, tax evasion among small business operators is rampant. In some industry sectors, it is estimated that for every $100 Argentina receives in the	It would be difficult to mitigate this risk as it depends on government policy relating to taxation, tax collection, and tax enforcement. Creating a lobbying

	form of tax revenue it loses $175. These losses come from small operators who fail to pay their tax obligations. To compensate, Argentina taxes larger and law abiding operators much more, resulting in an unbalanced tax system. More importantly, Argentina frequently increases it tax rate, again hurting operations such as ours.	arm would allow for communication with law makers which may result in a more favorable and balanced taxation and enforcement.

TABLE 1:

Registering Property			
Country	Procedures (number)	Time (days)	Cost (% of property value)
Chile	6	31	1.3
South Africa	6	23	8.9
Argentina	5	44	8.3
France	9	183	6.8
United States	4	12	0.5

TABLE 2:

Starting a Business				
Country	Procedures (number)	Duration (days)	Cost (% GNI per capita)	Min. Capital (% GNI per capita)
Chile	6	27	9.8	0
South Africa	9	35	6.9	0
Argentina	15	32	12.1	5.6
France	7	8	1.1	0
United States	5	5	0.7	0

TABLE 3:

Employing Workers				
Country	Difficulty of Hiring Index	Difficulty of Firing Index	Nonwage labor cost (% of salary)	Firing costs (weeks of wages)
Chile	6	20	3.4	52
South Africa	44	40	2.4	24
Argentina	44	20	23	138.7
France	67	40	47.4	31.8
United States	0	0	8.5	0

TABLE 4:

Trade Across Borders			
Country	Documents for export (number)	Time for export (days)	Cost to export (US$ per container)
Chile	6	20	510
South Africa	5	31	850
Argentina	6	16	1,470.00
France	4	15	886
United States	6	9	625