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BUSINESS SCHOOL

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**Frezite**

## **Internationalization in Brazil**

Case study

Reference nº

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## **Abstract**

Frezite had an early start in internationalization just a few years after its foundation. The experience gained after years doing business with nearby countries brought the company face to face with an important and difficult challenge: the launch of an operation in Brazil, a continent distant from its headquarters. Although facing many difficulties in this new venture, the Internationalization in Brazil has been a very successful one, a success that has continued in the past 15 years.

The company has gone through major changes during its period in the new continent: after starting with exports it has set up a production unit in the country, furthering the level of Internationalization.

This case study aims at understanding how the Internationalization in Brazil was made and to analyse its main features.

**Key-words:** internationalization, competitiveness, international marketing, entry modes, Uppsala model, Brazil, Portugal, engineering, cutting tools, furniture sector.

## **Introduction**

It all began when Mr. Manuel Fernandes was watching the international economic news on television and suddenly realized that Frezite could take advantage of the positive scenario that was being discussed. In the 1980's, Mr. Manuel Fernandes, Frezite's president, started to take a closer look into international markets and to analyse which had higher chances of success for his company. His enthusiasm while facing these Internationalization challenges and opportunities was crucial for Frezite's success in the markets where it entered.

Frezite was founded in 1978 to supply the Portuguese market with engineering cutting tools that the country lacked. Since its foundation the company has always tried to pay attention to market opportunities: to introduce innovative solutions and to improve its products and services. In doing so, Frezite soon realized that internationalization was fundamental to pave the way to its growth strategy.

Frezite started to analyse potential markets for expansion right after its foundation and participated in an International Trade Fair Ligna, in Hannover (Germany). Aware of its clients and of the potential of German and European markets the company took its first steps towards internationalization just three years after its foundation. Initially it expanded to locations near its national borders, because its technical knowledge would enable it to make an easier transition into other European countries.

During the 1990s, Frezite took up another challenge: to expand its business to a faraway continent. The Brazilian market presented (and still does!) promising figures in the wood furniture sector, which was the company's focus at the time. Besides having a high production in this sector, Frezite saw that the country lacked the quality suppliers demanded by the high specificities of manufacturing and saw there an attractive business opportunity.

Frezite has become a success story in Brazil, having managed to adapt its strategies to the Brazilian market and to stay updated and keep track of the changes dictated by economic scenarios. The company, who operates mainly in the B2B market, has made relevant changes in its business model at local level and in doing so has learnt how to provide valuable offerings that are in line with the needs of this market.

## **The Internationalization process**

The international expansion produces benefits that contribute to the company's growth and often allow it to become an international company once the entry costs in new markets is

overcome. However, entering international markets and starting to operate in different countries can also bring uncertainty, complexity and risk. Companies are very often faced with more unusual habits than the ones that they are used to in their home countries and take risks arising from uncertainty that may jeopardize its financial and material investment as well as management on a beyond-the-border project.

This situation is not different for the industry where the company in this case study operates: engineering solutions for cutting tools. Frezite, a Portuguese company who initially worked only with tools for cutting wood, faced competition from the European market before entering the Brazilian market. Its main competitors were in Germany– a country with a very positive country of origin effect, namely in the tools sector. Even in today's global market the German companies Leitz and Leuco remain strong competitors in the business of wood cutting tools. However, that did not stop Frezite from realising it had a potential for development beyond Portuguese borders since the suppliers of this type of product were not as numerous in other markets.

Despite competition, Frezite managed to position itself strongly in international markets and to be among the leaders in many countries, including Brazil. In addition, the company has recently created another products division, the FMT - FREZITE Metal Tooling, which offers cutting tools for metal, thus entering a new market and improving its presence in the global market.

### **The beginning of Frezite's Internationalization**

Some companies wait for times of crisis to pursue new opportunities overseas while others identify them in good economic times and are always watchful on changes in global economic flows. Frezite clearly belongs to the second type, having thought about its internationalization since very early.

Founded in 1978, Frezite developed at a time when Portugal benefited from economic growth and gained more and more space in the domestic market, increasing its expertise in the area. Since the 1980's the company has been participating in international trade fairs with the intention of internationalizing itself, initially preferring to take advantage of its proximity with other European countries. The first real step towards internationalization was the creation of Frezite Galicia in 1988. In addition to opening an office in Spain, Frezite also

increased its exports to many countries around the world during this period, moving on towards strengthening its future relations with Brazil.

The entry into the Brazilian market was primarily made through exports. Frezite, however, reassessed the potential of the market and decided that it would be worth to have a more definite stake in the country. A sales office was established in São Paulo in order to facilitate and enhance trade relations with Brazilian customers. The company's history in Brazil was just beginning and great developments would happen in the coming years. The consolidation of Frezite's presence in the Brazilian timber market and more recently in the metal cutting tools market is an ongoing process that has been happening for a long time.

### **Selection of markets and entry modes**

In the mid-90s, Brazil was undergoing a period of profound economic changes that led to the implementation of the Real Plan. Established in 1994, the plan promoted the change of the currency and the control of hyperinflation, restoring vitality to the economy and creating a healthier and more prosperous environment for business in the years that followed. The program established by the government also aimed at promoting greater trade openness in the country through measures such as exchange rate stability and the reduction of tariff and non-tariff restrictions on imports, thereby encouraging competition and improving the local industry. Brazil left behind the country that had experienced a 'lost decade' in the 1980s and made the clear choice of becoming a country that showed signs of improvement for the future and sent a sign of commitment with modernity and sustainable growth to the world.

During this period, other Latin American countries did not have the benefit of an economic renewal as healthy as the one Brazil was experiencing and represented more hostile environments for business. It was the case of the foreign exchange crisis experienced by Mexico in 1994. In fact, in the mid-1990s Brazil had a population of about 160 million inhabitants, a figure that represented a large domestic market to be supplied by various industries.

Brazil has important furniture makers in the country's south and south-eastern regions, and there were few suppliers in the cutting equipment sector in the 1990's. The most technologically advanced equipments of the furniture industry were mainly imported from Germany and Italy.

Frezite identified a great business opportunity and saw the potential that this product could have in the Brazilian market. The size of this area of activity in Brazil and its growth potential prompted the company to start their business in the Latin American giant. Currently, there are approximately 17,500 companies operating in this industry in the country, having manufactured 492,200 pieces in 2012. According to a report by Movergs (Association of Furniture Industries of the State of Rio Grande do Sul), São Paulo has the largest number of companies in the sector, while Rio Grande do Sul has the largest hubs of producers/exporters.

The company began its selling operations in Brazil, seeking partners and taking products from Portugal to its customers and dealers in Brazil, thus starting to gain significant market share. Still, despite the success of its operation in the country, Frezite soon realised that exports to Brazil faced a major problem: customs issues. Brazil continues to present uncertainty for companies exporting to the country, a situation that was even more dramatic in the 1990's. In fact, customs clearance in Brazil can be as complicated and time consuming today as it was in the beginning when the company first started to operate in the country. In addition to this, the costs associated with the clearance of goods and delivery time to customers need also be considered. Brazil is also quite protectionist in some sectors and such is the case of manufactured products, which are taxed twice by two different types of tax when they enter the country. Besides the ordinary import tax, industrial products also have their own tax (IPI) which makes imported products much more expensive than domestically produced products. This fact somewhat undermines the competitiveness of Frezite that ended up reaching the Brazilian market through exports at far less competitive prices than those of the products manufactured at home.

Given this reality and the problems faced by Frezite's business in Brazil, the company decided to change the shape of its activities in the country. After opening a sales office and gaining a good part of this market through strong commercial work, brand awareness and customer relationship, Frezite decided to set up a production unit in southern Brazil to meet demands and eliminate the old problems with delivery deadlines and customs.

### **The route of the company in Brazil**

The company started exporting to Brazil after the opening of Frezite Brazil based in São Paulo. This location was chosen because of the strong economic growth of São Paulo and its proximity to the majority of the companies established in the country.

Despite São Paulo's great economic potential, Frezite understood that it should be closer to its main customers, who were in the southern region. Besides the issue of customer relationships, the constant problems with imported products over customs led Frezite to take the important decision to start producing in Brazil.

The southern region of Brazil has a large furniture centre, which has influenced the company's decision to set up its production unit in São Bento do Sul (SC). According to the Association of Furniture Industries of Rio Grande do Sul, the state's furniture exports have represented about 30% of the country total in recent years, which proves the region's significant productive expression. The association also shows that between 2008 and 2012 Rio Grande do Sul represented 19% of the country revenue in the sector, with a growth of 52.2% in that period.

Frezite's production unit in the south of Brazil became responsible for 95% of supplies to the local market, complemented by a small portion of imports. Since 2000, the furniture sector grew 55% in terms of exports, which justifies the investment made in the domestic production to increase supply to these industries and avoid the cost of imports. This reduction in the costs related to the import tax led Frezite's products to become more competitive and to a decrease in the uncertainties related to delivery times to customers.

### **Cultural differences and adaptation to the Brazilian market**

Despite all the strengths associated with the setting up of the company in Brazil, going to a foreign country with the intention to establish a production unit requires great consideration of the local market and high commercial sensitivity, both critical factors that contribute to the success of any operation. While facilitating communication, linguistic proximity is often misused to justify the entry of other Lusophone companies in Brazil.

In fact, Brazil has a large domestic market with great potential for many industries. However, it is necessary to have a good understanding of the Brazilian consumer and of how businesses are operated in the country, so as not to risk losing everything. Frezite, unlike many of its fellow Portuguese companies, attached considerable importance to these issues in order to overcome barriers overseas.

According to an executive - Tiago Fernandes - all the products offered by the group were always also sold in Brazil. But the Brazilian market often requires adjustments, says the manager. And that was exactly what happened in this case, where the firm had to suggest a

different product portfolio. Some changes in the marketing mix of Frezite were therefore introduced, as the products sold in Brazil had to be adjusted in relation to what was proposed to the rest of the world. In Brazil, there is a typical preference for less expensive and 'ready to use' products.

Besides making adjustments to the products, executives soon realized that Frezite also needed to 'fit' in regarding the way of doing business with the Brazilian people. The adjustments concerned not only the relationship with customers and suppliers, but also teaching Portuguese executives how to deal with local employees. The different atmosphere in meetings, much more casual, and the much more relaxed way of Brazilian people, when compared to Europeans, can reflect itself in the business environment and often demands more selling dedication and greater patience to get responses.

The company's executives had to go into the country prepared to face a new reality and cultural challenges. Although the language is the same, there are many different expressions. The president of the company himself reports that there were situations in which different linguistic expressions caused reactions that were not expected. He soon realized that the same word often means different things, so a 'little problem' in Brazil may actually be a 'big problem', and vice versa. Learning from small details like these was essential for the company's headquarters to have a better understanding of how to act in this foreign country and of how to interpret not only local expressions, but also the signals given by the market.

### **The company currently**

In Brazil, the group has recently expanded Frezite in São Bento do Sul (SC) to accommodate FTM - Frezite Metal Tooling, the company's new division. With an investment of approximately two million Euros, FTM was created in Trofa, Portugal (see Figure 1 for the modern facilities of FMT) to produce high-tech cutting tools. In 2011, the company's revenues in Brazil were of approximately five million Euros, thus justifying the investment made in the new facility designed to further expand business in the country. The setting up of this new division brought a greater diversification in product offering and market coverage, with great chances of increasing the company's success in the coming years.

Figure 1 – FMT in Trofa, Portugal



Source: FMT Website ([www.fmttooling.com](http://www.fmttooling.com)) in 23/06/2013

It can be said that while FMT is still at an initial phase of exploration and search in the Brazilian market, Frezite woods' division has nonetheless secured a well-established position in the country. According to Tiago Fernandes, despite the lack of statistical control to measure the 'market share' of the companies operating in the sector, Frezite is the second most recognized brand in engineering tools for cutting wood in Brazil. With regard to communication, the promotion of the company's products is made through retailers nationwide that offer the product to customers and help to promote the brand and its quality. It is therefore a communication that focuses mainly on the role played by dealers and one that has earned a good reputation for the brand in the Brazilian market.

Figure 2 – Frezite Group current international map



Source: Frezite Website ([www.frezite.pt](http://www.frezite.pt)) in 10/04/2014

## Conclusion

The internationalization of Frezite can be considered a successful process that has carried the group's name to every corner of the globe, being present in over 50 countries. The company's performance counts with 70% of its sales abroad, through exports and with subsidiaries (as shown in the map in Image 2) in Brazil, Spain, United Kingdom, France, Czech Republic, Slovakia and Germany, and commercial units like Romania and Poland, set up in 2011. The company's next step will be to develop its internationalization process in Latin America, with a factory in Mexico, and in Africa, by creating a subsidiary in South Africa.

The experience gained over the years in Brazil will help Frezite to develop its operations in Mexico and South Africa, since, like Brazil, both countries present different local culture-related difficulties and on the way of doing business, plus different tariffs issues and imports problems. Success in Brazil was reached by putting a great deal of effort into understanding the local market well and by nurturing strong commercial sensitivity to important issues, two key factors that must be taken into account in other internationalization processes, particularly in countries with a very different culture from the Portuguese.

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