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Is a more inclusive and sustainable development possible in Brazil?

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Title of paper: Trust, finance and sustainable entrepreneurship in Brazil

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Abstract:

In absolute terms, Brazil has almost 33 million people playing some entrepreneurial activity where the presence of women is outstanding. Considering this background, this paper aims at increasing the understanding whether the interactions between trust, finance and entrepreneurship in contemporary Brazil could enhance sustainable growth. The importance of this attempt is due to the need to enhance further understanding of the current competitive features of micro and small business that are threatening their survival conditions.

Key- words: trust, finance, entrepreneurship, micro and small business, sustainability, Brazil

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Introduction

In the aftermath of the 2008 global crisis, there has been broad recognition that the current operation of the financial markets has not generated a sustainable long-run business environment in Brazil. In the last decades, transformations in global finance and corporate governance increasingly subordinated the dynamics of investment, production and economic growth to financial commitments (Minsky, 1975). The overall changes have been threatening the log-run business environment of almost 33 million people that play some entrepreneurial activity in Brazil - where it is outstanding the presence of entrepreneurs among women and people between 25 to 34 years old (Gem, 2009).

The immediate impacts of the global crisis on the Brazilian economy and society provoked the deterioration of private expectations, a fall in the levels of production, investment and employment; an increase in stocks, besides liquidity constraints on credit and capital markets. In this scenario, the social outcomes shifted to the political sphere and led to economic policy responses in order to support the growth of the domestic market. As in other developing countries, despite specific policies aimed to support micro and small enterprises (MSEs), the macroeconomic and financial environment turned out to favor the performance of large corporations (Reinecke, 2002). In truth, the Brazilian recent economic policy has not been able to improve trust in order to shape a sustainable entrepreneurship environment. As a result, entrepreneurship sustainability has been threatened

The understanding of trust within the context of a sustainable entrepreneurship environment should highlight the main elements of the historical transformation of economic and social life, especially the new dynamics of finance, production, enterprise international competition and increasing inequality. This changing reality enhances the need for micro-level research studies that cope with the recent challenges of small-scale entrepreneurial activities and the role of the government and financial institutions in the attempt to promote business sustainability (Unctad, 2004).

Since the 1980s, at the heart of the political, economic and social reorganization lies a search for the re-establishment of the conditions for capital accumulation. The growth of the influence of finance over the rest of the economy was best described as the financialization of capital (Foster, 2006). In this setting, the Brazilian industrial and financial policy contributed to a bias in favor of larger scale enterprises, while many efforts focusing on entrepreneurship development were frustrated to promote a robust and innovative MSE sector.

Our main concern is to address the interactions between trust, finance and entrepreneurship in contemporary Brazil in order to enhance further understanding of the competitive features of micro and small business that are currently threatening their survival conditions. Section 1 characterizes the Keynesian view on trust, finance and entrepreneurship. Section 2 presents the financial set up and the recent entrepreneurship challenges in Brazil. Section 3 analyses the entrepreneurial strategies and the sources of trust in the current business environment. Finally, the conclusions.[1]

1. Trust, finance and entrepreneurship

The current global crisis has restated the menace of deep depressions among the current challenges (Foster, 2009) while livelihood conditions turned out to be subordinated to the bailout of the domestic financial systems. Looking backward, in the context of the 1930 Great Depression, John Maynard Keynes pointed out that the evolution of capital markets increases the risk of speculation and instability since these markets are mostly based upon conventions whose precariousness affects the rhythm of investment and increases pressures on the political sphere.

Keynes (1936) called attention to the fact that the capitalist system has endogenous mechanisms capable of destabilizing the levels of spending, income and employment. He suggested a reconsideration of the understanding of the relations among individuals, society and governments within the market where institutions and conventions could shape human

[1]

behavior. Aware of the need to overcome the concept of rationality that overwhelms the *Homo economicus*, his contribution enhances a more extended understanding of the entrepreneurs' behavior, as well as of their strategies and decisions. Besides, his approach enhanced a more fruitful apprehension of the real-world where the outcomes of the entrepreneurs' decisions are not submitted to stochastic behavior, that is to say, they are not predictable.[2]

As a matter of act, the process of decision making is based on conventions. As uncertainty is present in all entrepreneurs' decisions, Keynes relied on the concepts of credibility and degree of confidence on a conventional judgment that is historically built within the markets. In his attempt to re-shape the world order in the 1940s, Keynes (1987) pointed out the need of a **"***wide measure of agreement***"**, that is to say, the need to create new conventions based on trust. In his view, trust has a historical and social nature and impacts entrepreneurial development. Trust is a conventional concept related to the level of confidence in the business environment, that is to say, in the legal, regulatory, macroeconomic and political setting that shape the evolution of the markets.

Keynes (1936) focused the analysis on the expectations associated with investment decisions in a business environment where uncertainty about the future pervades the decision-making process. The very nature of wealth management under uncertainty in a monetary economy is the cause of business instability. Money is a store of value with immediate liquidity and, thus, the ultimate purpose of an entrepreneurial economy overwhelmed by finance and speculative decisions. In this sense, on behalf of the uncertainty about the future, entrepreneurs could postpone spending decisions and search for alternatives of wealth management. One of the main thesis of his contributions to policy making, as opposed to the classical economists that defend the free-market system, is that government policies and actions could play a fundamental role in shaping a business environment that could reduce uncertainty and favor investment decisions. In fact, the interactions between the financial setting and business sustainability are emphasized since money and uncertainty affect the levels of production and investment**.**

[2] The role of expectations and private strategies is crucial in Keynes´ analysis. The principle of uncertainty is based on the idea that the past is irrevocable and the future is unknown.

In a specific historical setting, the average opinion of entrepreneurs on future scenarios shapes a convention based on a precarious set of expectations about the behavior of aggregate demand (consumption, investment, net exports, for example). The degree of confidence on this convention could affect the expected return on investment- the so called marginal efficiency of capital. Keynes explained that the incentive for long-run expanding productive capacity, that is to say, for investment, is highly dependant on trust about the business environment.

Entrepreneurship sustainability is particularly influenced by finance, as Keynes warned. When the speculative demand for money or for other financial assets increase, due to high uncertainty about future returns on future investments, entrepreneurs would reduce the demand for capital goods. Thus, under high uncertain expectations, the expansion f productive capacity could be postponed as entrepreneurs would prefer to maintain their wealth in more liquid assets. In this approach, the current interest rate is the reward for the renunciation of liquidity for a certain period of time- this reward depends on liquidity conditions in the money market and on expectations regarding the future interest rate. As a result, the increase in liquidity preference could lead to a continuous collapse of the expected returns on capital goods and disturb the evolution of the levels of investment.

Keynes' analysis of business instability highlights that the dynamics of contemporary finance is mostly based upon conventions whose precariousness could dampen the rhythm of investment. In his view, the expansion of capital markets reinforces the potential conflicts of interest between business strategies that favor short-run and long-run decisions putting pressure on sustainable entrepreneurship. The value of his analysis relies on considering uncertainty dimensions of business and entrepreneurship vulnerability, as relevant issues related to cultural and social factors. Finance, trust and conventions are intertwined. Under this perspective, trustworthiness in business conventions is embedded in the cultural and social structure, which could represent a challenge for sustainable entrepreneurship.

2. Financial set up and recent entrepreneurship challenges

In the last decades of the 20th century, it seems likely that financial institutions and policies have not been able to build a sustainable business environment for promoting economic growth, entrepreneurship and inclusiveness. Nowadays, great concerns arise from this financial and business dynamics since its outcomes could pass down social and environmental safeguards.

The outcomes of the global crisis revealed that MSEs are still facing structural major challenges to ensure their permanence in the Brazilian economy. Accordingly Sebrae (2008a), micro-enterprises employ up to nine people, in case of trade and services, or up to 19 people, in the case of manufacturing and construction. Otherwise, small enterprises employ 10 to 49 people, in case of trade and services, and 20 to 99 people, in the case of manufacturing and construction. In 2008, there were 5.9 million of formal micro and small enterprises (MSEs), equivalent to 97.5 percent of the total enterprises established in the country. The great number belongs to the trade and services sector. Besides, the MSE sector accounted for 51 % of the urban labour force employed in the private sector as of 2008, equivalent to 13.2 million formal jobs, 38 % of wages and 20 % in the average gross domestic product (Sebrae, 2008b).

As a matter of fact, MSEs have special structural features that restrict the level and continuity of their activities. The degree of vulnerability is influenced by a set of factors which include: access to finance; knowledge and information to improve management and innovations; the behavior and skills of entrepreneurs; public policies; trust toward conventions, the legal framework and the regulatory agenda. In other words, cultural and institutional vulnerability could overwhelm the entrepreneurship environment and explain growth discontinuity and financial fragility of small business.

The absence of economies of scale, financing difficulties and management problems are frequently central to the analysis of mortality among the Brazilian MSEs. Leading barriers to the sustainability of small and medium-sized enterprises and the lack of capital for investment and the difficulties to obtain financing (Steindl, 1945, 1983). The access to credit is restricted and financial institutions- in Brazil have not been able to face the MSEs' financial needs (Madi and Gonçalves, 2005). Supporting this idea, Gem research data (2009) reveal that the main reason for the discontinuance of this type of business is related to the lack of capital. Further research conducted by Sebrae (2009a) identifies that the main sources of financing used by micro and small enterprises have been: suppliers, short-term bank loans, credit card, predate checks. Under the entrepreneurs' perspective, changes in credit contractual conditions (interest rates, taxes and guarantees), would facilitate taking loans to buy inputs and equipment.

Aware of these demands, the Brazilian government has recently initiated attempts to favor the simplification of credit access' proceedings toward micro and small entrepreneurs. Other recent government measures include: enlargement of guarantees; agility in opening enterprises; financial cost reduction and expansion of access to online regulatory information (Mdic, 2009). Despite this attempt, the financial scenario for the micro and small enterprises continue to reveal strong asymmetries in credit access conditions. After the 2008 crisis, the credit flows of the Brazilian state banks turned out to benefit bigger corporations in spite of the micro and small enterprises accounted for 51 % of the urban private formal workers (equivalent to 13.2 million formal jobs) and 38 % of total wages.

Furthermore, in the current Brazilian business setting, the investment flows under the management of private-equity funds have turned out to increase the challenges for the survival conditions of MSEs. The Brazilian recent experience has been strongly affected by this new financial scenario where private-equity funds are relevant actors that concentrate investments in small business expansion (GVcepe 2008).[3] Private-equity funds are spreading, in truth, a business model which target is to sell small firms years later in a process called disinvestment (Wheatley, 2010). Actually, decisions taken by private-equity fund managers are strongly influenced by short-term returns and their management practices enhance the expansion of financial capital (Foster, 2009).

[3] In a private-equity firms´ portfolio structure, a company acquisition is equivalent to an addition to a stock of financial assets (Cullen and James, 2007). The selection of the portfolio companies has been influenced by the potential market growth and profits, besides legal and incentive structures, among other factors. Exit conditions become crucial in the investment decision-making process because capital mobility shortens the maturation of investments

Other relevant barrier to small enterprises' increasing productivity and growth is the lack of planning, professional practice management and knowledge about the market (Exame-Deloitte, 2009). Despite the micro and small ventures’ growth in the recent period, the role of management rationalization programs and the deployment of an innovative environment had not been decisive to explain their performance. Actually, Brazil has a very low product innovative capacity in products, processes and markets. Considering data from the period between 2004 and 2009, the vast majority of MSEs’ products or services were already known by most of the consumers at the time they had been launched (Gem, 2009). Even after the aftermath of the global crisis, innovations in industrial equipment continued to be the most relevant among innovative practices. Accordingly, these innovative investments have been associated with efficiency gains in production. However, research data from Sebrae revealed the growing importance of innovations in products and services, particularly, in sectors such as food; textiles; machinery and equipment; building materials; computer services, wood/furniture and metallic products (Sebrae, 2009b). Strategies related to foreign markets have received little attention.

The recent macroeconomic framework has also affected the small firm’s performance. The strength of the domestic currency (real) enlarged the difficulties for successful entrepreneurs in manufacturing in a context where small firms reveal poor innovative capacity, low competitiveness and weak participation in global exports (Sebrae, 2009b). As a result of the competition with Chinese's products in the domestic market, small firms recorded a fall both in the domestic market share and in exports, particularly in industries such as textiles, footwear and metal products (Cni, 2011). In this setting, cost strategies have been strongly affected by systemic competitiveness - understood as the set of conditions provided by external competitiveness of companies. Under the perspective of entrepreneurs, the quality and cost of energy, transport, telecommunications and technology services undermines productivity and efficiency targets. As a result, one of the main problems concerning the infrastructure of the country lies in logistics – especially in highways (Cni and Sebrae, 2006).

3. Entrepreneurial strategies and trust

In the last decade, deep changes affected the the Brazilian business environment (Sebrae, 2008a). Looking backward, the main transformations were driven by economic reforms and policies that promoted financial and trade integration into the global economy (Gonçalves and Madi, 2011). Nevertheless, the current business environment is currently not favoring long-run investments. Although policies related to financial inclusion, minimum wage and poverty reduction fostered the expansion of the domestic market, the Brazilian economy still lacks high levels of long-run investments to promote business sustainability.

Entrepreneurial strategies around long-run investment and profits have varied over time . In the context of the post Second World War it was widely spread that for a company's long term sustainability and profitability it was necessary to invest in long term expansion and to improve workers' relative wages. Lazonick and O'Sullivan (2000) describe this trend as a strategy of 'retain and reinvest' where profits were retained by the company and reinvested into productive capacity. Hobsbawm (1995) referred to this period as a "golden age" arguing that in many countries the patterns of living improved. This was also a "golden age" for workers' rights and organization practices.

However, this scenario began to change during the 1970s and 1980s. The new phase of financial dominance was concomitant with the reconfiguration of the international monetary system under the dollar supremacy after the 1980s that fostered the processes of globalization and financial deregulation. As a result, the historical changes in business have been related to qualitative transformations in capital accumulation and competition. New rules on corporate finance fostered the growth of the participation of institutional investors, such as pension funds or private equity firms, in business management as relevant shareholders. As a result, there was a change from reinvestment towards a strategy of maximizing short-term value for shareholders. The drive to increase share-holders' value and the incorporation of the managerial strata through share options tended to postpone long-term investments, favor mergers and acquisitions and foster financial speculation. As a matter of fact, the financial conception of investment increased in the context where financial innovations aimed to achieve fast growth with lower capital requirements could be used by managers to favor short-term financial performance (Fligstein, 2001).

In fact, the centralization of capital, through waves of mergers and acquisitions, created new challenges to sustainable entrepreneurship. Consequently, there has been noticed a tendency to slow down the accumulation process of *real* production. In this scenario, the economic and social outcomes have involved a trend to 'downsize and distribute', that is to say, a trend to restructure, reduce costs and focus on short- term gains. In practice this has meant plants displacement and closures, changing employment and labour conditions, outsourcing jobs, besides the pressure on supply chain producers in the global markets. The costs fall disproportionately on labour because the new priorities of shareholder value limit the social responsibility of firms. As recognized by Froud *et al* (2000) "*labour is usually the first casualty of restructuring at company level.*"

Financial liberalization has transformed the relations of power in Brazil since the discipline of finance affected the economic policy agenda in accordance with the requirements of financial actors and institutions (Grabel, 2002). Domestic monetary policies that preserved high real interest rates made financial accumulation more attractive, expanding it, and thus increasing the wealth and power of the owners of capital whose assets are embodied in securities, bonds, shares, etc.. Meanwhile, financial firms increasingly dominate firm groups (Froud *et al*, 2006). Within this framework, the corporations' strategies turn out to focus on short-term gains and the distribution of dividends to shareholders, that is to say, to investors (Lazonick and O'Sullivan, 2000). As recalled Minsky (1986), in contemporary capitalism, finance determines the pace of investment. The ability to generate competitive advantages has been increasingly related to favorable access conditions in credit and capital markets.

The Brazilian business reality shows that the advancement of concentration and centralization of capital favored the reordering of financial and productive structures where investors aim to maximize their short-term returns rather building long term sustainable business. In this historical setting, changes in the productive structures advanced in a scenario characterized by the expansion of financial actors and institutions (Crotty, 2002). As a result, a vulnerable entrepreneurship scenario has been subordinated to the expansion of deregulated financial markets that favored financial crises, macroeconomic instability and low levels of long-run investment.

As a matter of fact, business contexts change and new elements may arise that affect entrepreneurial decisions under conditions of uncertainty. In the current setting, new economic risks could be identified in society that reinforce the lack of commitment to long-run social sustainability (Beck, 1999). Business dimensions of risk also depend on social, cultural and political values, such as equity and trust. Considering the Brazilian background, great concern arises from the risks influencing entrepreneurship vulnerability, which include: lack of access to finance and technology; limited access to power and political representation; lack of trust in conventions, legal and regulatory framework.

Risk factors and outcomes may be cumulative. For example, lack of trust in the business environment could be coupled with high financial speculation, lower entrepreneurship performance and lower levels of investment and technological innovation. Considering trust as a pillar of sustainable entrepreneurship, it is possible to think about building new conventions that could be understood as common patterns of thought, anchored in shared beliefs and assumptions among entrepreneurs. These conventions cannot be shaped separately from the entrepreneurs' perception of risks that are strongly linked to information and knowledge, global integration, cultural features, and, also, patterns of behavior that could affect disposition to take risks.

Differences in social structures with respect to cultural differences influenced the evolution of entrepreneurship. Beyond sustainable entrepreneurship there exist institutions and behind those there are cultures, social, economic and political constructions. Access to information and knowledge is important to provide a basis for decision making and action. Norms support and provide parameters for entrepreneurial behavior and decision-making. Trustworthiness leads to a commitment to a sustainable business environment. Changes in conventions toward business sustainability, as Keynes recalled, rely on norms, expectations and actions that could favor long-run investments with inclusiveness. Entrepreneurship sustainability should focus on the social system. Its concern on social responsibility could not be separated of the understanding of sustainable social and economic development.

4. Final considerations

Globalization involves a “Janus-faced mix of risk and trust”, as Waters (2001) has noted. In fact, the current Brazilian economic and social reality has been overwhelmed by new risks within a context where financial dominance and entrepreneurship vulnerability put pressure on micro and small firms and threatened long-run investment. Considering this background, these risks should be addressed and trust must be strengthened by building new conventions that could favor strong bridges between entrepreneurs, government, financial actors institutions toward economic growth and social inclusion.

As a matter of act, the apprehension of the cultural, economic and political features of entrepreneurship in Brazil is decisive to reduce small firms’ vulnerability. And in that sense, further research is needed on how the policy environment oriented to MSEs may contribute to investment growth and job creation (Unctad, 2004). For example, alternative industrial and regulatory policies could be adopted to promote the sustainability of the MSE sector in a context where the redefinition of conventions could favor long-run investment.

The attempt to shape institutions toward sustainable and inclusive growth for future generations is decisively worthy. It is hoped that interdisciplinary studies could contribute to the institutional designing of conventions and norms that influenced expectations about the future. In creating that frame, further research could not only fulfill the interests of entrepreneurs but also benefit the society as a whole.

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