

# Apple faces competitive hurdle in Brazil market

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On a recent vacation to Orlando, Fla., from his home in Brazil, Tulio Avellar made sure to stop by such world famous tourist destinations as Walt Disney World and Universal Studios.

But he also visited one of the most popular spots for anyone traveling from Brazil: the Apple store.

The 23-year-old bought an unlocked iPhone 4S for \$570 - about half its cost back home. Brazilians planning to visit the U.S. are often besieged by requests from friends and family to procure Apple products for them.

"Buying an iPhone just isn't worth it in Brazil," Avellar said.

Avellar's case illustrates how far Apple Inc. has to go before it can compete in Brazil.

Thanks to hefty import taxes, Apple phones are priced well beyond the reach of most Brazilian consumers. Its efforts to build iPhones in Brazil to avoid those tariffs have hit a number of snags.

And although the country is one of the world's fastest-growing smartphone markets and a rising [economic power](#), Apple has yet to have a single retail store in Brazil.

The upshot is that Apple commands less than 10 percent of the market in Brazil. The story is much the same in other [developing nations](#), including

China, India and Russia, where rival Samsung Electronics Co. is fast becoming the brand of choice.

That has analysts worried. With Apple's revenue growth slowing in the U.S. and Europe, the company's fortunes depend on winning consumers in the developing world.

If Brazil is any indication, Apple has a lot to learn.

"I don't know what Apple's strategy is here," said Jose Roberto de Souza Pinto, a telecom analyst in Sao Paulo. "But they'll have to change it radically if they want to take advantage of the Brazilian market."

Brazil is one of the world's largest economies, with a population of almost 200 million. In the past decade, more than 40 million of those people have risen out of poverty into a new hard-working, big-spending middle class that now makes up more than half the population.

As a result, smartphone sales in Brazil are starting to soar. According to research firm IDC, Brazil is the world's fifth-largest smartphone market, with an estimated 23.9 million units expected to be sold this year. IDC projects that by 2017, Brazil will jump to fourth, behind China, the U.S. and India.

On an earnings call in early 2012, Apple Chief Executive Tim Cook said Brazil ranked only behind China in terms of importance in emerging markets.

"I think there's a huge opportunity for us there, and we've more than begun to go deeper into Brazil," Cook said.

Apple has made some moves in Brazil, such as opening a Brazilian iTunes store, hiring a Brazilian to oversee its Latin American operations,

and more recently, cutting the prices on the iPhone 4 and 4S by 25 percent and 15 percent, respectively.

Still, Apple remains far behind.

According to research firm Gartner, Samsung sold 42.4 percent of the smartphones in Brazil last year, followed by LG with 13.3 percent and Apple with 9.1 percent, just barely ahead of Nokia and Motorola.

Cook has repeatedly said that Apple doesn't care about market share, that it just cares about making great products.

But he's also acknowledged that the company needs to find ways to make its products more appealing in emerging markets.

"There are a lot of markets where we don't sell anything," Cook said at the company's annual shareholder meeting this year. "I look at it as the glass half full. We have a lot of work to do there."

Brazil should be a good place for Apple to start.

This is a country that loves its gadgets. Walk the streets of the poorest of Rio de Janeiro's favelas, or urban slums, or visit its shiniest shopping malls, and it's a common sight to see people on their smartphones.

But so far, the Apple brand has been almost invisible here. The biggest reason is price.

When Avellar was deciding on a smartphone in February, the unlocked iPhone 4S with 16 gigabytes of memory that he bought for \$570 would have cost \$950 in Brazil, while a Samsung Galaxy S3 was \$650.

Although Apple products tend to be more expensive than those of rivals

in the U.S., Brazilian taxes add as much as 60 percent to 70 percent to the cost of an imported smartphone, by some estimates.

In the U.S., Apple and other smartphone makers get help from carriers such as AT&T Inc. and Verizon Wireless, which heavily subsidize the cost of phones for customers who sign two-year contracts, a system known in the industry as "post-paid."

But Apple can't count on that help in Brazil. About 80 percent of mobile phone users select prepaid plans, where they pay a set amount in advance. Since consumers don't have to sign a contract, Apple can't count on carriers to subsidize their phones.

Analysts believe Apple needs to take a couple of big steps to be more competitive in Brazil.

The first is to make a cheaper iPhone that is perhaps smaller or contains less-expensive components that will be attractive to people on prepaid plans.

But even with a cheaper phone, observers say Apple will need to take a second, and perhaps more important, step: Build more phones in Brazil to avoid the punitive taxes.

"I think it's absolutely fundamental that Apple starts to produce locally, en masse," said Avellar, who works at Brazilian telecom giant Vivo.

In the city of Jundiai, an hour's drive from Sao Paulo in the hot countryside, is a tiny blue road sign that reads Avenida Steve Jobs. It's the entrance to the parking lot for the site of Apple's Brazil experiment.

Activities are secret, and men on motorcycles chase off a reporter taking pictures, but Eliseu Silva Costa, president of the Jundiai Metalworkers

Union, says they're now producing iPhones and iPads.

The plant was opened last year by Foxconn Technology Group, a Taiwan company that is a key Apple supplier. Foxconn had been in talks with the Brazilian government since at least 2011 to open factories here, but prolonged negotiations over tax incentives pushed back the start date.

Since launching, the Jundiai factory has hit some snags.

The job market in Brazil is tight and highly competitive, driving up costs. Filling the jobs at the plant has been a challenge for Foxconn. And for a company accustomed to calling the shots with workers in China, Foxconn is having to learn to work with Brazil's unions.

For instance, Foxconn is now locked in negotiations over profit-sharing for workers. And last year, there was a strike at the plant over the provision of transportation to and from the plant, and cafeterias for the workers.

"They came in here thinking they could do everything like they do in China," Costa said. "But they can't. They have to respect the laws protecting Brazilian workers."

A representative of Foxconn declined to comment.

Apple's and Foxconn's slow start here points to what may be Samsung's greatest advantage in Brazil. Unlike Apple, which has outsourced all of its manufacturing, Samsung still makes almost all its products in its own factories.

In Brazil, Samsung manufactures smartphones in the cities of Manaus and Campinas. Analysts say that helps Samsung escape many of the hefty tariffs slapped on Apple products.

Samsung's advantage over Apple in Brazil extends into the retail sector.

About 60 percent of smartphones in Brazil are sold through third-party retail stores or websites that have no direct relationship with the phone companies. That means forging relationships with retailers, many of which are locally owned shops, rather than mammoth chains, requiring lots of time and legwork.

Samsung has been working with retailers in the country for years. Just about any store in the country that sells smartphones is likely to be full of Samsung gadgets, posters and displays.

Opening an Apple store in Brazil would seem like an obvious step for a company that now has 405 stores worldwide and plans to open 30 more this year, including its first in Turkey.

The company has announced plans to open a store in Rio de Janeiro, the country's second-largest city and home of the 2016 Summer Olympics. But it has not said when.

"It's kind of strange given the market opportunity," said Gene Munster, a Piper Jaffray analyst.

Although the company won't discuss the reasons behind its timetable, some observers speculated that with the economy humming and the Olympics coming, real estate costs have soared and prime locations have become increasingly scarce.

"We look forward to opening the first Apple retail store in Brazil, where we have many longtime customers and we're thrilled to be adding new ones every day," Apple spokeswoman Amy Bessette said in a statement.

As with many of its other Brazilian challenges, this one will take time

and lots of money to solve.

"These spaces which are most desirable have already been taken," said Antonio Uras, an Ernst & Young partner based in Brazil. "Apple will have to invest a lot here to catch up."

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