

Esso Brasileira De Petroleo S.A.

A Case Study in Devaluation/Repatriation Risk Under High Inflation

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Abstract

The energy business is a long horizon business. Due to its capital intensity, investment payback periods last for years. This poses difficulties when the investments in question reside in volatile and risky locations. This case presents a petroleum products marketing company operating in Brazil during the 1980s. That period of time was quite volatile for the Brazilian economy. Especially concerning were the uncertainties associated with the \$US/Cruzeiro exchange rate. These factors handicapped American firms attempting to compete with their Brazilian counterparts. Students of this case will have to weight how to carry out Esso Brasileira's competitive strategy within this environment. They also will have to make decisions about the size and timing of dividend remittances back to the U.S.

The case's primary focus concerns a financial decision, the timing and amount of Esso's dividend remittance. Students first need to assess the devaluation risk and act accordingly. Doing so will involve an evaluation of Brazil's inflation outlook. That in turn affects the question of how to carry out Esso's retail investment strategy. If Brazil's inflation outlook is for higher inflation, retail investments will prosper, at least in local currency terms. However, the risks of leaving money in Brazil and the incentives for early remittance will also increase. Can Esso Brasileira protect its shareholder's money and still finance its investment program?

This case is based upon the retail strategy study carried out by Esso Brasileira in 1982 and the conditions it faced in early 1983.