

## **Odebrecht S.A.: The rise, fall and the future of Latin America's construction and petrochemical giant**

Odebrecht S.A. is a Brazilian multinational conglomerate that operates in the engineering and construction, petrochemical, agroindustrial, oil and gas, infrastructure, transportation and real estate sectors. The Odebrecht group currently employs 47,000 people in 7 business units, operating in 14 countries, with a gross revenue of 22.3 billion USD. This represents a steep decrease when compared to its 2013 numbers, when it boasted a revenue of 41.3 billion USD with 181,000 collaborators in 15 business units spread across 23 countries.

The leading construction and petrochemical company in Latin America, Odebrecht S.A. became heavily involved in the corruption scheme investigated by Brazilian Federal Police's Operation Car Wash. According to the authorities, the company used various illicit practices to secure roughly 100 projects in 12 countries, paying off USD 3.3 billion in bribes to important political and business figures in the countries in which they operated.

As the company tries to restructure itself, both in terms of performance and in terms of image, questions arise if the measures taken will be enough to keep the company alive. How has Odebrecht handled the transformation of its name from a successful case study into a synonym with corruption and illicit relations with officials? What can be expected of Odebrecht in the future?

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## Odebrecht's history (1944-2015)

### Origins

The Group's origin dates back to the year 1856, when German engineer Emil Odebrecht immigrated to Brazil. One of his grandsons, Emílio Odebrecht founded Emílio Odebrecht & Cia in 1923, which was responsible for construction of several buildings during the interwar period in the Northeast region of Brazil, being a pioneer in the use of reinforced concrete in the country.

With the start of the Second World War, construction materials coming from Europe became expensive and scarce, generating a crisis in the construction business. Emílio decided to exit the business and it fell upon his son, Norberto, to take his place in 1941. In 1944 he establishes a privately-owned firm, Construtora Norberto Odebrecht S.A. in Salvador, state of Bahia, initially focusing on local projects in the region.

### Expansion

The company started locally expanding in the 1950's, building more complex projects, such as a hydroelectric power plant and an oil pipeline for the government-owned oil company Petrobras, the first of many that would follow Odebrecht's growth. With the acquired knowhow and the increase in the company's portfolio, business started to take off in the 1960s, when international loans were plowed into large government infrastructure projects. According to Joel Millman's 1993 article in Forbes , "The company excelled in Brazil's rough-and-tumble regional patronage game, making millions on local Bahia state contracts for roads, power plants and refineries."

Not surprisingly, Odebrecht's first project outside the Northeast was the construction of Petrobras' headquarters in Rio in the late 60's. A milestone not only of the company's expansion, but of the relationship between the two firms that would be decisive for the future diversification of Odebrecht's business. The company then continued to extend its reach to southern Brazil with contracts such as the ones it secured to take part in the construction of Rio de Janeiro's international airport and Rio's state university campus.

The expansion in the period was drastic: in 1971, the company was the 19th largest construction company in the country; two years later it reached third place. It is important to note that this period of business expansion happened during an intense development policy encouraged by the Brazilian military dictatorship, when big infrastructure projects, aided by cheap credit in international markets, were carried out by local construction companies who had an intimate relationship with the generals.

With the construction of Itaipú, the world's largest hydroelectric dam spanning the Paraná River along the border between Brazil and Paraguay, the company sought to enter the bidding process. Odebrecht bought its way into the consortium building this project by paying about \$100 million for Companhia Brasileira de Projectos e Obras (CBPO), then among the biggest contractors in the state of São Paulo. CBPO's Itaipú contracts allowed Odebrecht to become a national player which enabled the company to engage in other important public works which included the Angra I thermonuclear power plant, a bridge in Florianópolis, a railroad through the Amazon forest and subways in important cities such as Brasília and Recife.

By the end of the 1970s, as Brazil's "economic miracle" slowed down, Odebrecht decided to diversify its activities, foreseeing that an era of lucrative government contracts for big public-works projects was coming to an end due to public budgetary problems. The first venture outside construction was Odebrecht Perfurações Ltda., specialized in drilling oil wells. More significantly, it entered the petrochemical field in 1979, when it acquired 33% of the state holding group Petroquisa in Companhia Petroquímica de Camaçari (CPC), a producer of polyvinyl chloride (PVC) in Odebrecht's home state of Bahia. In the same year the company became a contractor for Petrobras, prospecting for offshore oil from platforms in the Atlantic. In collaboration with English investors, it also searched for gold and vanadium deposits. The holding company Odebrecht S.A. was established in 1981 to manage the different business under the group.

### Internationalization

Around the same time, Odebrecht started working outside Brazil, beginning in 1978 with the construction of the Charcani V hydroelectric power plant in Peru and then in Chile with a project to divert the Maule River to the Colbún-Machicura hydroelectric power plant. It started business in Africa in 1984, when it became a contractor in Angola building another hydroelectric power plant. Later projects in the country included sanitation and water-treatment systems, petroleum extraction and the opening of a diamond mine. The company also drilled for oil off the coasts of Gabon and India, built irrigation dikes in Ecuador and Peru, power plants in Argentina, Mexico, and Paraguay, and pulp and paper plants in Chile.

It entered Europe in 1988 by purchasing a Portuguese highway and railroad builder and secured North Sea oil-drilling contracts by acquiring a British firm, SLP Engineering Ltd., in 1991. The Portuguese transport contractor, Bento Pedroso Construções S.A., Odebrecht's Portuguese subsidiary in this sector, won the right to construct and operate the Vasco da Gama bridge over the Tagus River, a contract valued at more than USD 1 billion. In 1994 foreign projects accounted for USD 811 million of Odebrecht's USD 2.18 billion in consolidated revenues.

Odebrecht entered the United States in the early 1990's by winning a contract to extend Miami's elevated-transit system. Odebrecht Contractors of Florida Inc. earned more than USD 400 million in public-works contracts during the 1990s, including a prominent part in the expansion and remodeling of Miami's international airport. By 2002, it was participating in the construction of Miami's American Airlines Arena, the South Terminal of the city's airport, and the city's Performing Arts Center. Odebrecht had taken part in more than 40 U.S. projects, including bridges and highways in the Southeast and the Seven Oaks dam-construction project in California, earning revenues of about USD 1.2 billion. The U.S. Army Corps of Engineers voted Odebrecht as its company of the year in 1999 for its construction of the Seven Oaks earth fill dam. The company had expanded overseas in such a successful manner that Brazilian government contracts represented less than 28 percent of Odebrecht's revenues in late 1993.

By 1990, Odebrecht had become a giant, with annual revenue of USD 2.6 billion and 43,472 employees. Petrochemicals now accounted for 30 percent of its assets. Foreign projects brought in USD 400 million, equivalent to 22 percent of its operating revenues. The following year Norberto Odebrecht, 70 years old at the time, yielded the presidency of the holding company to his eldest son, also called Emílio like Norberto's father, who was the president of the construction firm.

### Petrochemical investment

Odebrecht became the largest private investor in the Brazilian petrochemical industry during the early 1990s. The group bought assets not only from state-owned Petroquisa but also from numerous private holding companies, investing USD 350 million. It achieved its first controlling interest in a petrochemicals firm in 1992, when it bought a majority stake in PPH Companhia Industrial de Polipropileno, a polypropylene producer, from Petroquisa and the holding group Petropar. Its minority direct and indirect holdings included a stake in Unipar, a holding group participating in 16 petrochemical downstream companies, and Poliolefinas S.A.

Odebrecht kept expanding in the petrochemical industry when it joined forces with Petroquímica da Bahia S.A., a member of the Mariani group, in 2001 to purchase the government-owned holding company Companhia Nordeste de Participações (Conepar) for USD 320 million. In the same year, they acquired control of Petroquímica do Nordeste - Copene Ltda., Brazil's largest petroleum "cracker", the process in which complex organic molecules are broken down into simpler molecules through high temperatures and pressure.

In 2002, they merged several different companies into a new company, Braskem S.A., with majority control by Odebrecht and its head office located in Camaçari, Bahia.

Braskem immediately became Latin America's largest thermo-plastics producer and one of the five largest private-sector manufacturing companies. It integrated the production of feedstocks such as ethylene, propylene, and chlorine with downstream petrochemicals. Domestically, Braskem competes only with foreign companies in a country with one of the world's highest taxes on

thermoplastic resin imports. Hence, Braskem indirectly controls the price of oil products, with an estimated market share of around 80% of thermoplastic resins. Interestingly, Braskem is the only publicly traded company on the stock exchange in the group, however its control is mostly owned by Odebrecht Holding and Petrobras.

### Marcelo Odebrecht's leadership

In 1998 Norberto Odebrecht leaves the direction of the holding to his son, Emílio who, in turn, passes the command to Pedro Novis four years later and becomes president of the board. In 2008, in the wake of the global financial crisis, Marcelo Odebrecht, an engineer with a background in finance, grandson of Norberto and son of Emílio, becomes the CEO. He had been groomed by his predecessors to take charge of the family conglomerate, joining the company in 1992, after graduating in Bahia and worked on the construction of a building in the state capital, Salvador.

Under Marcelo's leadership, Odebrecht's empire prospered and lived its golden years from 2008 to 2015. When the heir took over the company, Odebrecht had BRL 40 billion in gross revenue, 84,000 employees and presence in 18 countries. By the end of 2015, the group had gross revenues of BRL 132 billion, 178,000 employees and was present in 25 countries. To put Odebrecht's gross revenue (internal and external) in perspective, the Brazilian GDP for 2014 was BRL 5.5 trillion, whereas the company totalled BRL 117 billion, or 2.1% of the GDP. At this point, its annual gross revenue growth over the 15 years previous to the arrest of Marcelo Odebrecht averaged 20%.

The holding company became one of the five largest business groups in Brazil and became the second largest employer in the country, behind only Petrobras. During the seven years of command of the Marcelo Odebrecht, the company's turnover more than tripled. The number of subsidiaries that were part of the holding company also doubled, from seven to 14. Odebrecht is a privately held family business and, in 2010, at the height of the global crisis, the IMD ranking considered Odebrecht as the best family business in the world.

His rise coincided with the second term of former President Luiz Inacio Lula da Silva, whose goal was to transform Brazil into a global power through the promotion of national companies and the development of a more robust infrastructure to the country. The construction division specialized in Government bidding contracts and concessions and heavily relied on subsidized loans from the State development bank, the BNDES. Between 2004 and 2013, the construction company and Odebrecht Oil & Gas received together more than BRL 498 million. But BNDES's favourite investee is Braskem: from 2008 to 2013, the petrochemical group received more than BRL 4.1 billion in loans.

Odebrecht was, for example, the main beneficiary from the contracts related to the 2014 Brazilian World Cup and 2016 Olympics in Rio de Janeiro. Of the ten largest projects involving these two events, Odebrecht participates in all but two. The total budget of the other eight projects with Odebrecht's participation in consortia exceeded BRL 27 billion.

Moreover, Odebrecht is the largest beneficiary of BNDES disbursements for export operations, having received more than USD 5 billion between 2009 and 2014. The company, relying on its network of contacts, including other local contractors, focused on building large projects in developing countries, such as airports in Mozambique, the Caracas' metro system and a port in Cuba, in line with President Lula's South-South foreign policy.

The construction company had reached a high level of diversification and internationalization, representing an outstanding development if compared to the beginning of the previous decade. By 2014, Odebrecht was present in 12 businesses, 3 investment funds, 3 auxiliary companies and 1 Foundation. In 2016, the company has scheduled the construction of Mexico's largest petrochemical complex, considered the most significant Brazilian industrial investment abroad in history. This internationalization effort also presented itself in the company's revenue. In 2015, Odebrecht Construção Civil's (OEC) portfolio had 79% of international contracts and only 21% of Brazilian contracts. In the same year, the Odebrecht Group had revenues of R \$ 125 billion, of which 75% came from international revenues.



## Corruption crisis in Brazil and abroad

According to the U.S. Justice Department, Odebrecht began to engage in bribery of officials in 2001. It became a frequent practice from 2006 on, when the company reportedly created an entire division dedicated to paying out bribes and other corrupt dealings. The division, called the Division of Structured Operations, had a separate computer system from the remainder of the company.

Besides this separate, complex computer system, Odebrecht also began to set up offshore accounts. In around 2010, the company allegedly bought a branch of an Austrian bank in Antigua to assist in further streamlining these illegal activities. Thanks to this complicated, well-developed system, Odebrecht was able to pay out roughly USD 788 million in bribes to secure profitable contracts in the countries it was operating.

In March 2014, Brazilian officials began a sting called Operation Car Wash, a massive investigation on the corruption scheme around the state oil giant Petrobras. Dozens of companies acknowledged paying bribes to politicians and officials in exchange for contracts with Petrobras, including Odebrecht.

Through this operation, officials determined that Odebrecht engaged in bid rigging, a process in which multiple companies would seemingly compete for projects. The reality was that Odebrecht oversaw the whole system, manipulating the process for its own gain.

In June 2015, the group's chief executive officer, Marcelo Odebrecht, was arrested. Since then, he and dozens of other company executives have been jailed. In total, 77 company executives agreed to plea bargains with Brazilian authorities, and the content of their statements to investigators were made public. By 2016, most executives had signed deals with Brazilian investigators, agreeing to confess to crimes and to identify corrupt officials in exchange for shorter prison sentences. Of those, 51 were dismissed, and the other 26 remained within the company, but out of executive positions or participation in business decisions.

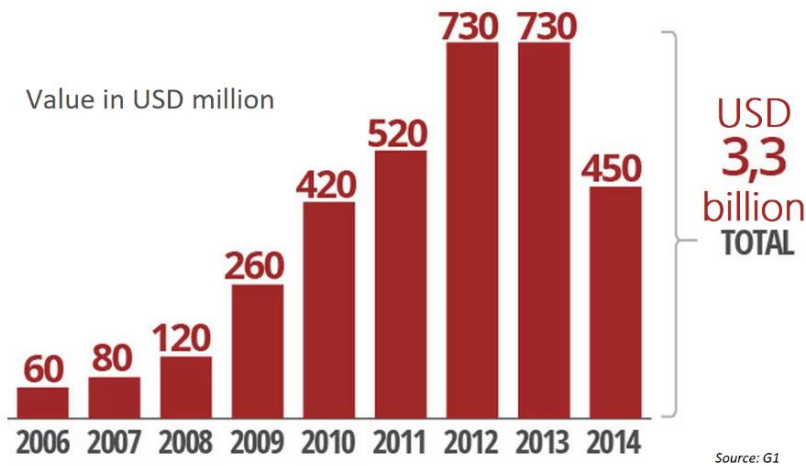
In March 2016, Marcelo Odebrecht was sentenced to 19 years and four months in prison for corruption, money laundering and criminal association, and resigned as president of the holding company in December of that year. He and his father, Emilio Odebrecht, signed an award-winning collaboration agreement in December 2016 and signed what has been described as the world's largest leniency deal with Brazilian, US and Swiss authorities, in which it confessed to corruption and paid USD 2.6 billion in fines.

Aside from the payment of fines, the agreement also stipulated the full disclosure of the company's executives' illegal acts and its supporting documents. The company was allowed to remain in the market, including the participation of bids and concessions, but must undergo an external audit and change in corporate governance in order not to perform illicit acts and to cherish ethics in its business. Among the important points of this agreement is the access to the Drausys system, a software used to control the kickback payments made in the scheme.

Reflecting on its international business presence, Odebrecht corruption allegations were not limited in Brazil. Company's executives have admitted illegal activities in different countries such as Argentina, Venezuela, Ecuador, México, El Salvador, Colombia, Dominican Republic, Panama, Angola and Peru. As Odebrecht executives have confessed to paying bribes in exchange for contracts in some of these countries, the company has also tried to settle cases with other governments so that it would be allowed to tender for future major infrastructure projects.

In Peru, for example, all four presidents who served in office between 2001 and 2018 have been implied in allegations of bribery with Odebrecht. Former president Alejandro Toledo (2001-2006) has been convicted by Peruvian courts and is considered a fugitive, currently living in the United States of America. Alan Garcia (2006-2011) committed suicide as police officers were preparing to arrest him over matters related to the Odebrecht scandal in April 2019. Ollanta Humala (2011-2016) was arrested in July 2017 and is currently awaiting trial. The last elected president, Pedro Pablo Kuczynski (2016-2018) resigned under pressure for different wrongdoings, Odebrecht included, was arrested in April 2019 and will remain in pre-trial custody for up to three years.

## Annual turnover from the Division of Structured Operations

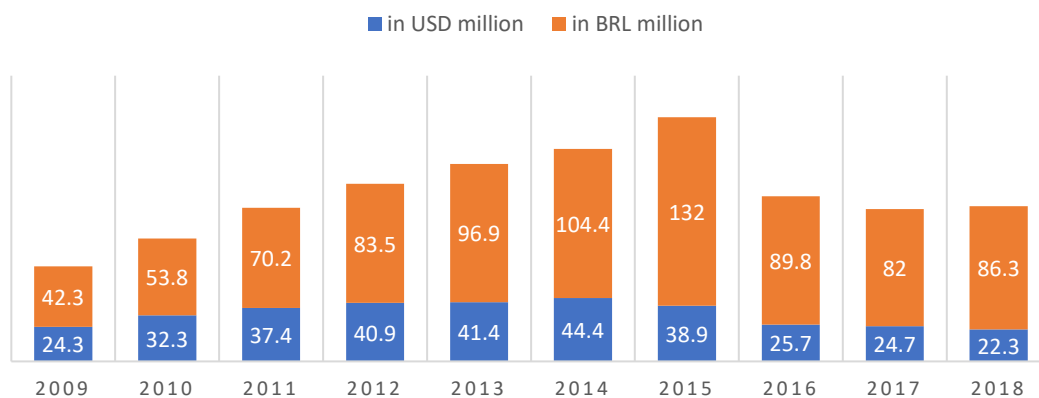


Odebrecht now

### Indicators

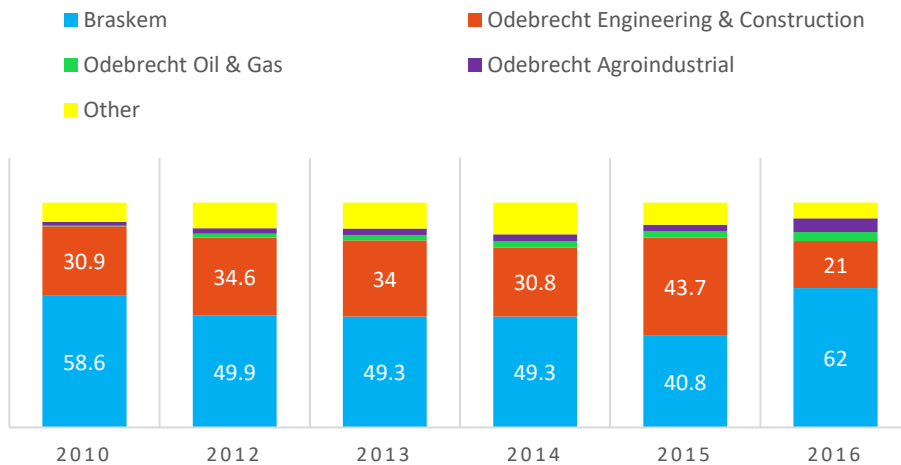
The evolution of Odebrecht’s gross revenue explicitly shows the substantial growth the company experienced in the early 2010’s. However, it is important to note that values in USD do not vary as much as the value in BRL due to the fact that, during Odebrecht’s height, the BRL experienced a significant appreciation over the USD.

## Gross revenue



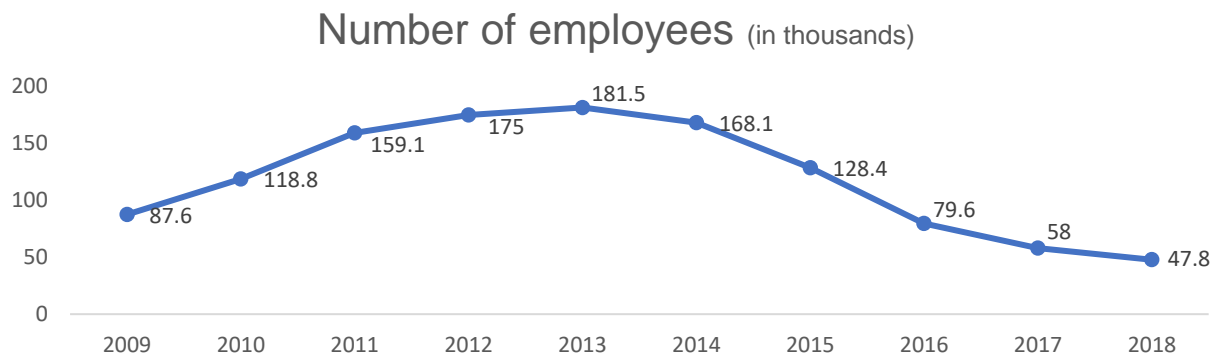
It is worthy to note the significance of both OEC and, especially, Braskem to the group’s total gross revenue. Despite incremental changes in the number of businesses within the holding, these two divisions have been responsible for, at least, 80% of the revenues of Odebrecht throughout recent years.

### Gross revenue per business



Source: Odebrecht’s annual reports 2010-2019

In consonance, the number of members within the company has seen a significant variation over the analysed period, showcasing how sensitive employment levels are with the company’s performance – even more so than revenue.



## Restructure

Following the corruption allegations made by the prosecutors in Brazil and abroad, Odebrecht had to make changes in its strategy both in terms of mitigating financial losses and to showcase a strict compliance to the public.

After admitting wrongdoings and signing a leniency agreement with Car Wash's officials, the corporation announced several changes in its structure, either by selling assets, creating compliance policies, changing its human resources policy, and even completely changing the name of some of the group's companies. According to Marcos Lessa, chief marketing officer of Odebrecht S.A., "When the company closed the delinquency and leniency agreement, it began a major process of reviewing its business structure and compliance systems".

With Marcelo Odebrecht's arrest, the group's management passed to Newton Souza and, in May 2017, Luciano Guidolin was elected president, with Emílio Odebrecht remaining chairman of the Board of Directors.

One of the changes was within the board of directors of the company. Before, the holding company Odebrecht S.A. played a more active role in the daily operation of the subsidiaries. Starting in mid-2018, as Emílio Odebrecht stepped down as chairman of the board of the holding company after 20 years, this overseeing role was fulfilled mostly by the board, acting as a **strategic architect** of the group. Hence, the governance model that Odebrecht has been implementing showcases a clear segregation of the role of shareholders and the management structure of the company. The family's ties within the daily operations of the group has also been severed as there are no longer any members of the Odebrecht family on the group board or executive positions in any company in the conglomerate. In addition, the board would now have to be composed of, at least, 20% of independent directors, with no former connections with Odebrecht S.A.

Since February 2017, the company has been monitored internally by about 20 members of the Attorney General's Office and the US Department of Justice. They will investigate, for three years, the contracts, balance sheets, vendor payments, documents and have carte blanche to enter anywhere in the company. In addition to government monitoring, Odebrecht has increased its

compliance team. In July 2017 there were 63 employees dedicated to this task, while in 2015 they were 30. The budget for this team is BRL 64.8 million, against BRL 11.3 million in 2015, an increase of more than 80%.

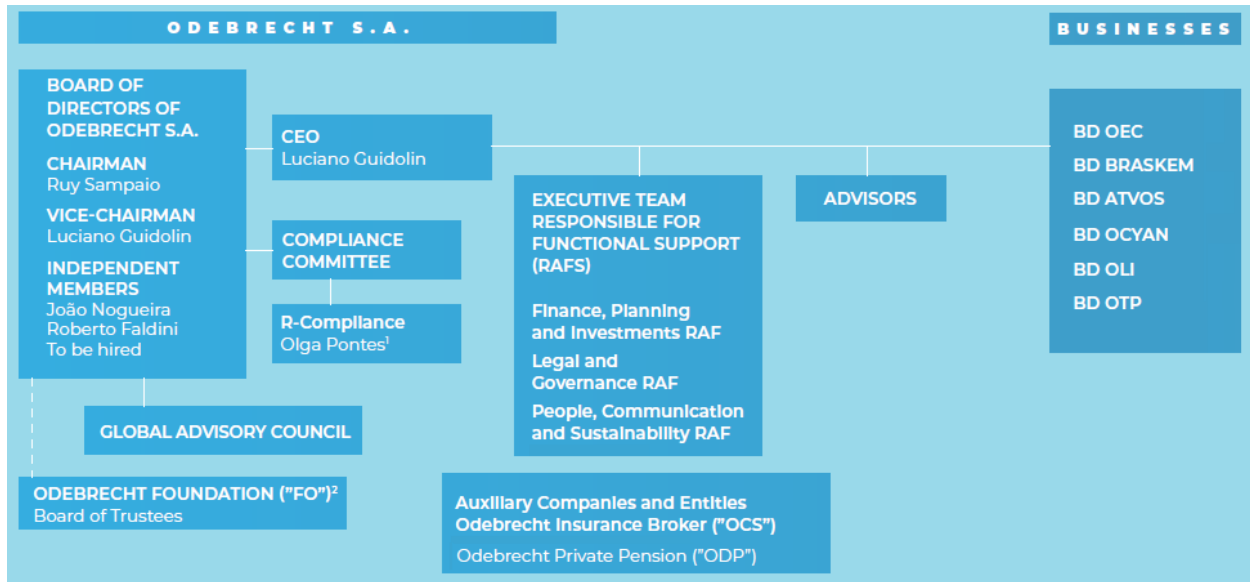
The strategy outlined by the company in its most turbulent period is to shrink to survive. It has successfully launched the ongoing process of deleveraging the Group through a program to divest assets worth BRL 12.5 billion. Odebrecht laid off 50,000 employees in 2016, reducing its staff to 128,000 people. The company has also sold various business divisions and participation in projects, such as Odebrecht Ambiental for BRL 2.5 billion, Embraport which was purchased by DP World, the Senandes Corredor Wind Complex and its participation in the concession of an airport in Rio de Janeiro, which belonged to Odebrecht Transport. The company also restructured the debts of some of its subsidiaries, such as Odebrecht Oil and Gas. Internationally, it has sold an oil block in Angola as well as hydroelectric dam and a highway in Peru.

Before the scandal, Odebrecht was not a company known to the general public. The holding companies, construction and oil and gas, dealt basically with other companies, without direct contact with the population. The first time many heard of the company was in the context of the investigations, making the name Odebrecht associated only to corruption.

One of the strategies used to tackle this issue was to change the name of the subsidiaries. Of the seven companies that remained in the group, five have changed their name or logo. Odebrecht Realizações Imobiliárias changed its name to OR and changed its logo; Braskem removed the red from its logo, which is now blue and yellow; Odebrecht Agroindustrial became Atvos; Odebrecht Oil and Gas is now called Ocyan; and, most importantly, Odebrecht Engenharia e Construção is now called OEC.

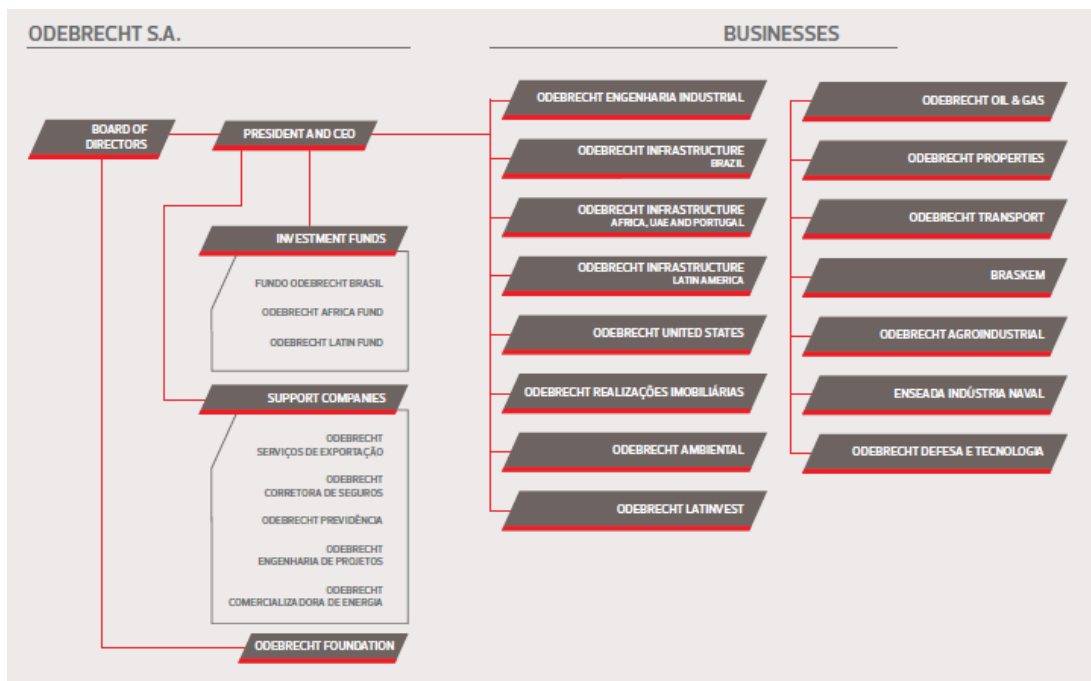
### Key companies

The 2019 annual report presented the following structure of the holding:



Source: Odebrecht's annual report 2019

The governance is heavily presented, more even than the business units. This presents a stark contrast with the company's 2014 annual report, at the peak of its glory days, when the huge scope of activities was highlighted and there was less emphasis on the board:



Source: Odebrecht's annual report 2014

### Future perspectives

This rebranding effort aims to give a new image to the general public, distancing itself from the name that arose in the media because of corruption and became heavily associated with it. This is especially important, as companies that are positively known to the public, tend to experience less impact on its image in a crisis, which is not the case of Odebrecht. To people more well informed and the companies Odebrecht does business with, however, these changes should not change their perception of the company.

One of the key missions of the new board of directors will be to encourage the different businesses of the Group to have partners, preferably through initial public offerings on the stock exchange. This is a critical change of strategy for the group, previously privately owned, in an effort to gain transparency and credibility.

The board will also have to focus on continuing to revise the company's policies, maintaining the cultural unity, supporting the succession process (by appointing an increased number of independent directors at all subsidiaries), attracting new talent and, more importantly, keeping a rigorous implementation of governance and the compliance system.

The challenges facing the group increased on June 17th 2019, when the Odebrecht Holding filed for bankruptcy protection in Brazil, the largest ever seen in the country. The company asked the court for protection while it seeks to restructure more than BRL 51 billion (USD 13.1 billion) of debt. Units **Braskem SA, Odebrecht Engenharia e Construção SA, Ocyan SA, OR SA, Odebrecht Transport SA, Enseada Indústria Naval SA** are not part of the restructuring.

**Apart from the BRL 51 billion, the holding company has inter-company loans and other debts totaling 98.5 billion reais, or more than \$25 billion. The holding came under strain in early June after the group's ethanol unit Atvos SA filed for bankruptcy protection and talks with LyondellBasell Industries NV over the sale of its petrochemical unit Braskem SA collapsed.**



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