



SPECIAL REPORT

# Peru: 2013 Business Prospects

Lima, February 2013

**d+i** LLORENTE & CUENCA

1. INTRODUCTION  
2. AN EFFECTIVE RECIPE: ECONOMIC GROWTH AND SOCIAL INCLUSION  
3. THE RISKS OF THE MINING DEPENDENCY  
4. URGENT GAPS: PUBLIC MANAGEMENT AND INFRASTRUCTURE  
5. REGIONALIZATION  
6. LEGISLATIVE PROCESSES  
7. THE UNION'S ROLE  
8. LABOR MARKET  
9. SOCIAL CONFLICTS  
10. SUSTAINABILITY  
AUTHORS  
LLORENTE & CUENCA

## 1. INTRODUCTION

The general view that entrepreneurs have on the social, political and economic context of the country is essential to create favorable scenarios of joint work to achieve the long-awaited development that everyone has been hoping for. Since we wanted to take account of the opinions of various business leaders, Directors, General Managers and representatives of major companies and associations of the most relevant productive sectors in Peru we decided to conduct this survey.

The aforementioned interviews included five items or topics:

- Public policies: which policies did they find appropriate and which needed further developments?
- Investment scenarios: which obstacles or hurdles did they have to overcome, what expectations did they have as regards growth?
- Regulatory or legal affairs: how did they interact with the pertinent State bodies?
- Business - Government relations: how good was the coordination between both parties and what role did unions play?
- Regional governments and decentralization: how would they improve and what was their opinion about the internal management of the country?

In this sense, we would like to thank all the people who greatly contributed to the preparation of this report. The findings will be found below.

**“Social programs seem like good initiatives, particularly due to their technical and non-political nature. With Trivelli, everyone supports the Government and will continue supporting it”**

**“I have seen the working plan of a social program in which we will participate and have been pleasantly surprised to see a flawless and very professional work. We know how difficult it is for them to implement it and it is precisely there where we want to provide our management skills and resources”**

## 2. AN EFFECTIVE RECIPE: ECONOMIC GROWTH AND SOCIAL INCLUSION

Entrepreneurs believe that the most valuable attribute of this government is the fact that it has decisively implemented its social program without modifying the economic model, as part of a policy that was launched in the nineties and has been maintained over time, despite the changes of government and their different ideologies. This clearly shows that long-term policies based on agreements that include all social sectors, besides being easier to implement, are also positive for the country.

As regards entrepreneurs, social inclusion policies are necessary and have served as a wake-up call for the sector. Businessmen are well aware that they have been ignoring this aspect and did not consider it to be a key factor within the business environment. Therefore, the business sector is now suffering reputation-related problems which are hard to overcome. They definitely recognize that the State has set an agenda promoting this field and understand that its sound public reputation is closely related to this aspect. Thus, many are now proactively supporting the State by aligning their CSR agendas with the initiatives fostered by the Government.

Poverty has been reduced by almost 30% over the past 7 years. That is, almost 6 million Peruvians have joined the emerging classes. Social programs can

complement and alleviate the needs of the sectors that do not benefit from this growth yet. Thus, while the economic growth is slowly enhancing the national development, social programs can solve the most urgent needs, those that the economic growth cannot cover yet.

Besides not changing the economic model and promoting social inclusion and the policies that have marked the government's approach, various specific policies should also be highlighted. The most relevant measure was the increase in the windfall tax on mining (ISM) which has marked the agenda since the new government took office. Furthermore, the Prior Consultation Act (LCP), which all respondents support, raises several doubts about its still unclear regulation, particularly as regards the worsening of the necessary administration processes to develop investment projects. Several respondents also commented on the existence of business models in which the very communities have shares in companies and that the LCP does not necessarily go against the business interests, as some people may think. Another policy supported by many of the interviewees was the wage increase in the sectors of Education and Health, in addition to those carried out in the Army and the Police. This is linked to the State and public management reforms that the Government has been boosting, besides improving the civil service conditions. Finally, another measure mentioned by several respondents was the Pension Fund Administrators reform

**“The international market concerns me far less than the domestic market. No new mining projects are being developed. We have neither launched Conga, nor Quilish. Yanacocha has reserves for only four more years and there is no replacement for the ounces of gold which have helped us survive as a country for 20 years”**

(AFP) -positively valued-, although it shows design and communication flaws that should be solved so that the issue is clarified in the eyes of the public opinion.

### 3. THE RISKS OF THE MINING DEPENDENCY

Many entrepreneurs have legitimately pointed out that the domestic consumption growth could be the national protective buffer against external disasters entailed by the drop in the prices of minerals or the Chinese economic slowdown, a country that strongly influences Peru, since the Asian giant is its largest purchaser. But if we are more specific, and according to the economic analysis of several respondents, domestic consumption would decline if the mining exports were to fall, since the Peruvian economy, including the emerging class, completely depend on it. Moreover, this sector has not yet entailed great impact local productive processes which enable the country to decrease the mining dependency. According to many of the interviewees, domestic consumption is growing thanks to mining. And this has not been achieved through the development of an important local industry, but due to the fact that the services' GDP has grown, as the mining industry required it.

The threat that this whole situation poses is the fact that the growth of the mining industry has not been achieved through an enhanced output. The rising mineral prices have been convenient for the country, but the concern of many

entrepreneurs is the related to the current context: the sector that mainly supports the national growth is producing less while new mining projects are not being launched. This represents a huge threat to the economy.

Thus, the aspects on which Government and the business sector must work urgently are clear. First, they need to promote the start of the mining projects that are currently locked and on which our economy depends; second, they need to take advantage of this economic boom to develop an important internal industry so that Peru slowly reduces the mining dependency.

In short, from the people who believe that Peru is experiencing a dangerous “mining dependency” which puts us in a comfort zone that does not let us see the fact that we are wasting an opportunity to develop our internal industry, to those who believe that the domestic consumption can be the protective buffer against a potential drop in the prices of minerals or the Chinese economic problems, most entrepreneurs are optimistic about the economic prospects of the country.

### 4. URGENT GAPS: PUBLIC MANAGEMENT AND INFRASTRUCTURE

All the interviewed entrepreneurs said that the gap in infrastructure is the most critical issue in Peru, a sector in which the most urgent investment projects need to be developed. Particularly, in the key fields of energy, transport and

**“The implementation of PPPs or works for taxes has taught us, as corporations, how difficult public governance is. We are finally recognizing that it did not depend on the political willingness of the authorities, but is an impressive network that has to be developed over the years”**

communications and sanitation. Employers recognize that this Government has the clear political will to provide the best possible scenarios for investment, but the management problems that the public administration needs to face are delaying their implementation.

Miguel Castilla, Minister of Economy, already confirmed it when he stated that there was too much paperwork and too many processes that a company needs to complete to carry out an investment project. Some interviewees even measured the costs that these processes and paperwork entail, which amounts to 1% GDP. Others have carried out studies showing that implementing a project takes about 5 years on average, from its inception to the end of the process. Cases such as Olmos, the Lima - Ica road or Camisea clearly illustrate this phenomenon, as they took several decades.

And the maintenance of this infrastructure is even worse. The central road, for example, is the only transverse road connecting Lima with important regions such as Junin, Pasco, Huanuco and Selva Central. In addition to being a road that has not been expanded since the 1930s, the year when it was built, if a landslide blocks it there are no alternative routes, generating interruptions every year from December to March.

This problem is even greater due to the lack of coordination within the State and the strong and authoritarian change of the rules governing agreements and

contracts. This is due to the great number of agencies involved in the long process that a company needs to complete to carry out a project, including processes with the Central Government, the Ministry of Energy and Mining, the Ministry of Culture –in case there are archeological remains in the region–, the Ministry of Transport and Communications and the regulatory bodies, as well as local and regional procedures. It is hard to face all these processes. Anyway, entrepreneurs recognize the great difficulties that dealing with the State entails, since these problems are systemic and have been present for decades.

To put an end to this “bottleneck”, Minister Castilla has launched the public management or civil service reform, which, according to him, would start in PROINVERSION with the recruitment of the best talent by offering competitive salaries in accordance with the market to avoid the high migration to the private sector. The Minister also spoke about mechanisms to enhance Public Private Partnerships (PPP) or the works for taxes. These measures certainly do not solve the current problems, but it shows the political willingness to correct the situation and that is a big step in itself.

Several respondents also pointed out an important aspect: the State should focus on the fields which cannot be delegated due to their nature: Justice, Security, Health, Education, Control, Regulation, etc. But in those sectors that require greater resources, both as regards management assets and human talent, authorities should seek

**“(Regionalization) was similar to the land reform, since the resource was granted without first developing the necessary skills to manage it”**

**“(...) we must work to strengthen the local capacities. It is not a matter of the State being absent. The State is there, but lacks the required skills. All entrepreneurs must invest in this field, since we are the main stakeholder in this matter”**

the aid of the entrepreneurs. The objective is for the State to become an efficient administrator and to leave the management of great projects to the private sector.

Thus, entrepreneurs need to receive tools and assets to speed up these processes. In addition to taking advantage of the PPPs or work for taxes, they need to take a more proactive role in the design and implementation of government initiatives and aid the State in the fields where it lacks the necessary resources through the transfer of powers, ultimately benefiting themselves in their quest to enhance the implementation of major investment projects.

## 5. REGIONALIZATION

The geographical factor opens up larger gaps in management and infrastructure. Several interviewees spoke about Lima and the interior region, some mentioned several “Perus”, with different languages, values and worldviews. Others just thought there were larger gaps in training and management, but identified the same problems of corruption and institutionalism everywhere despite the cultural differences. But everyone agreed on the hurried nature of the process of decentralization, which involved the appointment of posts with pretentious names without a clear objective and entailed the duplication of bureaucratic functions in several districts. This was one of the worst mistakes of the current Government.

The problems that entrepreneurs identify in these regions do not point to the authorities holding these posts –although several of them raise serious doubts—. They do not believe that these regions are not entitled to be represented either. Entrepreneurs believe that the problem lies in the poorly designed system and almost all agree on the fact that this problem cannot be solved. However, there have been cases of successful Regional Governments, curiously, in the regions receiving little or no money from the mining taxes.

In this field, the Government has the great challenge of redistributing the revenues from the mining taxes in a much more effective way. This Government is responsible for carrying out this policy.

That being said, as regards entrepreneurs, these regions require the development of competence transfer models which unlock the processes and establish solid and lasting relations with the local and regional authorities.

## 6. LEGISLATIVE PROCESSES

As regards the Congress, a particular aspect among its basic functions should be noted: the enactment of Laws. To this end, the best possible context would involve consulting a large number of social actors affected in some form or another by the Law. In theory, unions are responsible for channeling the demands and views concerning the legislative proposals. All social actors have the right to express their

**“(...) we must play a more active role in the public debate. No entrepreneur has taken a stance in regard to the increase in the number of congressmen, for example. It is serious, since we could have a view on this issue and ask ourselves: What salary would this public official have if he worked for me?”**

interests to the Congress and the latter has the obligation of listening to them, debate their requests and, finally, choose the best option, the one benefiting the majority. It is the role of legislators to seek input from all players, involve them in the decisions and thus create the Laws in the best possible way.

Entrepreneurs –and, probably most social actors– consider that Congressmen are not doing this task properly. In fact, quite the opposite. That is, they enact Laws without asking for their opinion, despite the fact that they are the most suitable people for this task, since they are specialists in the areas that these Laws seeks to regulate. In the end, this process results in anti-technical regulations. The lack of rigor in the establishment of Laws seeking to promote the general good, added to the scandals surrounding the parliamentary activity –the least valued public institution– translate into a rather serious threat to social order, as it can promote initiatives that distort the common good and have negative consequences, besides ultimately entailing much more radical measures to enhance their functioning.

In this sense, it is urgent to reform the legislative sector to promote a serious self-regulation which shows signs of political willingness to enhance its institutional reputation and management.

The Congress should debate systemic issues such as the nature of the vote, for example, whether it should be mandatory or voluntary,

or the issue of removing the preferential vote so that people do not merely elect candidates within the political parties depending on the amount of money they have donated; or more functional ones: whether to go back to Bicameralism, given the need to raise longer-term policies and not get lost in the daily management activities, among others.

In any case, it is clear that the Legislative Power needs to be reformed and it has to involve congressmen themselves and other social actors, those who need to demand this reform. Entrepreneurs thus have a legitimate task, since the sustainability of the common good and their investments depend on it.

## 7. THE UNION'S ROLE

It does not come as a surprise that there is mutual distrust between politicians and entrepreneurs, and the fact that government officers think that the collaboration between the State and the business sphere is high and sufficient, compared to a much less optimistic perception among businessmen. According to the latest Business - Government study carried out by LLORENTE & CUENCA (2012), the confidence that entrepreneurs place on public policies range from sufficient (55.3%) to low and non-existent (36.2%), while politicians consider it to be sufficient (50.7%) or even high or very high (39.1%).

But the most striking point are the mechanisms of joint work: entrepreneurs think that

**" (...) a meeting between an entrepreneur and a congressman is certainly not unethical. The offices of the German Congress, for example, are made of glass for these meetings to be public. In Peru, publicly meeting entails scandals, despite it being the best option, since more people will see it"**

the government support for the business sector is enough (47.4%) or low (46.1%), unlike politicians, who consider it to be sufficient (55.1%) or high (27.5%). Entrepreneurs clearly feel as if they are not part of the policy-making process while politicians believe the opposite. This lack of coherence is counterproductive for both, since it prevents the achievement of synergies so as to work towards mutual goals with greater efficiency and fewer costs.

However, entrepreneurs do think that there is a close relationship between the government and the leaders of each sector, although this relation needs to be carefully managed due to the potential perceptions that the public opinion might have. Thus, the relation is kept confidential, although making it public would probably be seen as a sign of transparency that would ultimately strengthen the relationship in question.

As regards the middle management levels, the context is more complex, since there are more hurdles to establish mechanisms for joint work, which in turn translates into bottlenecks.

The appropriate channel to convey these different views and interests, in addition to promoting joint efforts, should be the unions. But entrepreneurs clearly state that the latter are not fulfilling this task. All respondents agreed on the fact that the relationship mechanisms are still informal, i.e.,

there is a lack of institutionalized, fully public processes which promote transparency.

In their opinion, unions should stop being organizations that merely seek to approve or block laws to achieve a positive impact on the sector they represent, merely benefiting a small group of enterprises.

It is clear then that unions must fight the perception that their very own members have of them. Thus, this call for transparency should be achieved through the formalization and institutionalization of the Company–Government relationship, in a context governed by pre-established processes included on the agenda of both parties.

Moreover, unions must look inward and work to strengthen their respective sectors, for example, by formalizing and standardizing the corporate practices as regards their technological development levels or the certification of good practices in all companies. In this way, they would have a greater weight and support to achieve commercial benefits, whether tariff-related or access to markets that were previously restricted due to the lack of certifications.

Finally, entrepreneurs must increase the resources and commitment to the union activity, including it as an important aspect of their business and corporate plans, as well as significantly improving the collective inputs.

**“(...) we need more Senatis, more Tecsup. For example, we lack specialized and better trained truck or heavy load drivers, who have technological skills and can not only handle huge machinery, but also computers or tablets to better carry out their work (...)”**

## 8. LABOR MARKET

The only aspect that the respondents mentioned as regards labor affairs was the lack of specialized technicians and professionals. This does not only affect the activities at the intermediate level, but also as regards the management sphere. Many entrepreneurs are already considering the possibility of hiring the critical mass of unemployed European professionals. Others defend the business initiative seeking to create specialized technical education centers, in addition to the already existing ones: Tecsup and Senati or the Engineering and Technology University (UTE) promoted by the Hochschule group.

Furthermore, entrepreneurs should consider other aspects of the labor market context in Peru, the public policies that the Government has mentioned and the consequences they would have on companies, particularly as regards labor disputes.

In general, labor figures in Peru have improved if compared directly to the growth experienced in other economic areas. According to the INEI, the number of employed people increased from just over 13 million to 15.3 million between 2004 and 2011. This represents an average annual growth of the working population of 2.3% during the aforementioned period. It should be noted that the country needs to make efforts to enhance the working

conditions, since most members of the aforementioned group are underemployed.

However, the growth of employed people took place throughout the whole country, with the exception of two specific regions in which it decreased: Ancash (-0.8%) and Cajamarca (-0.5%). Similarly, as regards the gender variable, the female working population grew more (2.6%) than its male counterpart (2.1%).

In the midst of these indicators, the current government proposed several policies aimed at improving the labor conditions. Increasing the minimum wage and the Law on Safety and Health at Work were the two most relevant initiatives that the Government promoted at the beginning of the term. More specifically, the latter is the measure that has entailed the greatest obligations for companies. Although the impact on the workers' welfare is undeniable, several experts argue that these rules have not been debated; the government imposed them unilaterally.

Another area where much progress is needed is informal employment, since the approved regulation merely involves already formalized companies. For many analysts, the largest challenge of the government is not to create more jobs, but to formalize existing ones, protecting both dependent and independent people.

Furthermore, one of the last measures of the government was the creation of the Superintendence of Labor Inspection (SUNAFIL), which will strengthen labor inspection and control measures. Clearly, this is an appropriate measure to formalize the employment and fight underemployment. But it also a great challenge for companies seeking to improve the working conditions of their organizations.

Finally, the most important issue is the affair of labor disputes, which have slightly increased in recent years, both as regards the government and companies, whether represented by trade unions or not.

As regards the government, labor disputes involved the SUTEP unions, which paralyzed the school activities for almost two months and EsSalud, which ended the doctors' strike after 33 days. In both cases, a wage increase was the solution to satisfy the demands that both sectors had had for several years. These demands have also spread to the Judiciary sphere. Ideally, these measures would be combined with job evaluation initiatives seeking to improve the quality of the services, both in relation to Education and Health.

In relation to companies, it is always more convenient to solve the disputes before both parties decide to go to court, which would not only entail further costs, but would also have a negative impact on the corporate image. Enterprises should also establish preventive policies to identify potential conflicts and

prevent needing to act reactively against demonstrations or work stoppages. Instead of going to court, it is more appropriate to verify the compliance with the rule and reach an agreement between both parties.

## 9. SOCIAL CONFLICTS

Social conflicts are harmful to everyone concerned. To solve them, it is necessary to understand their origin. There are many factors involved in each social conflict. From the clear demands in relation to the environmental impact to lobbying activities for particular or political reasons. In any case, entrepreneurs must take a much more proactive stance on the matter.

The Ombudsman has reported 227 social conflicts since December, a figure that has been decreasing since June, when 247 cases were recorded, the highest peak in 2012. 148 were environmental issues and the vast majority mining affairs.

If we analyze the post-Conga project context, the dialogue between government and the communities involved in these conflicts seems to be positive, since there has been a clear drop in the number of conflicts recorded in the second half of the year.

What entrepreneurs need to understand first is the fact that, unfortunately, given the poor organizational capacity of the State, the latter must

**“(...) why do social conflicts arise? Why do entrepreneurs have a bad reputation? People always say “Peru has been on the wrong track since Velasco”, but do not understand that Velasco was the result of the business practices of former times, they do not want to realize, we do not want to realize and we focus on the short term. The problem of Peru is the lack of leadership”**

prioritize its mediation in urgent cases. Thus, the challenge for companies is to solve on their own the conflicts that are not on the public agenda of the central government. This type of disputes probably account for most of the conflicts that companies need to face. In this way, the large list of disputes that the State has been unable to solve so far would also be reduced. In fact, companies have much better tools and a greater experience in the contexts in which they operate.

Conga has been the great indicator of the performance of all involved players in an environmental conflict that even divided the country. We need to learn from this experience and establish collaboration mechanisms to generate loyalty among the various social actors to achieve the desired predictability. A previously mentioned measure, the transfer of competences and management capabilities to regional and local governments, would be a valuable option if companies are capable of convincing the authorities that a better management is the best possible campaign they can launch if they have legitimate political aspirations.

Another aspect they need to improve is the creation of collaboration networks with other organizations or entities: companies operating in the same area of influence, local governments, community organizations, NGOs, etc. This should be the goal of

an efficient department of institutional relations.

Instead of asking the State to act as a mediator, companies need to align their CSR actions with the Social Programs launched by the government. That is, supporting the State and lightening its workload so that it can solve our problems. In this way, the network of partners is established through a planning that is aligned with the business strategy and not through individual requirements or particular interests.

However, the most important point is the fact that entrepreneurs must understand that they are not victims of the public distrust, but have been its cause. The bad business practices carried out over the last century have entailed a liability that the whole sector needs to overcome. Thus, the first step to design any action concerning social conflicts implies assuming that liability and truly defending the social demands out of conviction and not merely due to philanthropic reasons.

## 10. SUSTAINABILITY

There are various levels of progress in relation to the establishment of a sustainability policy. Some entrepreneurs feel as if by paying their taxes they have already fulfilled their responsibilities towards society and believe that the State is responsible for promoting the common good. Thus, they feel entitled to require the State to fulfill its role in the best possible way.

**“(...) should entrepreneurs participate in politics? Of course they should! Because 80% of the Peruvian population believes that entrepreneurs are corrupt. If I did my job well, implementing a long-term approach, I would promote the common good rather than the corporate interest, as this would entail a positive scenario for my own business (...)”**

But others look at the situation in perspective and recognize that they have a greater responsibility than other entrepreneurs consider, due to the previously described old practices, which did not take into account the collateral harm they did to their employees, the communities around their production facilities, the impact on the environment, lobbying bad practices, the lack of quality control on products and services, abuse of power, abuse of other sectors, models merely seeking to generate returns without measuring their impact, etc.

We must even recognize that all social actors might be partially responsible for the situation in Peru, although entrepreneurs have played a much more prominent role in this process, due to their privileged position. Their access to resources, health and education turned it into an elite that should have planned the future that we are currently experiencing in a better manner as well as foreseeing the consequences more clearly.

Respondents who recognized this situation understood that the whole process entailed a legitimate resentment that lead to the current problems of reputation whose origin many businessmen still do not understand. This area must be worked on and not necessarily because businessmen acknowledge that they have an important “social debt”, but also because of the very sustainability of their businesses.

Indeed, all the aforementioned points show a lack of leadership to help the business sector develop its activities taking the future into account. This foresight also implies thinking about the sustainability of the business, although it should not become its main leitmotiv. Thus, they must use their vast resources to promote the common good, as it will improve their own welfare and their presence in the market.

Several aspects need to be taken into account as part of this demanding attitude. First, entrepreneurs need to recognize that their responsibility in this

**“(...) what would happen if the Financial Statements covered periods of 5 or 10 years? If we changed the reporting period from 12 to 60 months, we would work in the medium to long term and we would not focus on the daily activities. This is what Nobel Prize winners say, the economic gurus. Are we fulfilling our role? Certainly not. It is a necessity, not an option: we have to integrate all aspects of the life in society into our Business Plan (...)”**

issue is greater than they used to think. Second, they have to play a much more proactive role, not merely fulfilling their tax obligations, but working to help the State and not permanently ask the latter to support them. Moreover, entrepreneurs must play a more active role in politics and public issues, as they have been doing in the economic sphere and, lately, in social affairs. Education must also be taken into account, since one of the shortcomings of the country is the lack of entrepreneurs training other entrepreneurs. New generations need to acquire this type of leadership and vision that previous generations lack.

To the almost compulsory Corporate Governance, entrepreneurs now need to add the Theory of Integrity or Business Ethics, a concept that involves the responsibility for all aspects of social life. It is not a matter of turning companies into NGOs. It is a matter of promoting a greater social and public involvement.

Entrepreneurs invest, pay taxes, risk their capital, make huge efforts, create jobs and that is certainly positive, but unfortunately not enough. It is the time to go beyond, to think about the community and the country, since the current consumers might not exist anymore in ten or twenty years. It is a matter of thinking sustainably.

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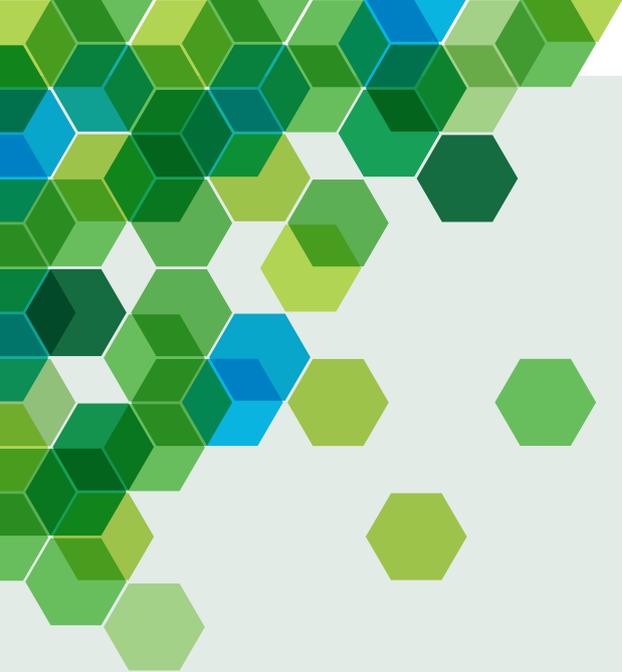
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