ARIZONA STATE UNIVERSITY

GENERAL STUDIES COURSE PROPOSAL COVER FORM

Course information:

*Copy and paste **current** course information from Class Search/Course Catalog.*

College/School: Thunderbird School of Global Management | Department: BGM

Prefix: TGM | Number: 353 | Title: Regional Management Enviornment | Units: 3

Is this a cross-listed course? No | If yes, please identify course(s)

Is this a shared course? No | If so, list all academic units offering this course

*Note- For courses that are crosslisted and/or shared, a letter of support from the chair/director of **each** department that offers the course is required for **each** designation requested. By submitting this letter of support, the chair/director agrees to ensure that all faculty teaching the course are aware of the General Studies designation(s) and will teach the course in a manner that meets the criteria for each approved designation.*

Is this a permanent numbered course with topics? No

If yes, all topics under this permanent numbered course must be taught in a manner that meets the criteria for the approved designation(s). It is the responsibility of the chair/director to ensure that all faculty teaching the course are aware of the General Studies designation(s) and adhere to the above guidelines.

Chair/Director Initials _____ (Required)

Course description: **Provides future global managers with the analytical tools and frameworks for understanding the political, social, cultural and economic contexts within which business activities take place in various countries and regions throughout the world.**

Requested designation:

Mandatory Review: No

Social-Behavioral Sciences–SB

*Note- a **separate** proposal is required for each designation.*

Eligibility:

Permanent numbered courses must have completed the university's review and approval process. For the rules governing approval of omnibus courses, contact Phyllis.Lucie@asu.edu.

Submission deadlines dates are as follow:

For Fall 2016 Effective Date: October 1, 2015

For Spring 2017 Effective Date: March 10, 2016

Area(s) proposed course will serve:

A single course may be proposed for more than one core or awareness area. A course may satisfy a core area requirement and more than one awareness area requirements concurrently, but may not satisfy requirements in two core areas simultaneously, even if approved for those areas. With departmental consent, an approved General Studies course may be counted toward both the General Studies requirement and the major program of study.

Checklists for general studies designations:

Complete and attach the appropriate checklist

- Literacy and Critical Inquiry core courses (L)
- Mathematics core courses (MA)
- Computer/statistics/quantitative applications core courses (CS)
- Humanities, Arts and Design core courses (HU)
- Social-Behavioral Sciences core courses (SB)
- Natural Sciences core courses (SQ/SG)
- Cultural Diversity in the United States courses (C)
- Global Awareness courses (G)
- Historical Awareness courses (H)

A complete proposal should include:

- ☒ Signed course proposal cover form
- ☒ Criteria checklist for General Studies designation(s) being requested
- ☒ Course catalog description
- ☒ Sample syllabus for the course
- ☒ Copy of table of contents from the textbook and list of required readings/books

It is respectfully requested that proposals are submitted electronically with all files compiled into one PDF.

Contact information:

Name: Cheri Roberts | E-mail: cheri.roberts@asu.edu | Phone: 602-978-7335

Department Chair/Director approval: *(Required)*

Chair/Director name (Typed): Roy Nelson | Date: 6/13/16

ARIZONA STATE UNIVERSITY

Chair/Director (Signature): Roy Nelson

Arizona State University Criteria Checklist for

SOCIAL-BEHAVIORAL SCIENCES [SB]

Rationale and Objectives

Social-behavioral sciences use distinctive scientific methods of inquiry and generate empirical knowledge about human behavior, within society and across cultural groups. Courses in this area address the challenge of understanding the diverse natures of individuals and cultural groups who live together in a complex and evolving world.

In both private and public sectors, people rely on social scientific findings to consider and assess the social consequences of both large-scale and group economic, technological, scientific, political, ecological and cultural change. Social scientists' observations about human interactions with the broader society and their unique perspectives on human events make an important contribution to civic dialogue.

Courses proposed for a General Studies designation in the Social-Behavioral Sciences area must demonstrate emphases on: (1) social scientific theories, perspectives and principles, (2) the use of social-behavioral methods to acquire knowledge about cultural or social events and processes, and (3) the impact of social scientific understanding on the world.

Revised April 2014

Proposer: Please complete the following section and attach appropriate documentation.

ASU--[SB] CRITERIA

A SOCIAL-BEHAVIORAL SCIENCES [SB] course should meet all of the following criteria. If not, a rationale for exclusion should be provided.

YES	NO		Identify Documentation Submitted
☒	☐	**1.** Course is designed to advance basic understanding and knowledge about human interaction.	Syllabus, textbook, and coursepack
☒	☐	**2.** Course content emphasizes the study of social behavior such as that found in**:** • ANTHROPOLOGY • ECONOMICS • CULTURAL GEOGRAPHY • HISTORY	Economics, History, Social Science (Political Science)
☒	☐	**3.** Course emphasizes: **a.** the distinct knowledge base of the social and behavioral sciences (e.g., sociological anthropological). **OR** **b.** the distinct methods of inquiry of the social and behavioral sciences (e.g., ethnography, historical analysis).	Syllabus and coursepack
☒	☐	**4.** Course illustrates use of social and behavioral science perspectives and data.	Syllabus and coursepack
		THE FOLLOWING TYPES OF COURSES ARE EXCLUDED FROM THE [SB] AREA EVEN THOUGH THEY MIGHT GIVE SOME CONSIDERATION TO SOCIAL AND BEHAVIORAL SCIENCE CONCERNS:	
		• Courses with primarily arts, humanities, literary or philosophical content.	
		• Courses with primarily natural or physical science content.	
		• Courses with predominantly applied orientation for professional skills or training purposes.	
		• Courses emphasizing primarily oral, quantitative, or written skills.	

Course Prefix	Number	Title	General Studies Designation
TGM	353	Regional Management Enviornment	SB

Explain in detail which student activities correspond to the specific designation criteria. Please use the following organizer to explain how the criteria are being met.

Criteria (from checksheet)	How course meets spirit (contextualize specific examples in next column)	Please provide detailed evidence of how course meets criteria (i.e., where in syllabus)
1	The entire course is designed to use frameworks for analysis to explain political and economic trends in Latin America.	Week 3 of the syllabus focuses on the theoretical frameworks/"tools for analysis" - such as the "Packenham Model" (a political science/ecomomics analysis model used to assess economic trends in Latin America; "Causes and Consequences of Brazil's Devaluation" (which is a framework to assess prospects for financial crisis and currency devaluation in individual countries); artciles on bargaining between host country governments and transnational enterprises (to show how governments acquire moe baragining power to demand concessions over time). All of these are theoretical frameworks grounded in political sciience, economics, and historica/cultural analysis. See Week 3 of the Syllabus, and look at articles related to these topics in the coursepack.
2	The course focuses on understanding the historical, economic, political, and cultural aspects of Latin America relevant to doing business in the region.	In the syllabus, Weeks 1 and 2 of the course focus on the geographic/demographic/historical/cultural/economic overview of Latin America; Week 3 focuses on "Tools for Analysis" which includes assessing the economic situation in Latin America; and every week includes political, economic, historical, and cultural analysis of individual countries. See Textbook, coursepack, and every week of the syllabus to support this.
3a	This course approaches the analysis of the Latin America region from multiple social science perspectives - economic analysis, political science analysis, sociological	Week 3 focuses on "Tools for Analysis" includes tools for economic assessment - from "Causes and Consequences of Brazil's Devaluation" (see coursepack) to articles on bargaining between multinational corporations and host country governments (see coursepack), etc. These

	analysis, etc.	theoretical/frameworks/tools are applied every single week thereafter for each country case (Brazil, Argentina, Mexico, etc.). (See syllabus and coursepack to support this - especially for Weeks 3 and thereafter.)
4	Every aspect of this course, from Week 3 onwards, is grounded in social and behavioural science concerns.	Week 3 focuses on developing "Tools for Analysis" for economic and political frameworks which are used to asess political and economic trends in specific Latin American countries. These are then used to explain each country case thereafter from these political and economic perspectives. See syllabus and coursepack for Week 3 to see these tools - specifically, "Summary of the Packenham Model"; "Causes and Consequences of Brazil's Devaluation" and the articles on bargaininng. These ttheories are then used to explain outcomes in the "Retail in Mexico" case, the "Intel Site Selection" case, and every country case on Brazil, Argentina, Mexico, etc.

THUNDERBIRD
SCHOOL OF GLOBAL MANAGEMENT

Syllabus

GM 4640-Regional Business Environment: Latin America

Professor: Dr. Roy Nelson
Office: Rm. 10 (Faculty Offices Building)
Telephone: 978-7025
E-mail: roy.nelson@thunderbird.edu

Spring Trimester, 2013
Hours: T/Th, 4:30-5:30 PM
(or by appointment)

Course Description:

This course surveys the geographical, historical, cultural, and political context of doing business in Latin America. The first part of the course provides a brief geographical and historical overview of the region, and develops analytical approaches to the study of Latin America. The second part of the course focuses on individual country cases: Brazil, Argentina, Mexico, Chile, Costa Rica, Peru, Venezuela, and Colombia. Throughout the second part of the course we will also be looking at current issues relevant to doing business in Latin America, such as economic liberalization and regional economic integration (NAFTA, Andean Community, and MERCOSUR). The purposes of the course are 1) to provide the international manager with a general familiarity with Latin America; 2) to develop analytical tools useful for understanding Latin America.

Required Books:

- Robert T. Buckman, *Latin America 2012* (46th annual edition). Washington, D.C.: Stryker-Post Publications, 2012. [This is the most recent edition.]
- Roy C. Nelson, *Harnessing Globalization: The Promotion of Nontraditional Foreign Direct Investment in Latin America* (Penn State Press, 2009). (Available on reserve or on Amazon.com.)
- GM 4640 coursepack (Nelson, GM 4640, Spring 2013).

Course Requirements:

There will be three case quizzes, a mid-term, a 5-7 page analytical research paper, a group project (the Corporate Site Selection Challenge) and a final exam. The paper is designed as a political/economic risk assessment for a country of the student's choosing; it must make reference to a specific business project chosen by the student (with the instructor's approval).

As part of Thunderbird's Writing Program, you will also write a 1-2 page analysis of the business project that is the topic of your research paper (see handout for more details on this assignment). This analysis will become part of your final 5-6 page research paper. See further details on the writing program at the end of this syllabus.

Course Grading:

Case Quizzes	10% (approximately 3.3% each)
Midterm	20%
Research Paper	20%
Group Project	15%
Final Exam	30%
Class Participation	5%

Course Objectives	Learning Outcomes	Assessments
To develop tools of analysis for understanding trends and developments in the Latin American business environment and in the business environment of specific Latin American countries.	Ability to think analytically in a global context.	• Examination • Case Quizzes • Group Presentation • Class Participation
To develop skills relevant to researching business prospects for a specific company in a specific Latin American country.	Ability to demonstrate effective written communication skills.	• Research Paper • Group Presentation
To develop students' understanding of Latin America and the prospects for conducting business in the region.	Knowledge of a particular region of the world (economic, social, governmental, cultural, etc.)	• Examinations • Group Presentation • Case Quizzes • Class Participation

THE RESEARCH PAPER: GUIDELINES

The paper is intended as an assessment of the prospects for a specific business project in the country you select. (Note: the country you select for your paper must be different from the country you select for your group project.) The paper should be 5-7 pages, double-spaced (typed). You **must** include footnotes (or endnotes) and a bibliography. (Endnotes, bibliography, and appendices, if any, will not be counted as part of your page total.) The paper will be due in three stages, as follows:

STAGE 1 DUE:	Thursday, February 7(11:55pm)	Paper Topic Proposal (one or two sentences)
STAGE 2 DUE:	Friday, February 22 (11:55pm)	Preliminary 1-2 page project analysis
STAGE 3 DUE:	Friday, April 5 (6:00pm)	Final 5-7 page paper

The paper proposal only needs to state your proposed business project. One or two. sentences, or a brief paragraph, would be long enough. I will provide comments on it. It is due **THURSDAY, February 7.**

The preliminary 1-2 page project analysis, due **FRIDAY, February 22**, is an assessment of the viability of the business project in your selected country. You can incorporate your research and writing from this preliminary analysis into the final research paper. Although I will not grade this preliminary analysis, I will be happy to advise you on it and discuss it with you at length. Also, the staff at the Thunderbird Writing Assessment Program will use this paper to assess your writing skills, and provide you with assistance in order to improve your final paper. *Writing is an essential business skill; I urge you to take advantage of this opportunity.*

The final 5-6 page research paper, which ***is*** graded and which I will grade entirely myself, is due **Friday, April 5.** *(Please note: I will need both a hardcopy version of this paper placed in my box on the Faculty Offices Building, and an electronic version uploaded into the drop box.)*This paper is a more in-depth assessment of the viability of the proposed business project given the **relevant** political, economic, cultural, demographic, and/or geographic factors in the country you select.

Given the severely limited length of this final paper, you cannot cover all of factors that might affect the viability of your project, but I urge you at, a minimum, to provide an assessment of the relevant political and economic factors that affect the viability of your proposed project. The challenge is to focus only on the most relevant factors in order to write a tight, persuasive analysis of the viability of your project.

Some suggested factors to consider:

Political Assessment: the long-term outlook for political stability; the nature of the current government's economic program; political factors behind changes in exchange rates; any recent legislation passed in the Congress relevant to your project; how any upcoming elections will affect business prospects in the coming year; the major power contenders in the country--domestic business firms, the military, labor, interest groups, politicians in the National Congress, dominant political parties, family networks, etc.--and the best way to deal with them.

Economic Assessment:

Current and projected rates of growth for the country; economic factors that could lead to a devaluation, depreciation, or appreciation of the currency; economic policies of the current government; inflation, unemployment, etc. (if relevant to the project).

Other Issues:

the effects of any specific cultural factors; the influence of unique geographic or demographic factors; the status of intellectual property rights; potential problems with corruption; any terrorist activity that might affect business

Course Schedule

(Note: all readings listed below are required. Asterisks (*) indicate course pack materials; a plus sign (+) indicates that the material is linked in the TLE coursepage. Additional required readings may be distributed in class or placed on the TLE coursepage throughout the semester.)

PART I: THEMES AND APPROACHES

WEEK 1 (January 29-31; ALSO: Friday, February 1 Make-Up Sesssion: 1-3pm – Location TBD)

TOPIC: **Introduction; Overview of the Latin American Business Environment**

READ: Geographic and Demographic Overview:

*Stephen R. Pelletier, "Latin America: A Geographic Preface," from Richard Hillman (ed.), *Understanding Latin America* (Boulder, Co.: Lynne Rienner Press), pp. 9-26. (Optional)

Historical Overview:

+William R. Rhodes, "Third World Debt: The Disaster That Didn't Happen," pp. 21-23. (Optional)

WEEK 2 (February 5-7)
Deliverable Due: Upload Paper Topic Proposal by Thursday, February 7 at 11:55 pm

TOPIC: **Cultural and Economic Overview of Latin America; Tools for Analysis**

READ: *Economic Overview:*

*John Williamson, "What Washington Means by Policy Reform," pp. 7-19. (Required)

*Stephanie Flanders, "Recipe for Reform Has Been Refined," *Financial Times*, March 14, 1997, pp. 2-3. (Required)

*John Barnham, "Refining the Washington Consensus," *Latin Finance,* November 2002, pp. 1-2. (Required)

WEEK 3 (February 12-14); ALSO : Friday, February 15 Make-Up Session – 1:00-3:00 pm – Place TBD
Quiz #1 on Thursday, February 14

TOPIC: **Tools for Analysis**

READ: *On Needler's Models to Predict Military Intervention*:

*Martin Needler, "Military Motivations in the Seizure of Power," pp. 63-72. (OPTIONAL.)

On the Packenham Model to Assess Prospects for Market-Oriented Reform:

*Roy C. Nelson, "Summary of the Packenham Model to Assess Prospects for Market-Oriented Reforms." (REQUIRED)

*Robert Packenham, "The Politics of Economic Liberalization: Argentina and Brazil in Comparative Perspective." (OPTIONAL.)

On the Nelson/Hipskind Model to Assess Prospects for Currency Devaluation:

*Roger Hipskind, "Who's Afraid of Rudiger Dornbusch?" [REQUIRED: READ ONLY THE THIRD PARAGRAPH ON THE FIRST PAGE.]

On Business-Government Relations and Bargaining in Corporate Strategic Alliances:

*Robert Grosse, "The Government-Business Relationship in Latin America," ch. 4 in Robert Grosse, *Multinationals in Latin America*, pp. 78-85 ONLY are REQUIRED, beginning with the section on "Testing the Bargaining Theory" (starting on p. 78).

*Roy C. Nelson, "Corporate Strategic Alliances and Bargaining in Latin America," *International Studies Notes*, pp. 9-17. (REQUIRED)

Roy C. Nelson, *Harnessing Globalization*, Preface (pp. ix-x) and Introduction (pp. 1-10.) (REQUIRED.)

TOPIC: **EMBRAER Case**

READ: *EMBRAER Case*:

*"Empresa Brasileira de Aeronautica S.A." (EMBRAER case). (REQUIRED)
(See case questions at the end of this syllabus.)

+Paulo Prada, "Plane Speaking," *Wall Street Journal*, March 29, 2010, p. R-8. (REQUIRED.)

Also see: www.embraer.com.br

PART II: COUNTRY CASES/ISSUES

WEEK 4 (February 19-21)
Deliverable Due: Upload Paper Project Analysis by Friday, February 22 at 11:55 pm

TOPIC: **Brazil: The Country of the Future?**

READ: *On Background and Current Assessment*:

Buckman (section on Brazil).

+Paulo Prada, "For Brazil, It's Finally Tomorrow," *Wall Street Journal*, March 29, 2010, p. R-1 and R-3. (REQUIRED.)

*"Roberto Marinho," *The Economist,* August 14, 2003, pp. 1-2. (OPTIONAL.)

OPTIONAL CASE: *Roy C. Nelson, "Dell's Dilemma in Brazil: Negotiating at the State Level," Thunderbird Case Series. (OPTIONAL.)

Roy C. Nelson, *Harnessing Globalization*, Chapter 2, pp. 87-88 and pp. 100-119. (REQUIRED.)

*Roy C. Nelson, "Summary of the Packenham Model." (REQUIRED.)

*Robert A. Packenham, "The Politics of Economic Liberalization: Argentina and Brazil in Comparative Perspective," pp. 1-28. (OPTIONAL.)

*Roy C. Nelson, "Cardoso's Challenge: Political Obstacles to Economic Reform in Brazil," *NIRA Review*, pp. 15-19. (REQUIRED.)

*Roger P. Hipskind, "Who's Afraid of Rudiger Dornbusch?", pp. 1-3 (read only the 3rd paragraph). (REQUIRED.)

*Roy C. Nelson, "Causes and Consequences of Brazil's 1999 Devaluation of the Real." (REQUIRED.)

*Roy C. Nelson, "Rethinking Foreign Investment: Lessons from the PT Government in Rio Grande do Sul," *Hemisphere*, Summer 2005, pp. 18-20 (OPTIONAL.)

[ADDITIONAL CURRENT EVENTS ARTICLES TO BE ASSIGNED.]

WEEK 5 (February 26-28)

TOPIC: **Argentina: Populism, Economic Reform, and Financial Crisis**

READ: Buckman (section on Argentina).

*Martin Feldstein, "Argentina's Fall," *Foreign Affairs*, March/April, 2002, pp. 8-14. (ABSOLUTELY REQUIRED READING).

+Pamela Druckerman, "Wal-Mart Fumes at Argentine Legislation – Provincial Bills that Limit Size of Stores Threaten Strategy," *WSJ*, November 28, 2000, p. A-23. (REQUIRED.)

[ADDITIONAL CURRENT EVENTS ARTICLES TO BE ASSIGNED]

WEEK 6 (March 5-7)

TOPIC: **Free Trade Agreements**

READ: +Lara L. Sowinski, "What Can DR-CAFTA Do For You?" *World Trade*, March 2006, pp. 68-69.
[additional readings to be assigned]

MIDTERM EXAM – THURSDAY, MARCH 7

WEEK 7 (March 12-14)

[No Class; Final Exam Week for 1.5-credit classes]

WEEK 8 (March 19-21)
QUIZ #2 ON THURSDAY, MARCH 21
Case study/discussion questions provided at end of syllabus and on TLE coursepage.

TOPIC: **Mexico: A Failed State?**

READ: *On Background and Current Assessment*:

Buckman (section on Mexico).

+Robert C. Bonner, "The New Cocaine Cowboys: How to Defeat Mexico's Drug Cartels," *Foreign Affairs*, July/August 2010. (REQUIRED.)

[ADDITIONAL CURRENT EVENTS ARTICLES TO BE ASSIGNED]
On Case (Retail in Mexico):

*HBS Case, "Retail in Mexico"

WEEK 9 (March 26)

TOPIC: **Chile: Test Market for Latin America**

READ: *On Background and Current Assessment*:

Buckman (section on Chile)

Roy C. Nelson, *Harnessing Globalization,* Chapter 3, pp. 120-122 and pp. 132-151. (REQUIRED.)

[CURRENT EVENTS ARTICLES TO BE ASSIGNED]

[***NOTE: Week 9 readings continue on next page***]

TOPIC: **Peru: The Next Chile?**

READ: *On Background and Current Assessment*:

Buckman (section on Peru)

*David Scott Palmer, "'Fujipopulism' and Peru's Progress,"*Current History*, pp. 70-75. (REQUIRED.)
[CURRENT EVENTS ARTICLES WILL BE ASSIGNED]

WEEK 10 (April 4; ALSO: Friday, April 5 Make-Up Session – 1:00-3:00pm – Location TBD)
NOTE: RESEARCH PAPERS DUE FRIDAY, APRIL 5 by 5:00 PM
Deliverable: Research Paper due Friday, April 5, by 5:00 PM
QUIZ #3 ON April 4
Case study/discussion questions provided at end of syllabus and on MTB coursepage.

TOPIC: **Costa Rica: Democracy and Economic Transformation**

READ: Buckman (section on Costa Rica)

[ADDITIONAL CURRENT EVENTS ARTICLES TO BE ASSIGNED]

For Case Discussion:

CASE: Roy C. Nelson, "Intel's Site Selection Decision in Latin America," *Thunderbird Case Series*. (REQUIRED.)

Roy C. Nelson, *Harnessing Globalization*, Chapter 1, pp. 77-86 (start on last paragraph of p. 77). (OPTIONAL.)

WEEK 11 (April 9-11)
Deliverable: Group Presentations Tuesday and Thursday of this week
Powerpoint Slides (Hardcopy and in Drop Box) due on April 16 (before class)

WEEK 12 (April 16-18)
THE CORPORATE SITE SELECTION CHALLENGE: Monday, April 15, 7 PM
(Attendance by all RBE: Latin America students strongly encouraged; all T-Birds invited)

TOPIC: **Venezuela: Populism – A Threat to Business?**

READ: *On Background and Current Assessment*:

*CASE: "Hugo Chavez's Public Policy Vision for Venezuela: Rooted in the Past, Doomed in the Future?"

[ADDITIONAL CURRENT EVENTS ARTICLES WILL BE ASSIGNED]

WEEK 13: (April 23-25)

TOPIC: **Colombia: Open for Business**

READ: *On Background and Current Assessment*:

Buckman (section on Colombia)

[CURRENT EVENTS ARTICLES WILL BE ASSIGNED]

The FINAL EXAM will be held during the scheduled exam period.

Case Study/Discussion Questions

Case #1: EMBRAER

[Note: you should read the article by John Williamson, "What Washington Means by Policy Reform," and other assigned readings on Washington Consensus (all in "Historical Overview" section), as well as the two assigned readings on bargaining (in "Analytical Approaches" section), in preparing to discuss the following questions.]

1. What role did the government play in creating EMBRAER?
2. Was this consistent with the "Washington Consensus" view of the proper role of the state? Why or why not?
3. Was "bargaining" between transnational enterprises and the host country government a factor in the outcome of the negotiations between Cessna, Piper, and EMBRAER? (See especially page 8 of the case.)
4. What were the terms of the bargain?
5. Which side "won" the bargain?
6. Does this outcome completely discredit bargaining theory, or does the bargaining model need to be modified in some way?

Case #2: Retail in Mexico

1. Why are volume discount retailers interested in investing in Mexico?
2. What are the challenges/opportunities of the Mexican market for these companies?
3. What are some possible solutions to these challenges?
4. If a company such as Wal-Mart forms a joint venture with a local partner, which firm would have the most bargaining power? Would this bargaining power obsolesce over time?
5. What are the lessons of this case?

Case #3: Intel

1. Why is Intel interested in investing internationally?
2. Why does the company want to invest in Latin America?
3. What characteristics does the company seek in a country where it will locate its investment?
4. What are the pros/cons of each country on Intel's short list?
5. If you were Ted Telford, which country would you invest in, and why?
6. Was bargaining a factor in this case?
7. To what extent are stable, predictable "rules of the game" important for high technology companies investing in foreign countries?

Case #4: Hugo Chavez's Public Policy Vision for Venezuela

1. What are the causes of Chavez's rise to power?
2. How would you evaluate Chavez's Reforms? What are the potential impacts and risks involved for each type of reform?
   a. Missions
   b. Land reform
   c. Takeover of idle factories
   d. Cancellation of existing oil and mining contracts and renegotiation
   e. Appointment of government representatives to boards of directors
   f. Price controls and subsidies

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Retail in Mexico, 1993

After a long period of relative stability, the Mexican volume retail industry was experiencing rapid change in the early 1990s. Improvements in the management of information technology, evolution in the execution of the distribution function, a more accessible business environment, and an upsurge in foreign investment all led to a revived retail sector in Mexico.

Though fragmented "mom and pop" stores had long dominated Mexican retailing, foreign-based volume retailers were seeking entry opportunities. Mexican firms were busy signing joint ventures and strategic alliances with these foreign-based volume retailers in the hopes of gaining operational expertise and capital, which would enable them to better serve Mexico's retail customers.

The Mexican Volume Retail Market

To many U.S. retailers, Mexico appeared to be an attractive retail market because of its large population and its geographically concentrated wealth. Mexico's 1992 population of 89.4 million—11th-largest in the world—provided plenty of retail customers. Future prospects were bright as the population was expected to reach 100 million by the year 2000. In addition, although Mexico's annual per capita Gross Domestic Product (GDP) was roughly $3,000 in 1992—only the 12th-highest among Latin American and Caribbean nations and one-fourth the purchasing power of the U.S.'s average level of wealth—the per capita GDP of the three largest Mexican cities (Mexico City, Guadalajara, Monterrey) was up to twice the national average. This allowed most retailers to focus on a few large cities.

Coming Out of the 1980s

The retail sector in Mexico had suffered throughout the 1980s. For much of the decade, the country lacked access to foreign capital—due in part to its well-publicized debt crisis. In 1982, the Mexican government had defaulted on interest payments to its foreign creditors. A 1984-89 annual compounded inflation rate of 77% (ninth-highest in the world) soured the international business community. Government regulations further discouraged foreign entry.

New Government Policies

The election of President Carlos Salinas de Gortari in July 1988 led to a more accommodating business environment in Mexico. Salinas lowered inflation from 125% in 1988 to 30% in 1990 by

Charles McHugh La Follette, MBA'92, prepared this case under the supervision of Professor David B. Yoffie as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

implementing a price control program known as the Pacto. Salinas pursued de-regulatory policies which allowed producers and retailers freedom in labeling and packaging. The Salinas Administration also negotiated the North American Free Trade Agreement (NAFTA) with the United States and Canada. If implemented, NAFTA would allow freer market access for foreign firms and eliminate import duties for foreign products.

Partly due to these changes, the Mexican economy thrived. Personal disposable income rose 70% between 1988 and 1991. Growth in private consumption outstripped growth in the gross domestic product every year under Salinas. From December 1988 through mid-1992, foreign investors poured $24.9 billion into Mexico—24.2% more capital than they had invested in Mexico between 1973 and 1987. Foreign private sector investment in Mexico was the fourth highest in the world (behind Singapore, China, and Nigeria) and represented 10% of total foreign private sector investment in the world.

In 1993, retailing appeared to be a logical target for investment: the population was young (approximately 50% of Mexicans were 19 years old or younger), urban (75% of Mexicans lived in cities in 1992 vs. only 50% in 1970), and becoming more demanding. Consumer research in Mexico suggested that consumers had a strong demand for high-quality products, were value conscious, yet increasingly price-sensitive. While income distribution in Mexico remained highly skewed, the research suggested that at least 40% of the population had the wealth, income, and life-style that made them prone to shop in supermarkets and mass merchandising outlets.

As a result, retailers had been among the leading investors in Mexico. K Mart, Wal-Mart, Price Co., and Fleming all entered the Mexican market during the Salinas Administration. Other retailers considering entry included Dillard's, J.C. Penney, H.E. Butt Grocery, and Carrefours.

Volume Retailing in the United States and Mexico

Though U.S. firms found Mexico an attractive region for growth, it was by no means an easy region for market entry. One significant complexity was that retail formats in the two countries were different. **Exhibit 1** provides a description of volume retail outlets in the United States—focusing on supermarkets, discount stores, hypermarkets, and warehouse clubs. **Exhibit 2** provides a description of volume retail outlets in Mexico. **Exhibits 3** and **4** provide performance ratios for U.S. and Mexican volume retailers, respectively.

Supermarkets

The supermarket format—founded in the nineteenth century—was the oldest existing format in the U.S. volume retail industry. Supermarket industry leaders included Safeway, Kroger's, and Albertson's. U.S. supermarkets were typically located in major metropolitan areas or in strip malls and averaged between 40,000 and 50,000 square feet of space. They carried a broad line of food products, including perishable food items, frozen foods, and dry groceries. They offered a limited selection of non-food merchandise (known as "general merchandise") which accounted for about 10% of total sales and included health and beauty aids, housewares, school supplies, and stationery. Supermarkets often housed several "satellite" stores—including bakeries, delis, pharmacies, dry cleaning outlets, and service counters that sold tobacco, film, and camera accessories.

In Mexico, the supermarket format was different. Though the product mix of the outlets was largely the same (80% of Mexican supermarket sales came from food items), there was less product variety within food items. Mexican supermarkets contained less stockkeeping units (SKUs) than U.S. supermarkets. This discrepancy continued even into the 1990s as consumer product firms that had not sold goods in Mexico were wary that the country's fortunes might reverse and that investment in

the region might be misplaced. In addition, unlike supermarkets in the United States, most supermarkets in Mexico did not contain "satellite" stores like delis and pharmacies. And Mexican supermarkets targeted middle- and middle-upper-income consumers while U.S. supermarkets targeted lower- and middle-income consumers. Finally, Mexican supermarkets had one-third the square footage of their U.S. counterparts.

Discount Stores

Discount stores in the United States were introduced in the mid-1950s as low-cost competitors to department stores. Discount stores' gross margins were 10%-15% lower than those of conventional department stores. National players included Wal-Mart, K Mart, and Target Stores. Regional players included Fred Meyer and Caldor. U.S. discount stores were typically located in strip malls, ranged from 30,000 and 130,000 square feet of space, and offered soft goods, convenience goods, and pharmaceuticals. Discount stores cut costs to the bone: in-store selling was limited and decor was functional. Discount stores arrived on the U.S. scene at a propitious moment. Supermarkets had gotten consumers in the habit of self-service. Government standards bolstered consumers' self-confidence in packaged products. As a result, sales from discount retailing formats boomed from $2 billion in 1960 to $68 billion by 1985. By the year 2000, some analysts had predicted that discounters' sales would exceed $100 billion.

The discount store format was substantially different in Mexico. Mexican discount outlets carried a distinctly different product mix—with 60% of revenues coming from food items. Discount stores in Mexico offered food items with long shelf life (powdered milk, canned chili) next to consumer durables (such as television and VCRs), and consumer non-durables (such as soft goods, cosmetics, and clothing). In effect, discount stores in Mexico were a combination of supermarkets and U.S.-style discount stores. Discount stores in Mexico were only one-third the size of the typical discount store in the United States.

Hypermarkets

Hypermarkets were a combination of supermarkets and low-priced discount stores. Hypermarkets were first introduced to the Western Hemisphere in November 1973 when France's Hypermarche Laval opened a store in Canada. In the United States, hypermarkets were located in large metropolitan areas and were between 200,000 and 300,000 square feet in size. They offered one-stop shopping usually with greater product variety than most retail locations. They typically stocked 2,500 items in packaged groceries alone. Sixty percent of revenues came from food items, wines, and beverages. Forty percent of revenues came from non-food items such as white goods, appliances, hardware, sporting goods, and apparel. Hypermarkets included "satellite" bakeries and charcuteries. Decor was functional and revealed exposed ceiling girders and durable flooring. Food and general merchandise was housed in large baskets or on pallets. Aisles were widened to allow easy refilling of goods from fork-lift trucks. Labor was low-cost and non-unionized. There was high dependence upon technology as higher store traffic justified more automation and expensive capital equipment.

Hypermarkets had scored a disappointing result in the United States. By early 1993, two volume retailers—Wal-Mart and K Mart—had ceased building new outlets. Only Carrefour continued to open hypermarkets—with one planned to open on Long Island during the summer of 1993.

Though the floor layout of the few Mexican hypermarkets which existed was similar to the layout of U.S. hypermarkets, the Mexican version was usually about one-half the size. And as with other formats, hypermarkets in Mexico had less product variety. Product mix was substantially the same, with offerings of food, general merchandise, soft goods, and luxury items. Like hypermarkets in the United States, hypermarkets in Mexico did contain satellite outlets like bakeries and delis.

Warehouse Clubs

Warehouse clubs were founded in the United States in the late 1970s and quickly met with success. Initial equity offerings were issued between 1984 and 1986 for Costco, Wholesale Club, and Pace. The major players in the market were Sam's Clubs (a subsidiary of Wal-Mart), Price Club, and Costco. Warehouse clubs usually had 90,000 to 150,000 square feet of space. They typically stocked up to 3,000 items across a wide array of consumer needs—including food, wine, beer, soft goods, sporting goods, books, tires, and tools. Targeted customers included small businesses and pre-screened, low-risk groups of individual customers. Business customers generally had to pay a $25 annual membership fee, while individual customers could either pay a $25-$50 annual fee and receive the same prices, or forgo the fee and be charged 5% higher prices.

Operations of warehouse clubs were driven largely by their pricing strategy. Gross margins were 9% to 10% of sales. Expenses below cost of goods were razor thin. There was no advertising, rents were low, and little customer service was offered. Warehouse clubs thrived off selling goods before they had paid the payables accounts through which they had purchased the material.

Until 1992, there were no warehouse clubs in Mexico. By mid-1992, several U.S. firms were entering the warehouse club market in Mexico with a U.S.-like format.

Trends in Mexican Volume Retailing

The Mexican retail sector was dominated by 700,000 small-shop owners ("mom and pop stores") in the form of corner stores, kiosks, and open air markets. In total, mom and pop stores accounted for approximately 60% of the retail market in Mexico. Mom and pop stores had retained customer loyalty because they were perceived by the market to provide cheaper goods than established retailers. In fact, the perception was usually inaccurate: large retailers offered a 15% to 30% price discount to mom and pop stores in Mexico. Four firms dominated Mexico's volume retailing industry—Cifra, Grupo Gigante, Comercial Mexicana, and Organizacion Soriana. Together, they controlled 90% of the "formal" volume retail market. **Exhibits 5** and **6** provide an overview of the operations of these major Mexican players.

After their introduction in the late 1950s, Mexican volume retailers had engaged in friendly competition through the mid-1970s. They generally avoided locating in close proximity to each other and very carefully monitored each others' prices. However, competition intensified in the 1980s and led to several mergers and three price wars. By the early 1990s, competition among the major volume retailers had lessened as attention shifted to new opportunities.

It was very easy to enter the informal retail sector in 1993 (thousands of shops opened and closed annually), but firms faced significant difficulties in opening and operating new chains in Mexico. First, there was a variety of government regulations ranging from tariffs to labeling restrictions. Tariffs, for instance, were a maximum of 20% on foreign goods. But tariffs at 20% had only a modest impact on the retail trade. Most Mexican shoppers had strong preferences for imported goods and often attached a cache value of at least 20% for a product with a foreign label. Furthermore, imported products made up an insignificant portion of the entire product mix for most retailers. Mexican firms also enjoyed profitable relationships with American suppliers. Accounts payable terms were 30 to 60 days for Mexican suppliers, compared with the 90 to 120 days that American suppliers offered. Therefore, Mexican purchases of American goods were able to achieve better working capital efficiencies.

Although official government policies regulated foreign ownership of Mexican firms, these regulations were rarely enforced under Salinas in sectors like retail. International firms needed only to adhere to local content and hiring guidelines. However, permits to open and operate retail stores

could be difficult to obtain. The process was lengthy in duration and often intensely political. For example, a Pizza Hut franchise had to apply for 17 different permits before opening for business in Mexico. In the U.S., only two permits were required. Finally, there were restrictions on labeling: all imported products had to be labeled in Spanish. This was done either through custom packaging at the point of manufacture or a custom label that was affixed at the point of distribution.

Perhaps the most difficult problem for local or foreign retail managers was the lack of available retail space or undeveloped land. Because of the rapid development of Mexico City, land had become extremely expensive in the early 1990s. Some firms, however, such as Liverpool, had substantial undeveloped real estate holdings. Local competitors also had difficulty in finding access to capital. Mexican retail executives estimated that minimum efficient scale for a discount chain was approximately 20 stores; without those 20 stores, firms lost leverage with suppliers and banks. Since a typical store carried 30,000 SKUs, and the largest stores had 35,000 SKUs, adequate bank financing for working capital was essential. Finally, local retail executives felt that merchandising talent was scarce in Mexico; there were relatively few good buyers and even fewer well-trained store managers. This led Cifra, in particular, to recruit extensively for senior managers outside the country.

One of the biggest debates among the firms in the retail sector was how large the market for discount retail would be over the decade of the 1990s. Some executives, for instance, believed that the Mexican market could support a maximum of only 25 warehouse clubs in the entire country before saturation occurred; others believed that the market was much larger.

In order to take advantage of the new opportunities in the market, Mexican volume retailers recognized that they had to improve their management of two critical functions: information systems and distribution/logistics. U.S.-based retailers had been in the lead in improving the management of both functions.

Developments in MIS

Throughout the 1980s, as volume retailers in the United States competed in an evermore price- sensitive industry, they sought to compensate for margin loss by increasing the productivity of their sales operations. U.S. volume retailers focused on three ratios which measured their sales productivity:

- *Inventory turns*—which measured the number of times in a year in which a firm sold its inventory stock.
- *Sales/employee*—which measured the productivity of the firm in leveraging its work force.
- *Sales/square foot*—which measured the productivity of the firm in leveraging its fixed assets.

The introduction of increasingly more sophisticated management information systems in volume retailing allowed for an improvement in all three of the key ratios—especially the first two: inventory turns and sales/employee. The main form of information technology in a volume retail operation was the bar-code reader at the checkout counter. Located inside the checkout table, bar-code readers log sales of products as consumers purchased them. A central computer within the facility tabulated all the sales of each product type at the end of the day. An in-store terminal then wired merchandise requests to a central purchasing location off the tabulations of the day's product sales. More sophisticated systems linked retail outlets directly to suppliers.

The result was that individual stores could more accurately gauge which products were popular and needed stocking. By focusing this information at the individual store level, stores were

better able to stock for their particular clientele—thereby increasing sales and developing customer loyalty. In addition, volume retailers also tabulated the purchase results across many stores—enabling the firms to gain volume discounts by buying for all of its stores in bulk. The overall effect on sales productivity ratios was that inventory turns were increased because inventory better reflected customer needs and preferences. In addition, the sales/employee ratio improved as some employee positions became redundant.

In Mexico, investment in information technology did not begin in earnest until the 1990s. By late 1992, 238 stores had scanners—up from only 38 in 1991. Several firms were anxious to learn more about this new area from their American counterparts.

Distribution/Logistics

The emphasis on greater cost sensitivity in volume retailing also affected the distribution and logistics functions of volume retail firms. After a firm had purchased goods for individual retail outlets, it had to transport the goods to each individual location. Cost of transport was in direct correlation to length of transport and quality of the infrastructure over which the goods were transported.

Wal-Mart, a major U.S.-based volume retailer, had developed some of its competitive advantage around an innovative distribution method. In the early 1970s, Wal-Mart's founder, Sam Walton, acknowledged that many of his suppliers would always be reluctant to serve his out-of-the-way locations. Walton concluded that his only alternative was to build his own warehouses. Through its two-step hub-and-spoke distribution network, Wal-Mart would buy goods from suppliers, bring them by truck to a distribution center where they would be sorted automatically onto another truck and delivered to an outlet—often within two days of the original order. Wal-Mart positioned warehouses in centrally located areas with respect to its store outlets. The result was shortened transport—meaning trucks could do more trips within a given time, have a significantly higher backhaul, and each trip was less expensive. Wal-Mart's distribution system cost approximately 35% of sales less than the industry average and allowed Wal-Mart to replenish its shelves up to two times per week—as opposed to once every two weeks for most other retailers.

The three largest Mexican retailers had relatively similar cost structures: they all advertised about 1% of sales; they all had shrinkage problems in the range of 1% to 1.5%; and they all had overhead of approximately 15% to 18%. Opportunities to create differences, however, were potentially significant in distribution and logistics. An efficient distribution operation could reduce the cost of sales by several percentage points. In addition, most stores were resupplied only about once a week; more efficient inventory management could improve sales per square foot.

The biggest problems for Mexican retailers in distribution and replenishment was infrastructure. Roads in non-urban areas were often in poor condition, and traffic in Mexico City could cause lengthy delays. In 1992, only 10% of products sold in Mexican retail stores were imported and the majority of Mexican suppliers were located in close proximity to Mexico City. As a result, there were significant costs and logistical issues involved in nationwide distribution. Cifra, with 90% of its revenues from Mexico City and its sophisticated use of purchasing and inventory control technology, held a significant advantage over its competitors.

The purchasing economies of the large retailers led to large differences in wholesale cost between the large retailers and smaller competitors. The large chains purchased directly from manufacturers, while they maintained large transportation fleets and received delivery directly from vendors to their stores. Several mid-size distribution companies acted as intermediaries and supplied small shop and mid-size stores in outlying areas. But small retailers in outlying areas had to pay 15% to 20% more than larger firms in Mexico City buying direct. The larger chains were supplied by distribution companies only for specialty products and irregular purchase quantities. The major

competitive weapon of these distributors was their large fleet of small trucks which could service small stores over poor-quality roads.

Another potential difference among the firms was their account payable days and their inventory turnover. Location was one of the most important contributors to this variation. Stores based outside Mexico City usually had higher costs because inventories were held for longer periods as products were shipped and stored before reaching their point of sale. (See **Exhibit 7**.)

The Trend to Strategic Alliances/Joint Ventures

While Mexican firms were looking for assistance in their local markets, they also recognized that they could gain much—especially in MIS and in the management of distribution/logistics. U.S.-based firms looked at Mexico as an attractive growth opportunity. U.S. firms also recognized that foreign firms had historically experienced difficulties in Mexico. Though Woolworth's and Sears had been industry players for over 20 years, neither had experienced much growth recently. K Mart had entered the Mexican market through a difficult acquisition which had led to a large corporate write-off in the 1980s. Most foreign firms balked at entering Mexico without local guidance.

By the early 1990s, strategic alliances became attractive vehicles for both U.S. and Mexican volume retailers. Strategic alliances provided foreign firms with local introductions. They also provided local firms access to capital, the latest technology and management expertise, and insights into new store formats. As the planning director of a large Mexican retailer (Grupo Gigante) Juan Carlos Mateos said in the January 19th, 1993, issue of *Financial Times*, "[Foreign firms] supply the know-how and we have the know-who." This industry dynamic led to the announcement of four strategic alliances in the early 1990s: Wal-Mart partnered with Cifra, Fleming joined with Grupo Gigante, Price Club forged an alliance with Comercial Mexicana, and K Mart joined ranks with El Puerto de Liverpool.

Alliances in Mexico

Wal-Mart—Cifra

Wal-Mart—overview Although Wal-Mart was incorporated in 1969, the firm's founder—Sam Walton—had been in the volume retail business since 1945. Right after World War II, Walton opened a Ben Franklin variety store in Newport, Arkansas. In 1946, his brother, James L. Walton, opened a similar store in Versailles, Missouri. Until 1962, the brothers were focused entirely on the operation of variety stores—owning 16 throughout rural Arkansas. Over time, Walton became convinced that discounting could work in smaller Southern towns with populations less than 100,000. His strategy was to maintain uniform prices, except where lower prices were necessary to meet local competition. Sales would be primarily on a self-service, cash-and-carry basis, with the objective of maximizing sales volume with a minimum of overhead expense. In 1962, the Waltons opened the first Wal-Mart discount store. In 1984, Wal-Mart opened its first warehouse club, "Sam's Clubs." In 1988, the firm opened its first hypermarket store—Hypermart USA. By 1992, Wal-Mart had 1,720 discount stores, 208 Sam's Clubs, and 6 Hypermart USA stores, and the firm had sales of $55.5 billion.

Initially concentrated in the southern United States, Wal-Mart discount stores operated in 39 states across the country by 1992. The firm's 208 Sam's Clubs operated in 36 states throughout the nation. The average size of a Sam's Club was 112,000 square feet—and club sizes ranged between 90,000 and 150,000 square feet. The average size of a Wal-Mart store was 75,000 square feet and store sizes ranged from 30,000 to 127,000 square feet of building area. Growth in store outlets was high. During the fiscal year ended January 31, 1992, Wal-Mart opened 148 Wal-Mart stores and 61 Sam's Clubs. Through its three main formats, 75% of the firm's sales were in hardgoods (hardware,

housewares, small appliances), softgoods, stationery, and sporting goods. The rest of the firm's sales were in health and beauty aids, electronics, pharmaceuticals, shoes, and jewelry.

In the 1990s, the firm had begun to diversify some of its holdings by experimenting in new volume retail outlets. In 1991, the firm integrated backwards by acquiring McLane's 10 full-service centers and 4 specialized distribution centers which primarily bought, sold, and then distributed merchandise to the convenience and grocery store industry. The firm further diversified its holdings in 1992 when it purchased The Phillips Companies' 20 food stores. And in 1992, the firm also acquired Western Merchandisers, a wholesale distributor of books and prerecorded music.

Cifra—overview With $2.8 billion in volume retail sales in 1992 (not including restaurant revenues), Cifra had the largest number of stores (210) in Mexico and had the second-highest amount of square footage. (**Exhibit 8** provides financials on Cifra.) Cifra was founded by Jeronimo Arango, the son of a Spanish immigrant who prospered in textiles. Arango had received the inspiration for Cifra in 1956 when he visited the no-frills E.J. Korvette discount department store in New York. "For 30%-40% off, people were willing to be mistreated," said Arango. "I called my two brothers and said, `I have this great idea.'" The Arango brothers opened their first discount store in 1958. They caused a sensation by offering household goods and clothing as much as 20% below manufacturers' list prices.

Over the years, Arango's operation was always considered one of the leaders in volume retailing in Mexico. It was the first to offer generic brands, the first major retailer to go public, and the first to put clothing, food, and hardware in one store. Throughout the 1980s and into the early 1990s, Cifra gained 90% of its revenues from Mexico City. Its four formats—hypermarkets, discount warehouses, supermarkets, and warehouse clubs—provided price-sensitive, low-service bargains for cash-strapped consumers.

Cifra—formats Cifra provided two discount store formats. The first—a discount warehouse—was known by the brand name Bodega. Targeted consumers were lower-middle-income families. Price discounts could range up to 50% on most items. The 29 Bodega stores offered a product mix that included food items (especially long shelf-life food items such as powdered milk and canned chili) as well as consumer durables, such as imported TVs and VCRs. Average store size was 46,000 square feet. Cifra's second discount store outlet—also with 29 stores—included a department store format. Though also targeted at lower-middle-income families, Suburbia discount stores sold only soft goods and cosmetics. Cifra also had 34 standard supermarkets operating under the Superama brand name. Superamas were targeted at middle- and upper-income consumers. These locations held a very specialized product mix featuring imported products and specialty foods. The average store size was 14,000 square feet. Thirty-nine Aurrera hypermarkets stocked about 3,500 products—including food, general merchandise, soft goods, and luxury items (including fur coats).

Cifra had entered the warehouse membership club format through an alliance with Wal-Mart. Targeted at individuals and small-business owners, Cifra's two Club Aurreras had achieved a high degree of acceptance with Mexican consumers. In its second year of operation, one of Cifra's Club Aurreras had a higher average of sales per square feet than any Sam's Club in the U.S. Cifra also owned 77 family-style restaurants, called VIPs. As with many Mexican volume retailers, Cifra had first developed restaurants next to many of its properties in order to attract customers to the retail outlets. Over time, Cifra had found the operations highly profitable and had therefore continued the business in a more independent fashion. By the 1990s, VIPs—like the restaurant chains of many other volume retailers—were located throughout Mexico and not necessarily located next to retail outlets.

Cifra—the alliance By the early 1990s, Arango had decided to capitalize on the increase in disposable income among Mexican consumers. He wanted to upgrade Cifra's outlets to meet increasingly choosy customer preferences. His growth strategy had two components: investment in MIS and expansion outside of Mexico City. To assist him in the execution of this plan, Arango forged

a joint venture with Wal-Mart. Cifra's alliance with Wal-Mart supported both of Arango's goals. The venture included a 50%-50% agreement to build six Aurrera hypermarkets and two warehouse clubs. Wal-Mart also gained the option of becoming a 50%-50% partner in all future Cifra store developments. Twenty-three supermarkets, which Cifra had planned to operate independently, would be managed by the joint venture. And the companies planned to operate six new Club Aurrera Warehouse Clubs in Mexico City as well as several in Monterrey and Guadalajara. After Price Club started building a store in Guadalajara in early 1993, the Wal-Mart-Cifra partnership bought land across the street and started construction of a Club Aurrera Warehouse.

Cifra's alliance with Wal-Mart also allowed Cifra to gain expertise in technology and management information systems. In 1991, the firm invested three times more than any of its competitors in information technology (IT); by August 1991, Cifra was installing a $55 million satellite communications system that would link all the firm's outlets and enable the firm to control inventory and adjust pricing quickly; 47% of Cifra's stores had scanners by the end of 1992.

Fleming—Grupo Gigante

Fleming—overview The Fleming Company was engaged primarily in the wholesale distribution of food and related products. The company served as the principal source of supply for over 4,800 retail food stores in 36 states. These were predominantly independent stores, many of which operated and advertised under a common name to promote greater consumer recognition. In 1992, the firm had sales of $12.9 billion.

The company distributed a wide variety of both national and private brand groceries, meats, dairy and delicatessen products, frozen foods, fresh produce, and a variety of general merchandise and related items. In addition, Fleming offered a full range of support services, including long-term financing of certain retailers, which enabled retailers to compete with other types of food stores in their respective market areas. Fleming also operated 59 retail food stores for its own account.

The retail stores that Fleming served ranged in size from small convenience outlets to conventional supermarkets to large superstores. Ninety percent of Fleming's business was concentrated on 2,900 supermarkets with annual sales of over $2 million each. Over half of the firm's product sales were in groceries. The rest were in perishable foods and general merchandise.

Grupo Gigante—overview Grupo Gigante was Mexico's largest retailer in square footage and its second-largest in number of outlets (181 in 1992). (**Exhibits 9** and **10** provide financials on Grupo Gigante.) Grupo Gigante was founded in 1962 and focused at first in Mexico City—primarily because the quality of infrastructure throughout the country made distribution prohibitively expensive and raised goods to price levels that were beyond the reach of the average consumer. In the 1970s, however, Mexico, after discovering oil reserves, started investing heavily in highways, bridges, and roads. Infrastructure development enabled large retailers to reach more remote locations. Grupo Gigante was the most aggressive Mexican retailer in pursuing regional opportunities. It pursued its development strategy largely through acquisition. In 1978, Grupo Gigante entered Guadalajara by purchasing Hemuda—an 8-store mass retailer. In 1980, Grupo Gigante significantly increased its Guadalajara presence with the acquisition of another mass retailer chain, Maxi. By 1982, Grupo Gigante had moved into middle-sized (less than one million residents) cities like Celaya. And in 1987, the firm made its biggest acquisition by purchasing the 23 stores of the Astra chain.

By 1992, Grupo Gigante outlets blanketed 41 cities—the most far-reaching volume retail network in the country. Commenting on the company's aggressiveness, the EVP of Gigante said, "We will keep going, we will be a fighter and contender." Gigante was the industry leader in Guadalajara where its 27 locations accounted for 70% of local retail sales and dominated Cifra's four outlets. Gigante also supplied 55% of the Monterrey market. By 1992, the firm was spending over $30 million

to develop over 300,000 square meters of land. The firm also had purchased 208,000 square meters of land for future expansion. Due to the firm's widespread retail network, the distribution function was particularly critical at Grupo Gigante. The firm operated eight distribution and storage centers throughout Mexico (two each in Mexico City, Guadalajara, Monterrey, and Tijuana.) Grupo Gigante owned a fleet of 224 trucks.

Grupo Gigante—formats Grupo Gigante had retail outlets in three different formats—hypermarkets, discount warehouses, and supermarkets. Gigante's hypermarkets focused primarily on perishable food items but also stocked a variety of other soft good items. Gigante had 29 discount warehouses spread throughout 17 cities under the Bodega Gigante name. Merchandising was low cost, store decor had no frills, and the targeted consumer was a lower-middle-income wage earner. Sixty percent of the format's product mix came from food and 40% from clothing and general merchandise. Average store size was 30,000 square feet. Gigante's supermarkets were known under the Supermart Mas x Menos brand name. These outlets focused primarily on food items (80% of store revenues came from food) offered at everyday low prices. Grupo Gigante owned 25 Toks Family Restaurants and 28 Radio Shack electronic stores.

Grupo Gigante—future plans By the early 1990s, Grupo Gigante had three development goals: increasing MIS investment, forging new alliances to improve customer service, and broadening its national network of stores. Gigante had committed to spend over $26 million on MIS in 1993. By the end of the previous year, 39% of its stores had point-of-sale scanners. The firm was also exploring new customer services. In 1992, Gigante formed an alliance with Banamex—one of Mexico's largest banks—to provide a banking facility in all of its Mexico City locations. Banamex's Automated Teller Machines allowed deposits, withdrawals, credit card transactions, and bank payments.

In 1992, Gigante concluded a venture agreement with Fleming, which provided new opportunities for Gigante. Fleming's core competency was food distribution. Its expertise in this area might serve Gigante well—as the firm already had Mexico's most widespread retail network. Under the terms of the agreement, the venture's initial investment was $21 million—51% provided by Gigante and 49% provided by Fleming. The plan was to open up to 50 Supermart stores by the end of 1997. The units were to open in towns with 120,000 inhabitants or more and in popular neighborhoods in the nation's largest cities. Each store would sell between 10,000 and 14,000 different products.

Price Club—Comercial Mexicana

Price Club—overview Price Club was founded in 1976. By August of 1992, it operated 81 membership warehouse clubs under the name "Price Club" in 12 states in the U.S.A. Thirty-four of those locations were in California. Sales for 1992 were $7.3 billion. Price Clubs generally conformed to a warehouse format with an average of 117,000 square feet of floor space. The interior and exterior of Price Clubs were generally designed without substantial embellishments. The standardized floor plan provided substantial operating efficiency. Merchandise was generally offered in case, carton, or multiple-pack quantity or in single, jumbo-sized packages and was displayed and stored in packing cartons on pallets. Over 60% of the firm's sales were in sundries (health and beauty aids, office supplies, tobacco and candy) and food. Another 20% was in housewares (appliances, books, calculators). The rest was in automotive products and hardware, soft goods, and liquor.

The company's facilities were generally open only to its members—of which there were two types of memberships: "Business" and "Gold Star." Businesses or individuals with a resale license, business license, or other proof of business existence could become "Business" members by paying a $25 membership fee. "Gold Star" memberships were available to employees of federal, state, and local governments, and to banks, hospitals, and certain schools. As of August 31, 1992, Price Club had approximately 1.6 million "Business" memberships and 2.7 million "Gold Star" memberships.

Other Price Club businesses included tire installation centers, food services, mini-lab photo finishing, and pharmacy. For fiscal 1992, the firm had plans to open 15 new Price Club warehouses—of which 6 were to be located in California.

Comercial Mexicana—overview Controladora Comercial Mexicana—known in the trade as Comerci—was founded in 1930 as a store specializing in fabrics. By 1962, it had evolved into a self-service volume retailer from the same family that started Gigante. By 1992, Comerci has sales of $1.6 billion and owned 131 stores—75% of which were either in Mexico City or in the surrounding region. (Exhibits 11 and 12 provide financials on Comercial Mexicana.) The firm's portfolio of retail locations included supermarkets, discount stores, and hypermarkets.

Comercial Mexicana—formats Comerci owned 29 Sumesa supermarkets—all in Mexico City. Sumesas targeted middle-income customers. Comerci owned 17 discount supermarkets—known as Bodega Comercial—all in Mexico City. The format thrived on discount pricing. Comerci's hypermarkets—known as Comercial Mexicana—were the only formats in which the firm had a significant presence outside of Mexico City. The firm owned 81 hypermarkets in 31 cities throughout Mexico. Ten additional hypermarkets were under construction. The hypermarkets were lightly invested with information technology but they had begun to invest in Hewlett Packard computer products. Comerci also owned Garment clothing stores—targeted for middle-income customers—and 14 California Restaurants.

Comercial Mexicana—future plans Comerci's future plans rested on expanding operations outside Mexico City, investing more in information technology, and opening new store formats. Under new formats, Comerci had plans to expand its discount hypermarket format into small towns with 150,000 to 300,000 residents. Comerci also decided to reverse its conservative investment policy in MIS. Prior to 1992, only 5% of the firm's stores had scanning equipment. The firm had plans to buy scanners for all its stores by the end of 1993, and it had recently raised a $130 million Eurobond offering to pay—in part—for the technology expansion.

In 1991, Comerci forged an alliance in 1991 with Price Club to open warehouse clubs targeted at individuals and small-business owners. The venture's outlets would operate large self-service wholesale warehouses. The stores would sell about 3,000 products—including perishables, groceries, household electrical goods, tools, and clothing. The outlets would also provide such services as quick photo development and printing of stationery and calling cards. The venture would give Comercial technological and organizational expertise, a greater variety of products, and buying power in its negotiations with suppliers.

K Mart—Liverpool

K Mart was incorporated on March 9, 1916, by S.S. Kresge. K Mart's principal business was general merchandise retailing. It targeted lower-middle and middle-income wage earners. K Mart stores were generally one-floor, free-standing units ranging in size from 40,000 to 120,000 square feet of gross area. The firm's sales in 1992 were $37.7 billion. As of January 1992, K Mart's general merchandise retail operations included 2,249 K Mart stores in the United States and Puerto Rico. K Mart's general merchandise retail operations were located in 48 of the 50 states and in 257 of the U.S.'s 261 Metropolitan Statistical Areas. K Mart also owned PACE Membership Warehouse—which operated 87 membership warehouses in 25 states. PACE warehouses typically occupied 107,000 square feet. The firm also owned Pay-Less Drug Stores, Northwest, Walden Books, and the Sports Authority—a retailer of sporting goods and apparel.

K Mart had already experienced one very difficult venture in Mexico. Its purchase and management of the Astra volume retail chain during the 1980s had led the company to sustain a $100 million charge against earnings.

El Puerto de Liverpool (1991 sales—$776 million) was a retailer in Mexico focused on upper-income earners. Its 16 stores were divided equally into two retail store chains—the Liverpool department store chain and the Fabricas de Francia chain. El Puerto de Liverpool's outlets were concentrated mostly in desirable—and scarce—retail sites in Monterrey and Mexico City. The firm's future plans rested largely on a strategic alliance with K Mart to sell both food and general merchandise—a venture in which K Mart was planning to invest $500 million in the venture. Retail industry analysts questioned whether the two firms were ideally partnered—given their historically distinct customer bases.

Other Competitors

Organizacion Soriana

Organizacion Soriana owned 19 retail locations, mostly in Northern Mexico. Ten stores were located in Monterrey. Soriana supermarkets were known simply as Sorianas. They were unusually large by Mexican standards. Their average size was 90,000 square feet. They focused on middle-income customers. Soriana also owned five hypermarkets with an average of 120,000 square feet. These stores were often anchors for larger mall developments. They offered high value-added services, such as photo processing, an in-house bakery, and video clubs.

Soriana rested its future growth plans on investing more in technology and in opening smaller retail outlets. Soriana had been a conservative technology investor. With only five of its stores possessing scanning technology, Soriana had a 1992 MIS budget which was 4% of Cifra's MIS budget—though its sales were 20% of Cifra's. The company had acknowledged that the policy had to be reversed in order to increase its sales productivity.

Sears Roebuck de Mexico

Sears Roebuck (Mexican 1992 revenues—$317 million) first invested in Mexico in 1947. The firm had national coverage—operating in 26 Mexican cities with 33 Sears stores. Nevertheless, 48% of the firm's square footage was located in Mexico City. Sears targeted middle income consumers with a product mix of clothes, furniture, and general merchandise. The firm had the most widely issued retail credit card in Mexico with 850,000 accounts. Seventy percent of the firm's merchandise was purchased on credit.

Sears future plans relied on targeting three distinct socio-economic groups: upscale customers, middle-income customers, and discount/price sensitive customers. The firm planned to open 24 new stores in the next three years to address each market category.

Government-Owned Stores

Government-owned stores—known under the ISSSTE and IMSS names—accounted for $1.8 billion in sales in the Mexican retail market. Eighty percent of the government's outlets were in Mexico City. The ISSSTE outlets were controlled by the government employees' social security agency. The IMSS outlets were controlled by the private sector social security agency. Government stores lagged far behind in technology investment. They were also rapidly losing share—even though their prices were consistently 5% to 10% less than the lowest-priced privately owned stores. Product variety in the government stores was hurt by the fact that major consumer products companies—like Procter and Gamble—refused to let the stores carry their products.

Exhibit 1 Overview of Volume Retail—U.S.A.

	Discount	Supermarket	Hypermarket	Warehouse Club
Founded	1960s	19th century	1960s	1980s
Product Mix	· Soft goods · Pharmacy	· Food · General merchandise · Stationery	One-stop shop · Food · Drugstore · Appliances	· Food · Soft goods · Alcohol
Size (sq.ft.)	30,000-130,000	40,000-50,000	200,000-300,000	90,000-150,000
Labor	Nonunion	Union	Nonunion	Nonunion
Pricing	Regularly 10%-15% lower than supermarkets	Frequent price wars discounting	Lower than discount stores	Razor-thin margins; 9%-10% gross margin
Service	Minimal	Medium	Minimal	Minimal
Locations	Strip malls	Metro-areas	Metro-areas	At least 400,000 to 500,000 population
Players	Wal-Mart K mart Target	Safeway Kroger Albertson's	Wal-Mart K mart Carrefour	Sam's Club Price Club Costco

Source: Literature search

Exhibit 2 Overview of Volume Retail—Mexico

	Discount Warehouse	Supermarket	Hypermarket	Warehouse Club
Product Mix	· 60% Food · Consumer durables · Cosmetics	· 80% Food · Imported products, Specialty foods	· Food · General merchandise · Soft goods · Luxury items · Deli, bakeries	· 3,000 products - stationery - general merchandise
Size (sq.ft.)	30,000	14,000-20,000	120,000	N.A.
Target Customer	Lower-middle income	Middle-upper income	Middle-upper income	Small-business owners
Players	· CIFRA · Grupo Gigante · Comercial Mexicana	· CIFRA · Grupo Gigante · Comercial Mexicana · Soriana	· CIFRA · Grupo Gigante · Comercial Mexicana · Soriana	· CIFRA · Comercial Mexicana · Grupo Gigante

Source: Literature search

Exhibit 3 Performance Ratios for Selected U.S. Volume Retailers, Fiscal 1992 Year-End

	Proxy	Sales/ Square Feet	Expense Ratio[a]	Operating Margin	Operating Income/ Square Feet
Supermarkets	Albertson's	$337.7	19.2%	5.3%	$17.9
Hypermarket	Anonymous	430.0	19.0	0.0	0.0
Warehouse Club	Costco	670.0	8.1	2.9	19.4
Discount Store	Wal-Mart	286.0	17.0	7.8	22.3

In 1991, the average large volume retailer in the United States had a 5.1% operating margin, net income of 2.1%, and sales per square foot of $247.

Source: Goldman Sachs Research

[a]Expense ratio: SG&A/Sales

Exhibit 4 Productivity by Store Format and Company—Mexican Volume Retailers

	CIFRA	Grupo Gigante	Comercial Mexicana	Organizacion Soriana
Hypermarket				
- Name	Aurrera	Gigante Hypermarket	Comercial Mexicana	Soriana Hypermarket
- Sales/sq.ft.	$430	$274	$234	$296
Discount Warehouse				
- Name	Bodega Aurrera	Bodega Gigante Hypermarket	Bodega Comercial Mexicana	
- Sales/sq.ft.	$426	N.A.	$202	
Supermarkets				
- Name	Superama	Supermart Mas x Menos		Sumesa
- Sales/sq.ft.	$891	N.A.		$521
				Soriana
				$225

Source: Literature search

Exhibit 5 Mexican Retailers Store Formats, 1992

Type of Store	Percentage of Total Stores					
	Cifra	Gigante	Comercial	Soriana	Liverpool	Sears
Supermarkets/hypermarkets	44	85	87	66	0	0
Discount warehouse	21	12	9	34	0	0
Convenience stores	8	0	0	0	0	0
Department store/apparel	25	0	0	0	100	100
Warehouse club	3	3	4	0	0	0

Source: Annual Reports

Note: Does not include restaurants or store formats operated under other licenses.

Exhibit 6 Performance Ratios in Mexican Volume Retailing (not including restaurant and other operations), 1991

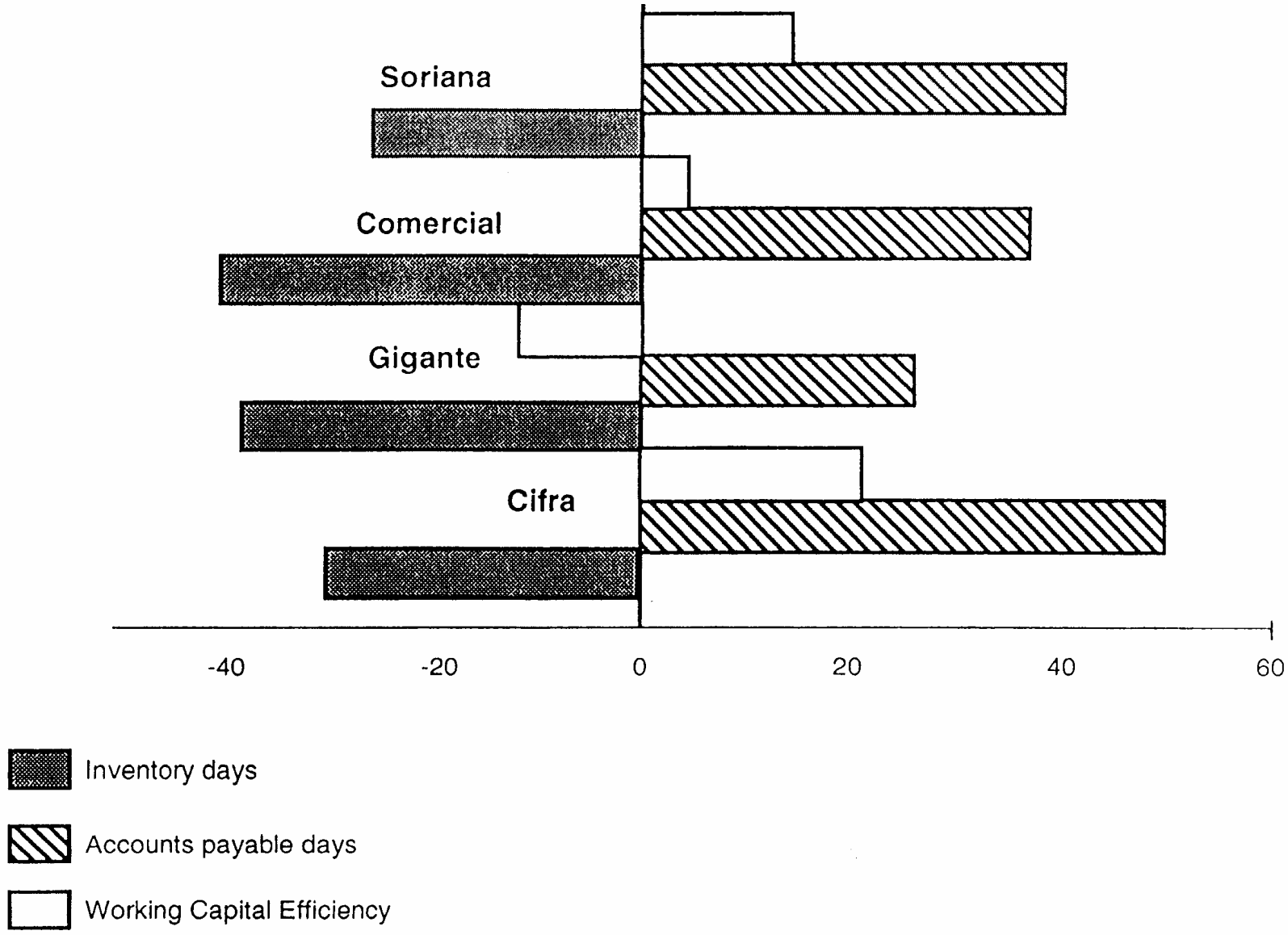
	CIFRA[a]	Grupo Gigante	Comercial Mexicana	Organizacion Soriana
Sales ($ millions)	$2,800	$1,653	$1,600	$747
Number of stores	210	181	115	19
Square feet ('000)	6,108	7,510	5,907	1,788
Employees	25,785	24,190	21,709	8,369
Inventory days[b]	28	49	45	36
Sales/square feet	$458	$220	$271	$418
Sales/employee	$108,590	$74,411	$73,702	$89,258
Operating margin[b]	6.4%	2.5%	4.5%	5.3%
Inventory turns	13.0	7.4	8.1	10.1

Source: Analyst Reports

[a]Calculated off 1992 numbers

[b]Calculated off first nine months of 1992

Exhibit 7 Inventory and Accounts Payable Comparison of Mexican Retailers, 1992



Source: Company financial statements

Exhibit 8 CIFRA Income Statement (U.S.$000)

	1991	1992
Total net sales	$2,765,452	$3,690,166
Cost of goods sold	2,115,577	2,830,616
Gross profit	649,875	859,550
Operating expenses	$499,657	$640,163
Operating earnings	$150,218	$219,387
Comprehensive financing income		
Financial income	$64,212	$100,338
Gain on net monetary position	24,340	12,383
Total	88,551	102,721
Other income—net	4,254	(1,567)
Net operating earnings	243,023	320,541
Income tax and employee statutory profit sharing	67,085	91,740
Consolidated recurring earnings	175,939	$228,801
Reimbursement of surplus in pension	83,075	163,306
Fund for remodeling	(48,255)	(80,244)
Reserve for seniority premiums	0	(6,382)
Consolidated net earnings	210,759	305,481
Wal-Mart minority interest in J/V Subsidiaries	0	(4,340)
Net earnings	210,759	301,141
Per share amounts		
Operating earnings (before CFI)	$0.047	$0.069
Net operating earnings (after CFI, pretax)	0.076	0.100
Consolidated recurring earnings	0.055	0.072
Consolidated net earnings	0.066	0.095
Net earnings excluding extraordinary items	0.055	0.070
Net earnings	0.066	0.094
Average shares outstanding (000s)	3,200,000	3,200,000
Converted to USD using following exchange rates:	3.077	3.116

Source: Annual Report

Exhibit 9 Grupo Gigante, S.A. De C.V. and Subsidiaries, Consolidated Statements of Income, Year Ended December 31, 1991 (in millions of U.S. dollars at December 31, 1991)

	1991
Revenues	
Net sales	$1653.8
Other	81.2
	$1734.9[a]
Costs and expenses	
Cost of sales	1331.1
Operating expenses	316.9
	$1648.0
Operating earnings	$ 86.9
Integral result of financing	
Interest (expense) income—net	(7.2)
Monetary position gain	26.7
	$ 19.5
Earnings before income tax, employee statutory profit-sharing and extraordinary item	$ 106.4
Income tax	20.7
Employee statutory profit-sharing	0.2
	$ 20.9
Earnings before extraordinary item	$ 85.5
Extraordinary item—Tax reduction from carryforward losses	
	$ 3.7
Net earnings	$ 89.2

Source: Annual Report.

[a]Grupo Gigante Revenues in **Exhibit 9** do not match those in **Exhibit 6** because the company's annual report relies on a different exchange rate than that used by analysts in **Exhibit 6.**

Exhibit 10 Grupo Gigante, S.A. De C.V. and Subsidiaries, Consolidated Balance Sheets, December 31, 1991 (in millions of U.S. dollars at December 31, 1991)

	1991
Assets	
Current assets	
Cash and temporary investments	$ 74.9
Accounts receivable	
Trade	21.9
Recoverable taxes	15.9
Affiliates	19.8
Other	31.6
Total accounts receivable	$ 89.3
Merchandise inventories	181.9
Prepaid expenses	14.0
Total current assets	$359.7
Investments in shares	0.5
Property and equipment	535.7
Other assets	10.2
Total	$906.1
Liabilities and Stockholders' Equity	
Current liabilities	
Bank loans	
Trade accounts payable	$ 205.8
Accrued expenses and taxes	52.6
Employee statutory profit-sharing	1.0
Total current liabilities	$ 259.5
Stockholders' equity	
Common stock	
Par value	23.9
Restated	131.8
	$ 155.7
Additional paid-in capital	
Par value	70.2
Restated	30.5
	$ 100.7
Retained earnings	152.4
Par value	260.6
Restated	$413.0
(Insufficiency) excess in restatement of stockholders' equity	(22.8)
Total stockholders' equity	$646.6
Total	$906.1

Exhibit 11 Controladora Comercial Mexicana, S.A. De C.V. and Subsidiaries, Consolidated Statements of Income for the Year Ended December 31, 1991 (in millions of U.S. dollars)

	1991
Net sales	$1600.0
Cost of sales	1238.3
Gross profit	$ 361.7
Operating expenses	
Selling	$ 241.1
Administrative	49.4
	290.5
Operating profit	$ 71.2
Integral cost of financing	
Interest expense	$ (28.1)
Interest income	17.1
Foreign-exchange (loss) gain—Net	(0.1)
Gain from monetary position	21.3
	$ 10.2
Profit after integral cost of financing	$ 81.4
Other financial operations	
Other income—Net	$ 1.2
Profit before provisions and interest in results of associated companies and of minority stockholders	$ 82.6
Provisions for	
Income tax	$ 0.1
Assets tax	2.8
Employees' profit sharing	0.8
	$ 3.8
	$ 78.8
Interest in results of associated companies	(1.8)
Interest of minority stockholders in the results of subsidiaries	0.1
Net profit for the year	$ 77.1

Source: Annual Report.

Exhibit 12 Controladora Comercial Mexicana, S.A. De C.V. and Subsidiaries, Consolidated Balance Sheet, Year Ended December 31, 1991 (in millions of U.S. dollars)

	1991
Assets	
Current	
Available	
Cash	$ 16.6
Temporary investments	95.9
	$ 112.5
Trade accounts and notes receivable (net)	$ 19.4
Other accounts and notes receivable	38.5
Inventories	188.8
Other assets	7.7
Total current assets	$ 366.8
Accounts receivable from associated and affiliated cos	4.1
Investments in shares of associated companies	$ 8.9
Property and equipment—net	$513.4
Structures on leased land and installation expenses—net	$ 52.8
Other assets	$ 1.1
Total assets	$947.1
Liabilities and Stockholders' Equity	
Current	
Trade payables	$ 278.3
Taxes payable	7.3
Notes payable	9.1
Other accrued liabilities	30.1
Total current liabilities	$ 324.8
Reserve for seniority premiums	$ 3.2
Contingent	
Total liabilities	$ 328.1
Minority interest	$ 2.8
Stockholders' equity	
Contributed capital	
Nominal capital stock	$367.8
Unpaid subscribed capital stock	-
	$367.8
Restatement	67.1
	$434.9
Earned capital (deficit)	
Premium on sale of shares	$ 15.7
Legal reserve	2.7
Prior years' results	14.0
	$ 32.3
Excess (insufficiency) in the restatement of stockholders' equity	
Accumulated result from monetary position	-
Result from holding nonmonetary assets	$ 72.0
	$ 72.0
	$ 104.3
Net profit for the year	$ 77.1
Total stockholders' equity	$616.3
Total liabilities and stockholders' equity	$947.1

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Intel's Site Selection Decision in Latin America

Ted Telford faced a dilemma. As the only full-time member of Intel Corporation's worldwide site selection team, he had to make a recommendation about where Intel should locate its first manufacturing plant in Latin America.[1] After months of analysis, involving both desk research and numerous field trips to potential country locations, the site selection team had narrowed the choice to four countries: Brazil, Chile, Mexico, and Costa Rica. All were attractive in different ways, but now it was October 1996, and Ted had to write his final report for the headquarters office in Santa Clara. Headquarters would want his recommendation and evidence to support it. He shifted uneasily in his chair. At stake was a long-term investment decision involving $300-$500 million, a substantial amount of money even for a company like Intel, with over $20 billion in annual revenues. Ted hunched over his files, and began reviewing the data one more time.

Intel and The Semiconductor Industry

Microprocessors are the brains of personal computers. They are composed of millions of microscopically small transistors—essentially, tiny electronic switches—grouped and interconnected with each other on individual chips of silicon to store and manipulate data.[2] This is why microprocessors are often

[1] The principal members of the site selection team were Ted Telford, International Site Selection Analyst; Chuck Pawlak, Director, New Site Development; and Bob Perlman, Vice President for Tax, Customs, and Licensing. Telford and Pawlak worked out of Intel's Chandler, Arizona, office; Perlman was based at the headquarters office in Santa Clara, California. Beyond these three members, there was an extended group of about 15 Intel employees all over the world who participated in detailed assessment of countries on issues such as energy availability, construction, operations, security, etc. Frank Alvarez, Vice President of the Technology and Management Group, was also based in Santa Clara and ultimately had final say over the site selection decision, along with Mike Splinter, Vice President of Worldwide Manufacturing and, of course, Craig Barrett, Intel's CEO.

[2] Silicon is used because it is a semiconductor. Semiconductors are materials that can be altered either to be conductors of electricity or insulators—a useful quality in a material used for constructing the complex electronic circuitry of microprocessors. "Silicon Valley" is a nickname for the region around Stanford University, which includes many towns that serve as a home to important high-technology companies (including Santa Clara, where Intel headquarters were located).

Using sophisticated chemical processes and engineering techniques, microprocessors are manufactured by the hundreds on extremely thin layers of silicon known as wafers. Each wafer is about 6-8 inches in diameter. The microprocessors are tested while they are still on the silicon wafer. Later, these wafers are cut into individual pieces or chips, each containing one microprocessor. The microprocessors are then tested again, packaged, and sent to customers for installation in many different kinds of automated devices.

referred to as chips, as in "the Pentium II chip." Computer software enables microprocessors to perform specific functions with the stored data. As a result, microprocessors today are found not just in computers, but in virtually any inanimate object that can "think" (be programmed to perform certain tasks): traffic lights, cars, cellular telephones, airplanes, etc.

This enormous range of applications for microprocessors spawned a huge industry—the semiconductor industry—with well over $120 billion in sales in 1995, and a projected growth rate of over 20% per year.[3] Intel, as the first company in the world to introduce microprocessors in 1971, quickly established a dominant position in this industry and, in 1996, remained the dominant player with over 85% of microprocessor sales worldwide.

Although Intel had a number of competitors, the company invested billions each year in Research and Development (R&D) in order to retain its lead in innovation and design of new chips. As a result, Intel was constantly introducing faster and more powerful microprocessors in order to stay ahead of the competition. Intel's former CEO, Andy Grove, noted that in a high-technology industry such as semiconductors, "only the paranoid survive."[4]

The contrast between Intel's first microprocessor, the 4004, with only 2,300 transistors, and the one it planned to assemble and test in the proposed Latin American plant, the Pentium II—with over 7.5 million transistors—illustrated this dramatic rate of growth in computing power. Gordon Moore, one of Intel's founders, highlighted the fast-paced nature of competition and innovation in the semiconductor industry when he devised his famous "Moore's Law": driven by competitive market forces, the power of microprocessors will double every 18 months. This law had been fairly consistent with developments in the industry, and Intel had been leading the way since the beginning.

Given the speed of developments and growth in the industry, Intel needed to open a new plant at a rate of almost one every nine months.[5] Doing this, as well as maintaining high levels of spending on R&D, was very expensive—a serious disadvantage when the company had to deal with competitors who could imitate its product designs, then offer similar products at lower cost. Clearly, if Intel wanted to remain competitive, it could not pass on these costs to consumers in the form of higher prices. Early on, then, Intel's management realized that the company would have to build at least some plants in countries where costs (especially labor costs, which in assembly and testing facilities amount to between 25-30% of total costs) would be lower than in the United States.[6]

Intel's first overseas plant was built in Malaysia in 1972. Later plants followed in Israel, the Philippines, Ireland, and mainland China. But now, in 1996, Ted knew that there was a sense among management that the next plant should be in Latin America. Excessive investment in one region could create risks. For example, although Intel's plant in Malaysia had been productive for many years, in 1996 the plant faced problems resulting from a shortage of qualified labor. As a result, turnover among employees was approaching 30-40%, training was becoming expensive and difficult, and salaries were rising. It made sense to diversify the geographic location of the plants. The company already had a number of plants in Asia, but absolutely none in Latin America. The region offered relatively low labor costs, as well as logistical advantages for exporting production to the U.S. or Europe.[7]

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[3] World Bank, Foreign Investment Advisory Service, *FDI News*, December 1996, p. 5.
[4] Grove later wrote a book with this title.
[5] Debora Spar, "Attracting High Technology Investment: Intel's Costa Rican Plant," Foreign Investment Advisory Service, World Bank, Occasional Paper #11, April 1998, p. 4.
[6] Ibid., p. 8.
[7] Interview with Ted Telford, Site Selection Analyst, Intel, Glendale, Arizona, September 10, 1998.

Intel's Proposed Latin American Plant: Characteristics

Ted knew that the plant Intel had in mind would be an assembly and testing facility, rather than a more sophisticated fabrication plant ("fab"). Still, when it came to making microprocessors, assembly and testing was an involved, complex process, requiring significant technical and engineering expertise, clean rooms, advanced knowledge of chemical processes, and considerable expense. The site selection committee already knew that the plant or plants would employ about 2,000 technicians and engineers initially; this number would eventually increase to 3,500. It would also require the participation of significant numbers of expatriate personnel for extended periods, at least during the startup phase.

While all of these considerations would influence the site selection process, the size of the selected country's market would be irrelevant. This was because Intel planned to export 100% of the product assembled and tested at the plant; almost all of that would be going to the United States.

The Site Selection Process, Phase 1: Desk Research—And Costa Rica Makes the Short List

As Ted reviewed the data before him, he reflected on the long, highly systematic site selection process. It had all started with several weeks of desk research. During that time, a group of Intel employees had gathered as much information as they could on a long list of countries in Latin America. The group gathered data on such issues as political and economic stability, labor unions and labor regulations (a particular concern of Intel's), infrastructure, and the availability of an educated workforce (after all, the plant would need trained technicians and engineers).

After this desk research, Ted had been able to eliminate some countries altogether. Venezuela, for example, seemed to be too unstable financially; the desk research phase quickly ruled it out as a serious candidate. But three countries stood out as seeming to have necessary conditions for Intel's planned investment: Mexico, Chile, and Brazil. Costa Rica was added later.

Ted recalled that Costa Rica had *not* been on the original short list. It was only after officials at *Coalición Costarricense de Iniciativas para el Desarrollo* (CINDE, Costa Rica's Investment Promotion Agency) had given presentations to Silicon Valley executives in late 1995 about Costa Rica's potential as a center for high technology investment that Intel executives in California had considered this possibility.

CINDE had been created in 1982 with financial assistance from the United States Agency for International Development (USAID). Its original purpose was to serve as a private, nonprofit export promotion center. Its Board of Directors was (and still is) composed almost entirely of businessmen from the Costa Rican private sector. CINDE was a collaborative effort between USAID and civic-minded businessmen in Costa Rica to promote nontraditional exports (in Costa Rica, this meant anything that was *not* bananas or coffee) and enhance economic development in Costa Rica.

At the time CINDE was created, the Reagan administration was hoping to strengthen the private sector in Central America and the Caribbean to prevent the spread of political instability in these regions. The Administration's Caribbean Basin Initiative (giving preferential access to the U.S. market for manufactured goods from Central America and the Caribbean) was one way to do this. USAID's creation of CINDE was a separate policy but was consistent with the overall strategy.[8]

Over the years, especially after the end of the Cold War in the early 1990s and the fall of the Sandinista regime in Nicaragua in 1990, USAID reduced its funding to Costa Rica and finally closed its offices in the country in 1996. CINDE, with new funding from the World Bank and a trust fund of its own to finance its activities, continued—but with a different emphasis.

Following advice from a consultant with the highly successful Irish Development Authority (IDA)—Ireland's investment promotion agency—as well as from the World Bank, CINDE's directors realized that they should focus on promoting investment from specific firms in specific industries.[9] Professors at the *Instituto Centroamericano de Administracíón de Empresas* (INCAE), Costa Rica's premier business school, gave CINDE similar advice. Founded by Harvard University, INCAE was influenced by Harvard professor Michael Porter, a frequent visitor to the school and a close adviser to Costa Rica's president, Jose Maria Figueres (himself a Harvard graduate). INCAE recommended that CINDE pursue Porter's idea of promoting clusters of firms in particular industries as a way to accelerate national economic development.[10]

In a detailed study, the World Bank recommended to CINDE that it should target the electronics industry.[11] The Bank argued that the level of technical education in Costa Rica, and the number of electronics firms already located there, made it a suitable location for attracting a number of companies and creating clusters of firms in this industry. Others in CINDE had already made similar arguments, but the World Bank study confirmed these views.[12]

While not a government organization itself, CINDE was fortunate that it had support for its plans at the highest levels of government. Costa Rica's President, Jose Maria Figueres (1994-98), was very interested in promoting high-technology investment in Costa Rica.[13] Educated at West Point (with later graduate study at Harvard), Figueres had a vision of making Costa Rica a haven for high-technology investment. He believed very strongly that the country would be left behind in its quest for economic development if it remained principally an exporter of bananas and coffee, with only some manufacturing investment in low-tech, low-wage, low-value-added industries such as textiles. Costa Rica's gradual increase in Gross Domestic Product (GDP)/capita, education levels, and living standards, combined with the end of political unrest in neighboring Central American countries, had already resulted in a

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[8] Mary A. Clark, "Transnational Alliances and Development Policy in Latin America: Non Traditional Export Promotion in Costa Rica," *Latin American Research Review*, Vol. 32, No. 2, 1997, p. 91.
[9] Interviews with CINDE officials, San Jose, Costa Rica, October-November 1998.
[10] Thomas T. Vogel, "Costa Rica's Sales Pitch Lures High-Tech Giants Like Intel and Microsoft," *Wall Street Journal*, April 2, 1998, p. A-18; interviews with CINDE officials, San Jose, Costa Rica, October-November 1998.
[11] The World Bank, "Costa Rica: A Strategy for Foreign Investment in Costa Rica's Electronics Industry" (Washington, D.C.: The World Bank), 1996.
[12] Interview with Rodrigo Zapata, former Vice President of CINDE (now General Manager for GE-Costa Rica), San Jose, Costa Rica, October 1998. The study was conducted by the World Bank's Foreign Investment Advisory Service. Although the final version was published in 1996, CINDE was well aware of its main points long before that time.
[13] Jose Maria Figueres was the son of Jose (Pepe) Figueres Ferrer, who led a civil war in 1948 when the Costa Rican legislature had nullified the outcome of a presidential election for a candidate who had won a legitimate election victory. During a brief period as interim president immediately following the war, Pepe Figueres succeeded in writing a new constitution and abolishing Costa Rica's military entirely, an unprecedented feat in Latin America (or virtually anywhere else, for that matter). He then turned power over to the rightful victor in the 1948 presidential election. He was elected president of Costa Rica himself several years later (1953-57).

migration of investment out of Costa Rica's textile sector. New investment in this industry was going to countries like Nicaragua, where wages were much lower.

Clearly, changes in the world economy meant that Costa Rica would have to change its strategy, as well. As Figueres explained his government's plan:

> *We wanted to incorporate Costa Rica into the global economy in an intelligent way. Globalization was more than simply opening the country to foreign trade. We needed a national strategy not based on cheap labor or the exploitation of our natural resources. We wanted to compete based on productivity, efficiency and technology . . . . many textile firms [had] left the country, and the government received severe criticism for not trying to sustain the maquila industry . . . . [but] the foreign investment attraction strategy had changed. We wanted to attract industries with higher value-added, that would allow Costa Ricans to increase their standard of living.*[14]

All of these factors, including the high level of support from the Figueres administration, made CINDE eager to approach Intel when they heard, in 1995, that the company was planning to put a plant somewhere in Latin America. CINDE officials paid a special visit to Intel's headquarters in Santa Clara and were able to persuade management there that Costa Rica should be on the list. During the actual country visits, the site selection team decided to visit Costa Rica on their way to Brazil.

The Site Selection Process, Phase 2: Initial Country Visits

Actually visiting the countries on the short list was crucial to get a sense, beyond all the data and statistics the team already had, of whether a plant would be a viable investment for a given country. For example, would the country's roads and airport facilities be adequate to transport the product quickly and efficiently to foreign markets? Did the country pose a security risk, to expatriate personnel or to the product? After all, silicon wafers containing hundreds of chips were very valuable—indeed, they were literally "worth more than their weight in gold." (Intel executives used this phrase often in interviews when referring to silicon wafers.) If trucks transporting hundreds or thousands of these on a daily basis were likely to be robbed, the site should be ruled out.

Other questions Intel wanted answered were even more difficult to glean from secondhand written reports. For example, would Intel executives be able to negotiate effectively with government officials in the country in question? Could a good working relationship be established? Finally, would expat managers be happy living in the country?

Ted was in charge of making the initial contacts with the relevant government officials in each of the countries the site selection team planned to visit. In setting up the visits for the team, he wrote detailed letters explaining what the team hoped to learn during its visit. Central concerns, he stressed, included the following:

* *availability of technical personnel and engineers to staff the proposed plant;*
* *labor unions and labor regulations;*
* *transportation infrastructure and costs (roads and airports only, since Intel would export all of its product via air);*
* *the availability and reliability of the electrical power supply;*
* *the government's corporate taxation rates—and more specifically—whether the government offered any tax incentives for investments of the kind Intel proposed to make.*

[14] Excerpt from interview with Jose Maria Figueres, quoted in Nils Ketelhohn, "The Costa Rican Electronics and Information Technology Cluster," unpublished manuscript, 1998, p. 6.

Ted had been confident in asking about incentives, for he knew that his requests for meeting with the relevant government officials would be well received. In the past, governments in Latin America had adhered to ideas of protectionism and economic nationalism, but by the late 1990s those ideas were a thing of the past. The proposed investment was something that would be attractive to almost any government in Latin America. After all, Intel's $300-$500 million investment would bring with it thousands of good jobs for technically trained workers and engineers.

In addition, rather than displacing indigenous producers by selling in the domestic market, Intel's product would be 100% exported. This would also contribute to the country's balance of payments. Finally, there was the possibility that Intel would use at least some locally produced components or products, thus creating so-called "linkage effects" and contributing to local economic development. If anything, Ted knew, Intel's proposed plant was the kind of project that countries would compete with one another to attract.

As it had turned out, the site selection team's initial experiences in each of the four countries were very important in making their decision. The team's first visit was to Costa Rica, then Brazil, Chile, and Mexico. Ted opened the first file, and began reviewing what he had learned.

Costa Rica

At first, despite CINDE's lobbying, Costa Rica had seemed an unlikely prospect. The country was simply too small. With only 3.5 million people and a tiny (if reasonably healthy) economy, the Intel executives feared that their investment would overwhelm the small nation. As Bob Perlman said, they were concerned that if Intel did invest in Costa Rica, it would be like "putting a whale in a fish bowl."[15] But the CINDE officials had been persistent, and the site selection team was willing to give the country a closer look.

When it came to luring foreign investors, Costa Rica had many advantages. One was its well-deserved reputation for political stability and democratic government. Surrounded by other countries that had been engulfed in political turmoil and war for much of the 1980s, Costa Rica, in contrast, had abolished its military in 1948 and had been stable, peaceful, and democratic ever since. Costa Rican President Oscar Arias (1986-90) won the Nobel Peace Prize for brokering a peace among the warring Central American nations, thus enhancing Costa Rica's reputation as a center of peace and stability in a chaotic region. Since 1948, the nation had devoted its main government activities toward providing social welfare for the populace and improving education and health care. The government had even set aside over 25% of its national territory as national parks in order to preserve its astonishingly rich biodiversity (and to promote ecotourism).

But for Intel, more important than any of this was the role CINDE played in attending to their concerns. CINDE, autonomous from the government and administered by private business people, was by the mid-1990s a streamlined, efficient, flexible organization. One factor in CINDE's success was that its private status allowed it to pay its employees far more than they could have made working for the government. As a result, CINDE had bright, highly competent employees who were able to pursue Intel aggressively and creatively.

[15] Telephone Interview with Bob Perlman, Intel's Vice President for Tax, Customs, and Licensing, August 1998.

During the visit to Costa Rica, the site selection team was deeply impressed with how prepared CINDE was to receive them and answer their questions quickly and efficiently. The CINDE officials had clearly done their homework. For the harried team, trying to get information as quickly as possible so that a decision could be made and a plant could be built fast, this quality made a very favorable impression indeed.

Following specific advice from Michael Porter, and also from the World Bank's Foreign Investment Advisory Service (an agency at the World Bank that provides less-developed countries with advice on investment promotion), CINDE knew that for a high-tech company like Intel, quick, speedy responses to questions were essential. Therefore, Enrique Egloff, CINDE's General Director, assigned three investment promotion specialists to the task of working only on the upcoming Intel visit. Because of the magnitude of the Intel project and the considerable benefits for the country if Costa Rica could land it, Egloff decided that these CINDE employees would be responsible only for the Intel project for the duration of the site selection team's decision-making process.

The three CINDE staff members on the project were Danilo Arias, Julissa Bravo, and Marcella Mora. Danilo, a lawyer by training, was assigned to handle any Intel issues related to legal matters or taxation. Julissa dealt with questions about human resources and education, and Marcela with questions of real estate, construction, and permits. It is significant that Intel executives were so impressed with these CINDE employees that all three were later offered jobs with the company. Danilo Arias became a Director of Public Relations, and Julissa Bravo accepted a position as a Human Resources manager with Intel. Although Marcella Mora was also offered a job at Intel, she chose to accept a job as Microsoft's Sales Manager for Latin America and the Caribbean.[16]

Rather than waiting for the site selection team to arrive and then responding to questions, each of these CINDE officials researched potential questions *in advance* to *anticipate* what Intel might ask. Then, if asked, they were exceptionally well prepared with facts, figures, etc. Also, together the three organized visits for the Intel executives with all of the key government officials that they knew the team would want to meet.

When Ted and his colleagues arrived in Costa Rica, CINDE had a well-planned, extensive agenda already laid out for them. During this and later visits, the Intel team was able to have in-depth discussions on relevant issues with, among others, the head of the ICE (the Costa Rican Electric Utility Company, still state-owned); the Minister of Transport and Public Works; the Minister of Education; the Minister of Science and Technology; the Dean of the *Instituto Tecnológico de Costa Rica* (ITCR); two separate accounting and consulting firms; and a number of other high-technology companies already established in Costa Rica, including Motorola, DSC Communications, and Baxter Healthcare. (Although Baxter had nothing to do with microprocessors, Intel found that it was useful to consult with this company during site selection. Like Intel, Baxter had operations all over the world and had similarly high standards in its production processes, such as the use of clean rooms.)

During the site selection team's initial visit to the country, CINDE officials arranged a visit with Jose Rossi, Minister of Foreign Trade, and President Figueres himself. Figueres impressed the team with his level of personal interest in the company, and his willingness to get involved in details of the negotiating process. But Figueres' level of personal involvement really hit home when the team casually mentioned that they were interested in getting to know Costa Rica's central valley better, since that was where the proposed plant would be located. Figueres said that if they could show up at 7:00 am the next

[16] Interviews with all three individuals in San Jose, Costa Rica, October-November 1998.

day, he could arrange a helicopter tour. When Ted and his colleagues showed up early the next morning, they were astonished to find Figueres himself at the controls.

Despite the high level attention and the apparent willingness the government had to work with Intel, the site selection team still had several very serious concerns about Costa Rica. The main issues were:

- Education

  Although Costa Rica appeared to have a sufficient number of engineers, it was lacking in mid-level technicians, crucial for staffing the assembly and testing plant. While the engineers needed to keep the plant operating might number in the several hundreds, the need for mid-level technicians would be in the thousands. Finding enough people with the right training was clearly going to be a problem in Costa Rica.

  In discussing this problem with Figueres, the Minister of Education, and the Dean of the Costa Rican Technological Institute (ITCR), the virtues of Costa Rica's small size quickly became evident. All of these officials made clear that they could adapt to Intel's needs, modifying the curriculum of the ITCR and even creating a special certification program to produce the requisite numbers of technicians.

  Adapting to Intel's need in this way raised a potential problem. The site selection team had emphasized from the beginning that Intel did not want special treatment, no matter how much Costa Rica wanted its investment project. A major concern was that any special deals or special incentives offered by the Figueres government, and not done in a transparent, legal way, would create problems for Intel in the future, should the next president want to withdraw this special support. Intel was very explicit from the beginning, therefore, that the government not try to offer anything like this.

  But the Costa Rican government took care to make sure that the agreement to modify the ITCR's curriculum did not fall into this category. Although the new curriculum would be created in direct response to Intel's concerns, adapting the ITCR's curriculum to Intel's rigorous standards would make the school's graduates better-trained overall, and thus better-equipped to work for *any* high technology firm. The modifications were not just for Intel—they were strengthening the ITCR generally.

  In addition to investigating the technical preparedness of Costa Rica for the proposed plant, Ted and his colleagues also observed the level of English language proficiency in the general population, which they perceived to be much higher than it was in other Latin American countries. Ted and his colleagues observed that in Costa Rica, even cab drivers seemed to have a high degree of proficiency in English. Clearly, the general population was relatively well educated, and this was just one indication of that. In addition, the team noted that the current government had made English a required subject in the public school system. While a relatively minor point, English proficiency would be important when expatriates arrived to train local workers, especially since most technical manuals were in English.

- Labor Issues

  Labor unions were a major concern of Intel's. It did not want them in any of its plants, anywhere in the world, even if they were weak or labor unions in name only. In large part this had to do with the

company's complex, highly technical production processes, which simply could not function properly with work stoppages or other kinds of union-related disruptions. These kinds of issues appeared to present few problems for Intel in Costa Rica. In fact, only about 7% of Costa Rica's private-sector workers belonged to labor unions.[17]

Labor unions had not had much power in Costa Rica since the end of the civil war in the late 1940s, when the new government banned the largest labor confederation in the country because of its affiliation with the Communist Party. Later, when the *Partido Liberación Nacional* (PLN) government was elected in the 1950s, it established *Solidaridad* (Solidarity), a government-sponsored movement to create special voluntary associations as an alternative to more confrontational, industry-wide unions.

Workers who belonged to these *solidarista* associations received numerous benefits, including participation in special savings plans (with contributions made by employers as well as employees), low-interest loans, and profit-sharing. (The profit-sharing was with the association, not the company.) *Solidarista* associations were quite different from labor unions in that they allowed management as well as workers to participate, and had no negotiating power of their own. Some believed that this system had contributed greatly to "labor peace" in the workplace.[18] Over 19% of multinational corporations in Costa Rica, including Firestone, McDonalds, and Colgate-Palmolive, had *solidarista* associations.[19]

In addition to the Solidarity movement, other factors also prevented the development of more traditional, combative labor unions in Costa Rica. One was the government's establishment of a national collective bargaining system, using wage boards to establish wage levels—thereby eliminating an important role for such unions. Still another was the law stating that unions could call a strike only if 60% of affected members signed a petition in favor of doing so, and a judge decided that the reason for the strike was valid. While the judge was deciding, the employer could fire any workers who were involved.[20]

Clearly, labor unions in Costa Rica would not be a major concern for Intel. Moreover, wages in Costa Rica were low in comparison with those in the United States, even for technical workers or skilled technicians. However, this was also true of the other countries on Intel's short list, with the exception of Chile (more on that below).

- Transportation

While the roads from most potential sites for the plant to the airport were in excellent condition, and San Jose's international airport was acceptable, Intel's main concern was that the airport did not offer sufficient daily flights. This presented a very serious problem, because Intel would need to export all of its chips by air. After discussing the problem at length with Intel's executives, Costa Rica's Ministry of Transportation and Public Works was willing to be flexible in creating an "open skies" program. It began issuing more licenses and encouraging many other airlines to use the national airport. Again, while this might have seemed a special concession to Intel, it benefited other companies and other industries, especially the tourism industry, as well.

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[17] Bruce M. Wilson, *Costa Rica: Politics, Economics, and Democracy* (Boulder, CO.: Lynne Rienner Publishers, 1998), p. 70.
[18] CINDE website, www.cinde.or.cr.
[19] Ibid.
[20] Wilson, *Costa Rica*, pp. 69-70.

- Electrical Energy

  Because Costa Rica was not accustomed to industrial projects of the size Intel proposed, it did not have adjusted rates for heavy industrial users. The rate for industrial users varied only between $0.07 and $0.09 per kilowatt-hour—much more expensive, for example, than Mexico's rate of about $0.02 per kilowatt-hour. [21]

  After discussion of this issue, ICE agreed to create a new rate for especially heavy users of electricity: $0.05 per kilowatt-hour. This rate would apply to any company using more than 12 megawatts of electricity (more than any other user of electricity in the country). Again, this was *not* a special concession to Intel—because *any* large industrial user that chose to invest in Costa Rica could also take advantage of this heavy use rate.

- Investment Incentives

  Costa Rica already offered generous incentives to companies located in its eight industrial parks with free trade zone status. Companies in the *Zona Franca* not only did not pay duties on imported parts or components, but were also completely exempt from income tax for eight years, and 50% exempt for four years after that. Intel wanted even more than this and the Costa Rican government was willing to negotiate. After all, other multinational corporations operating in the free trade zones, such as Baxter and Conair, had expressed concern about paying the higher tax rate at the end of their eight-year exemption, even if they planned to reinvest in the country.

  Jose Rossi, the Minister of Foreign Trade, agreed to lobby the Costa Rican legislature for a change in the legislation. The new law would give a company a 75% exemption after eight years, provided that it reinvested more than 25% of its initial investment after the fourth year. Again, this would benefit not just Intel but other multinational corporations as well. Jose Rossi emphasized to Intel executives that he would do his best to push for the new policy to become law, but that he could promise no more than that.[22] Working its way through the slow but democratic legislative process, this law finally passed in 1998.

  Clearly, there were reasons to be concerned about putting the plant in Costa Rica. But the government did seem willing to work with Intel without breaking any of its own laws by offering special deals. The prospects at least looked promising. But the next country the team planned to visit, Brazil, seemed potentially to offer a lot more.

Brazil

The site selection team's experience in Brazil was in marked contrast to what had happened in Costa Rica. Brazil's size alone was an enormous contrast: 160 million people in contrast to Costa Rica's relatively puny 3.5 million. Also, unlike Costa Rica's simple, unitary political system, where power was centered in the national legislature and the president, Brazil offered another layer of complexity: it had a federal system. This meant that Intel could pick and choose among Brazil's 26 states for just the right investment deal. Under Brazil's decentralized system, states and even municipalities had some control over taxation policy and could offer individual incentives in order to lure investment. This practice had

[21] Interview with Danilo Arias, Public Relations Director, Intel-Costa Rica, San Jose, Costa Rica, October 1998.
[22] Interview with Jose Rossi, former Minister of Foreign Trade, San Jose, Costa Rica, November 1998.

grown to such an extent that in Brazil it had come to be known as the *guerra fiscal* or "taxation war." Some states had actually driven themselves to the point of bankruptcy in their efforts to compete with other states in offering the most generous exemptions from the state value-added tax, the ICMS.[23]

At the federal level, Brazil provided a tax incentive specifically directed toward the computer industry through the *Processo Produtivo Básico* (PPB), or Basic Productive Process law. In order to receive this incentive (which included a reduction of up to 50% of corporate income tax, as well as reductions in some other taxes), companies had to invest 5% of total revenue in research and development. At least 2% of this had to be invested in universities or other government-approved institutions; the rest could be invested internally.[24]

While the PPB potentially seemed interesting, the fiscal incentives at the state level turned out not to be very relevant. The site selection team had already decided that the best location for a plant would be in the state of São Paulo—where the governor, Mario Covas, had explicitly rejected offering any special tax incentives.[25] In any case, the ICMS tax itself would not apply to Intel, since this tax was not levied on exported products.[26]

Covas's reason for not being generous about incentives was that São Paulo did not need to do much to lure investment. For after Brazil had finally stabilized its economy with the implementation of the *Plano Real* in 1994, billions of dollars of foreign investment were flowing into the country every year. And the lion's share of this investment went to São Paulo, the most heavily populated and economically developed state in the entire country.

What intrigued Intel about São Paulo was that the state had already succeeded in attracting numerous high technology firms. In fact, within a couple hours' drive from the capital, the megacity of São Paulo (population: 16 million people), were the much smaller cities of São Jose dos Campos and Campinas. In these cities, hundreds of high-technology firms had already established themselves. São Jose dos Campos was the home of EMBRAER and many other high-technology firms. Campinas, of particular interest to Intel, had managed to attract IBM, Compaq, Hewlett Packard, DEC, and Texas Instruments, to name just a few. Significantly, while São Paulo state did not offer any special tax incentives, Campinas's municipal government did provide them. Specifically, it granted exemption from city property and service taxes for any high-technology companies that established manufacturing plants in either of two industrial parks in the city, both specifically oriented toward high-technology firms.[27]

Clearly, Brazil had a lot to offer. In terms of *adequate numbers of technical personnel*, there was no question that the numbers in Campinas (home of the famed technological university, the *Universidade Estadual de Campinas*, or UNICAMP) would be far superior to what Intel could find in Costa Rica. *Infrastructure* was more than adequate; electrical power was readily available at reasonable costs, and the airports were already capable of meeting Intel's needs.

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[23] I use only the acronym for the state value-added tax here because the full name is quite a mouthful. ICMS stands for *Imposto sobre as operações relativas a Circulação de Mercadorias e sobre a prestação de Serviços de transporte intermunicipal e de comunicação*.

[24] Renato Bastos, U.S. Department of Commerce, "Computer Hardware and Peripherals," Industry Sector Analysis for Brazil, São Paulo, Brazil, October 1998, p. 15.

[25] Although São Paulo did allow an exception for the computer industry by reducing its relatively high ICMS from 18% to 12% for computer products only, this was still a high rate. See Bastos, p. 15.

[26] American Chamber of Commerce-São Paulo, "How to Undertstand Corporate Taxation in Brazil" (informational pamphlet), São Paulo, 1999, p. 17.

[27] Município de Campinas, Lei N. 8003 de agosto de 1994, in "Incentivos Fiscais do Município de Campinas – SP," provided by Prefeitura Municipal de Campinas, November 1998.

But other issues worried Intel's site selection team. *Security* was of some concern; according to some reports, hijacking of trucks in the São Paulo area was on the rise.[28] Another concern was *labor unions*, which, while not as powerful as they were in some Latin American countries, could be more militant than those in Costa Rica. In Brazil, all workers paid union dues, whether they were formal union members or not (of Brazil's total workforce, about 20-25% was unionized). A single union represented all workers in a particular industry in a given geographic area. These unions were organized at the federal level into labor federations. The *Central Única dos Trabalhadores* (Central Workers' Union, or CUT), the more combative of Brazil's two principal labor federations, was linked to the *Partido dos Trabalhadores* (Workers' Party, or PT), which controlled some state and municipal governments in Brazil. While workers' base wages were relatively low, overall labor costs in Brazil tended to be higher than in other Latin American countries because mandatory benefits for full-time employees, such as paid vacations, lengthy maternity (also paternity!) leaves, and social security taxes, added 50-80% to the total cost.[29]

But perhaps the biggest problem that the site selection team encountered in their visit to Brazil was that, after their highly favorable experience with CINDE, and all the personal attention to their concerns lavished upon them from Figueres, Brazilian government officials seemed indifferent to their concerns. Foreign firms were so eager to get into Brazil to get access to its huge internal market that state and national government officials did not need to concern themselves with addressing special concerns of individual corporations—even of an industry giant like Intel. Moreover, on balance, the federal government's policies did not seem all that favorable. While the federal government did offer the specific PPB incentive for firms investing in R&D, it offered no general exemption from corporate income tax—and it had a high rate of taxation.

After the Costa Rica experience, all of this left a negative impression. Certainly Brazil did have a huge and very attractive domestic market. But for this particular project, Intel had no interest whatsoever in the domestic market of the country where its plant would be located. 100% of the product manufactured in the plant would be exported.

In addition to the lack of special incentives in São Paulo state, and the required income tax at the federal level, there were still more additional costs associated with doing business in Brazil. There seemed to be numerous other taxes, such as the infamous tax on financial transactions, and other expenses that all added up to what expatriate executives referred to as "the Brazil cost"—the extra cost of doing business in Brazil. Extra costs might be worth enduring if the tradeoff was access to a huge local market. But when a company intended to produce exclusively for export, as in Intel's case, these costs could be prohibitive. After all, aside from the (at the time) overvalued exchange rate, the "Brazil cost" was one of the chief reasons Brazilian firms themselves had difficulty exporting and why Brazil's current account deficit was so large.

Chile

After Brazil, the site selection team visited Chile. The team was very impressed with Chile's modern infrastructure and the country's technical training programs. But they immediately encountered four problems: distance, labor costs, capital controls, and lack of government incentives.

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[28] Interview with Intel executive, Glendale, Arizona, October 1998.
[29] "Brazil: Investing, Licensing, and Trading," The Economist Intelligence Unit (London: The Economist Intelligence Unit), January 1999.

- Distance

  The site selection team was struck by the sheer amount of travel time to get from the United States to Santiago, Chile (almost 12 hours, given the scarcity of direct flights). Aware of the number of expatriate executives who would have to be travelling to the plant, at least in the startup phase, the team saw that this could present a problem. Costa Rica, in contrast, was only a three-hour flight from Texas or California.

- Labor Costs

  One legacy of the dictatorship of General Augusto Pinochet in Chile (1973-89) was a labor code that inhibited the development of powerful, confrontational labor unions. Only about 12% of the workforce was unionized. Unions that included members from more than one company were allowed to engage in collective bargaining only if the company in question agreed to this arrangement—which few companies ever did.[30]

  Partly as a result of these rules, labor costs for unskilled workers were low in Chile, even though the country had one of the highest GDPs/capita in all of Latin America. However, salaries for technically trained personnel, which Intel needed most, were relatively high. The starting salary for an engineer in Chile was between $30,000-$40,000—not very different from what it would be in the U.S. Intel could hire engineers in Costa Rica or Mexico for almost half that amount.

- Capital Controls

  At the time of Intel's visit in 1996, Chile's Central Bank had a policy designed to control capital flight during times of market volatility. This policy stated that for portfolio capital investments (*not* for direct foreign investments, such as what Intel planned), investors would be restricted from withdrawing their investment from Chile for one full year. In addition, investors would be required to deposit an amount, called the *encaje*, equivalent to 30% of their overall investment in a special account at Chile's Central Bank during that time period.[31]

  This policy was a legacy of an earlier era, when capital controls were common throughout Latin America. Most Latin American countries had already eliminated this kind of policy, considering it to be counterproductive, in line with the overall "Latin American consensus" in favor of market-oriented policies. Even though Intel presumably would not be affected, since the proposed plant would be a *direct* foreign investment (as opposed to portfolio investment, e.g., investment in the Chilean capital markets), Intel executives were spooked by this policy. One government official was struck with how often the Intel executives brought up this issue, in meeting after meeting.[32]

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[30] Matt Moffett, "Pinochet's Legacy: Chile's Labor Law Hobbles Its Workers and Troubles the U.S.," *Wall Street Journal*, October 15, 1997, p. A-10.

[31] Technically, the policy still exists. However, currently, the rate is set at 0%—so portfolio investors do not have to put any money in this special account. Some in Chile, and all foreign investors, would like to see the end of this policy once and for all. The fact that the policy still remains, even if the rate is set at 0%, means that a higher percentage could be re-imposed at any time.

[32] Interview with Francisco Troncoso, Director, International Relations Division, CORFO, Santiago, Chile, December 1998.

- Government Incentives

  Beyond these other concerns, the Chilean government simply was not able to offer any significant investment incentives to Intel. Government officials at *Corporación de Fomento de la Producción* (CORFO), Chile's government development agency, explained to the site selection team that the market-oriented "Chilean model" was designed not to interfere with market forces, i.e., *not* to give special incentives for investment in selected industries.[33]

  CORFO *was* authorized to offer incentives if the investment were to be located in an especially poor region of the country in need of economic development. CORFO officials went so far as to suggest a location for Intel's plant that would meet these criteria, a poor region of Chile not far from Valparaiso. But the site selection team made very clear to CORFO that they did not want to be outside of the general vicinity of Santiago.[34]

Mexico

The final country on the team's itinerary, Mexico, offered an especially promising location for Intel's plant: the Silicon Valley of Mexico, Guadalajara. The second-largest city in the country, Guadalajara had by the mid-1990s established itself as a center for high technology firms, particularly in the electronics sector. Beginning with Motorola and IBM in the 1960s, hundreds of electronics firms had established plants in and around Guadalajara, the capital of the relatively prosperous Mexican state of Jalisco.

The site selection team was highly impressed with Guadalajara. They talked to a number of executives in high-technology firms, including Motorola and Lucent, which were already there. The *Secretaría de Promoción Económica* (SEPROE), or Jalisco State Economic Development Agency, was extremely well prepared with eye-catching brochures and detailed information that rivaled what the Intel executives had encountered at CINDE. SEPROE, too, prepared a detailed agenda, just as CINDE had done; and the site selection team had plenty of opportunities to speak to several expatriate executives on their own, just as they had done in Costa Rica.

The response from all of the site selection team's interviews was highly favorable about Guadalajara.[35] As part of Mexico's fabled "Golden Triangle," infrastructure in the city and surrounding area was more than adequate. The airport's number of flights and capacity was sufficient. Labor costs were low, yet there appeared to be a relatively large supply of skilled engineers and technicians. Finally, energy in Mexico, produced from abundant supplies of natural gas, was relatively inexpensive. As mentioned before, electrical power in Mexico was only about $0.02 per kilowatt-hour—significantly cheaper than Costa Rica's rate, even after implementation of the ICE's new policy granting special rates to heavy industrial users.

Unlike the indifference the site selection team had encountered in São Paulo, the Jalisco state government was eager to work with Intel. SEPROE officials explained that, in collaboration with the governor of Jalisco (renowned for his honesty and effectiveness), the agency was actively pursuing a strategy of encouraging high-technology investment. It was doing this indirectly by subsidizing numer-

[34] Ibid., and interview with Mario Castillo, Deputy Director, Strategic Planning Division, CORFO, Santiago, Chile, December 1998.
[35] Interview with Ted Telford, Phoenix, September 1998. Information from this section is also based on my interviews with officials at SEPROE, with executives at Lucent, Motorola, SCI, and IBM, and with others in Guadalajara, Mexico, December 1998, and August 1999.

ous technical training schools so that there would be an adequate supply of skilled labor in the region. Also, like CINDE in Costa Rica, SEPROE officials traveled frequently (sometimes accompanied by the governor) to spread the word about Guadalajara overseas and encourage foreign investment by high-technology firms, particularly in the electronics sector. The governor, Alberto Cardenas, was a member of the *Partido de Acción Nacional* (PAN), a business-friendly political party with market-oriented economic views.

SEPROE had a complex formula that it used to determine the number of jobs a company's investment project would be likely to produce, and the capital that the project would bring to the state. On the basis of this formula, SEPROE was prepared to offer Intel free land for the plant's site, and subsidized training for Intel employees for an extended period. But despite all of these positive factors, Intel had two serious concerns.

- Lack of Government Incentives at the Federal Level

  For all of the incentives the Jalisco state government was prepared to offer at the state level, the federal government of Mexico refused to budge on giving income tax exemptions at the federal level. Also, the extreme centralization of the budget process in Mexico meant that, while the states could provide incentives such as free land and subsidized training for employees, state officials had no ability to offer fiscal incentives of their own, even if the federal government had allowed them to do so. As one top SEPROE official remarked in frustration, "The federal government receives 100% of the tax revenues, but then only redistributes about 20% of that revenue to the states."[36]

- Labor Unions

  Mexican federal law also contained certain rules about unions that worried the site selection team. Intel had a policy about not having unions anywhere in the world. But Mexico's federal law stated that if a minimum of 20 employees in a given company decided to form a union, the company would be required to recognize it. If only two employees chose to affiliate with a union from outside the company, the company would be required to recognize and work with that union, provided that it was already recognized by the Mexican labor authorities. However, the workers would have to decide which form of representation they wanted, because only one union was allowed to represent the workers in a specific company. Most workers belonged to unions that were members of Mexico's nine largest national labor confederations, which had close ties to the dominant *Partido Revolucionário Institucional* (PRI) party.

  Although companies were not required to have unions, in practice union organizers from outside the company would often work with company employees to organize a union or recruit them to affiliate with outside unions. This meant that most large companies in Mexico had to deal with unions, and that the country had a high rate of unionization. Of Mexico's total workforce, nearly 40% was unionized; of industrial workers in companies with more than 20 employees, the figure was closer to 80%.[38]

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[36] Comments by SEPROE official, Guadalajara, Mexico, August 1999.
[37] Edward G. Hinkelman (ed.), *Mexico Business: The Portable Encyclopedia for Doing Business with Mexico* (San Rafael, CA: World Trade Press), 1994, p. 15.
[38] "Mexico: Investing, Licensing and Trading," The Economist Intelligence Unit (London: The Economist Intelligence Unit Limited), September 1998.

Many companies in Mexico ensured harmonious labor relations by working with company unions referred to as *sindicatos blancos* ("white unions"). In some cases, these unions were not really representative of the workers, but served only to comply technically with Mexico's legal requirements. Outside organizers would not be able to come in and form a more combative union (unless a majority of the workers voted for this), because the company would technically already have union representation. Other white unions were more genuinely representative of the workers, but worked in a collaborative way with management. In any case, white unions were much easier to work with than the more combative, confrontational unions that existed in many industries in Mexico.

But even if Intel were able to negotiate an agreement with a white union, this would still go against Intel's worldwide policy not to have unions in its plants. Intel would no longer be able to tell its employees elsewhere that the company had no unions whatsoever, at any plant in the world.

IBM managed to get around this problem at its own plant in Guadalajara by contracting out the majority of its workforce. Although 10,000 people worked at the IBM plant in Guadalajara, only about 500, all non-unionized management-level personnel (engineers and executives), were actually IBM employees. The rest worked *at* the IBM plant but were actually employed by other companies that were contact manufacturers, doing specific projects on a temporary basis for IBM. (Of course, all of these companies had unions.) This arrangement gave IBM flexibility in terms of its payroll, because during times of slack demand it could simply hire fewer contract manufacturers without having to worry about dismissing its own personnel and dealing directly with Mexican labor law issues.

Knowing about these different ways of working around Mexico's labor laws, SEPROE officials told Intel's site selection team not to worry. The company would not need to have a labor union. Intel could very easily be an exception to the general norm in Mexico.

But this very willingness on the part of government officials in Mexico even potentially to make an exception in Intel's case alarmed the site selection team even more. If the rules were not clear-cut, objective, and adhered to in a straightforward manner, then this created an unpredictable, non-transparent environment. This potential for lack of predictability and transparency in the rules of the game was of grave concern to Intel. It smacked of the "special deals" that the company had tried so much to avoid in Costa Rica.

Ted closed the last file and rubbed his eyes. He really had to finish that report.

The World Today Series

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Latin America

Robert T. Buckman

47th edition

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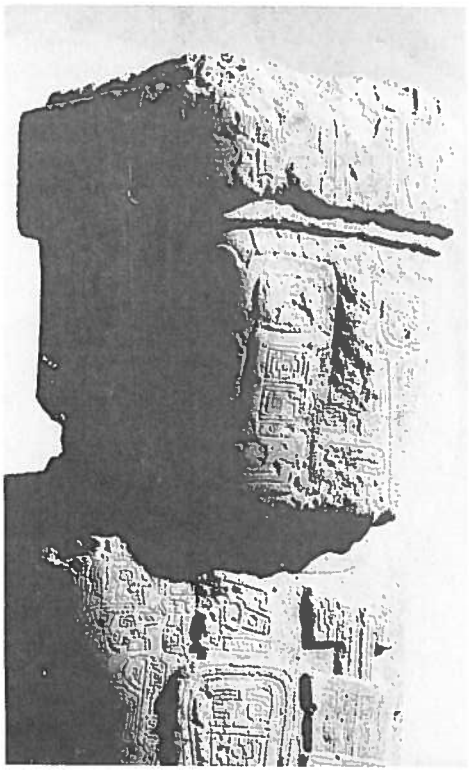

Stone piece, Tiahuanaco culture, Bolivia

The UN has received into its ranks many small countries, such as those of the Caribbean region. The purpose of this series is to reflect *modern world dynamics*. Thus, we mention only briefly the beautiful nations of the Lesser Antilles and concentrate our attention on the growth of the larger, developing countries.