Surviving the Competition in Central America

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Many Central American businessmen have had to develop innovative strategies to become competitive in the international marketplace as a means of fighting the new—and sometime ferocious—competition resulting from the region's opening to the world economy. Each business is different and requires individually tailored strategies. However, the strategy responses developed in response to the increasing competition in Central American markets are similar.

There are seven strategies that merit in-depth discussion:

➤ Modernize

The implementation of modernization programs is one of the first strategies carried out by Central American companies to deal with international competition. Such programs consist of acquisition of technology to increase productivity; improvements in product quality, packaging, customer service, delivery schedules, and marketing campaigns; new financial options; and new policies to train and recruit workers and managers. Increasingly, the leaders of Central American companies understand that survival depends on becoming—and staying—up to date.

Businessmen understand that quality is a basic requirement to compete in international markets, and that it does more than provide them with a competitive advantage. Quality includes raw materials, production processes, final product, delivery schedule, and post-sale service. Multinational companies verify that their Central American suppliers of goods and services fulfill quality standards by demanding that they meet international norms such as those established by the International Organization for Standardization.

The survey responses of several Central American businessmen confirm that many companies in the region are pursuing modernization processes. Atlas Eléctrica, a manufacturer of household appliances in Costa Rica, has made its production process more flexible by purchasing the most advanced technologies. As a result, the company has reduced by seven days its delivery turnaround time to Central America, the Caribbean and several South American countries. It has also improved the quality and appearance of the product, reduced its cost and improved sale and post-sale services. The company has also set up customer-service centers in each market in which it operates. A similar process has taken place at Fábrica de Jabones la Luz in Guatemala. This company has produced benchmark studies, increased the quality of its products, boosted its advertising budget, and improved the factory's productivity by incorporating new technology and by training personnel.

Many businessmen—particularly those from Costa Rica—think that having an established national brand and a rapid and well-organized distribution system

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gives them a competitive advantage over foreign companies. They acknowledge the importance of offering good quality products at a competitive price, but choose a competition strategy based on marketing and distribution rather than one based solely on price or quality. “Nowadays, having a good quality product is not enough. It is necessary to have the resources to promote it aggressively through marketing campaigns. Every product is ultimately sold by how it looks to the purchaser,” said a manager from one of the biggest dairy companies in the region.

A producer and exporter of palm hearts shared the same opinion. He commented: “I was unable to export palm hearts until I met my current partners who are businessmen from Chile and Spain. It was the same product I sell domestically, but I had to change its packaging to be able to sell it overseas. Now it is even selling more domestically.”

It is not clear whether this strategy will be successful in the long term, since most of the companies are not trying to improve their products or reduce prices. These are key requirements to compete successfully in the long term. Most executives in the region do agree that having a qualified workforce is vital to rapidly take advantage of new market opportunities. Gains in productivity resulting only from capital investments—without human resource training—are no longer sufficient. “Nowadays, human productivity is what makes the difference. It is unacceptable to view personnel training as an expenditure. Training is an investment, and those who do not understand that will be in trouble,” said a banker from Guatemala.

Many businessmen are evaluating opening their companies to outside investors as a means to finance the substantial investments needed to match international competition. Because local credit is expensive or not available, many businessmen now have to choose between partially losing control of their companies—many of which are family enterprises—or not making the necessary investments to succeed in the face of new international competition.

➤ Obtain expert advice

A second modernization strategy pursued by local businessmen consists of contracting experts, conducting research, market studies and competitive analysis, and evaluating new suppliers and materials, before making decisions. Companies are also developing benchmarks to stay informed and learn about best practices, including those used in other industries.

A retailer from El Salvador best represented the need for the region’s businessmen to be better informed and have more decision-making tools when he said, “It is not that I do not trust my intuition any-more. But now I use the opinions of consultants and studies to supplement it. You can no longer afford to make mistakes in the face of such strong competition.”

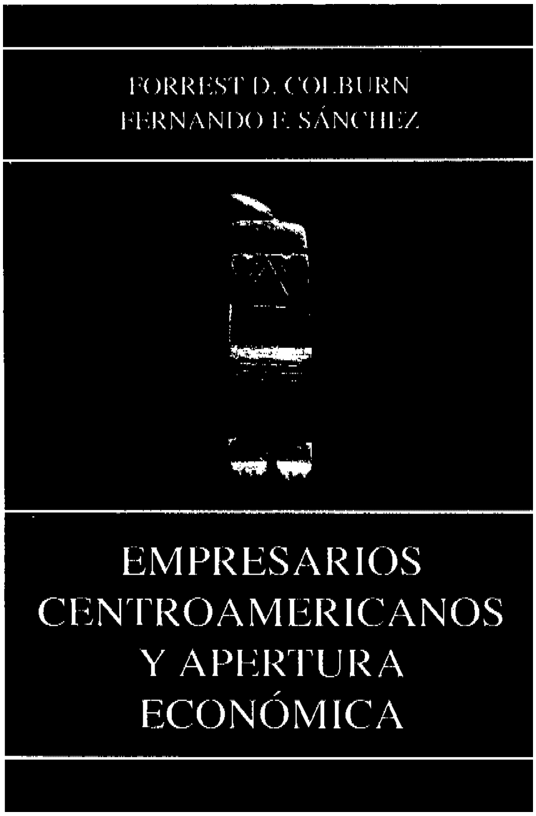
➤ Become more professional

Making their companies more professional is another strategy pursued by regional businessmen. They are making notable efforts to switch from traditional management systems of companies—many of which are family enterprises—to more “corporate" styles of management. Employee training is important in order to make companies more professional, but having professional management is even more important given the large number of family enterprises in the region.

Modernization is easier for those family companies whose “heirs” have been educated at prestigious international institutions. In such institutions they learn how to manage effectively and are also exposed to the opportunities of world trade. The “heir” to one of the most successful companies in the region provides one of the best examples of this shift. In his office in Guatemala City, where his MBA diploma from Harvard University is displayed, he explained the changes implemented by the company since he took over:

This study is based on 81 interviews with businessmen and politicians from Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica. The majority of the interviews, which lasted from one to two-and-a-half hours, were conducted in mid-1999. The interviews were unstructured to encourage honest and detailed responses from the interviewees. The confidentiality of the sources was also guaranteed.

We have expanded internationally, increased our sales and achieved economies of scale. As a result, we were able to reduce costs and offer better prices. We have also redefined our business. Before, we had eight different types of stores and now we have four. Our goal is to shift from generalists into specialists. We have commissioned studies by consultants and set up benchmarks with the best businesses in our field from Mexico, Argentina, Chile, and Brazil. We have invested a lot in personnel training, and when hiring people we now prefer those with master's degrees and executives with experience in multinational companies. Logically, we have improved our compensation system and have tied it as much as possible to performance and loyalty to the company. Finally, we have invested heavily in information systems. You can not be a leader in this business if you do not have large amounts of information and high levels of processing capacity as well as speed and accuracy.



➤ Limit focus

Concentrating on a smaller number of businesses or products—as markets become more competitive and require more resources for a company to stay in the market or maintain a product—represents a fourth strategy used by businessmen in the region. There is an inverse correlation between the degree of competition and the number of different businesses that can be operated effectively.

The private sector understands that as competition increase, it will neither be feasible nor profitable to operate several businesses simultaneously. An industrialist from Guatemala recounted, "After the opening of markets, we had to face competition from world giants like Unilever, Colgate-Palmolive and Procter & Gamble in the soap and hygiene products market. Thus, we had to identify the line of products where we could compete and concentrate on those. For instance, we continue competing in the soap market but no longer produce shampoos."

The same process is happening in other countries. A businessman from Honduras with investments in agriculture, cattle, banking, cement, and media confirms this new approach: "When our countries have a real commercial opening and competition grows, we will be better off working with one bank in each of the five Central American countries than with five different businesses all concentrated in Honduras."

➤ Establish market niches

The opening of the Central American economies has led businessmen in the region to a fifth strategy: establishment of new niches in the international market. The export of nontraditional products is promoted as one of the most feasible alternatives for the hard-hit agricultural sector. Costa Rica, where this trend started, is exporting several nontraditional products such as organic bananas, fresh and dried herbs, palm hearts, and melons. This trend is also important in Guatemala, where fresh fruits and vegetables, fish, shrimp, organic coffees, among other products, are exported to Europe.

This new strategy is also gaining ground in Nicaragua, which is now exporting cigars, melons, ginger, sweet onions, cucumbers, watermelons, tangerines, and other products. Organic products also are becoming important in all Central American countries. According to Nicaragua's Export and Investment Center, the market for organic products is worth $2.3 billion in the United States alone, and it is growing by 20% annually. Besides, these products command a 30% price premium over other products. And some specialty products, such as coffee, enjoy a 100% premium over conventional products.

In spite of the advantages offered by alternative markets such as those for organic products, it is significant that traditional exporters of products such as coffee, sugar, bananas, and meat have been slow to reform their businesses. Here management practices are slow to change, and many producers do not assign a capital cost to the land they use.

➤ Achieve economies of scale

Another strategy used by businessmen in the region is cost reduction by taking advantage of economies of scale in production and in purchasing raw materials. An entrepreneur from El Salvador illustrated the strategy: "Volume purchases and stronger market presence is our company's strategy to face globalization. The bigger you are, the larger your purchasing power, thus improving your ability to offer clients the best prices." The need to develop larger businesses, coupled with the small size of Central American markets, has renewed the interest of many businessmen to enter different markets in the region. These businessmen argue that it will be the initiatives and pressures from the private sector that will be the catalyst that furthers the region's integration process.

Entrepreneurs in the agricultural sector also support the integration of Central American markets. They know it is very difficult to compete in agriculture without adequate economies of scale. A larger regional market would allow them to produce for thirty million consumers. They could also obtain significant transportation savings given the short distances separating Central American countries.

The words of an industrialist from Costa Rica highlight this new concern with getting larger markets: "We serve our 800,000 customers in Costa Rica with what we produce in one shift. We will have to decide what to do with the production we can obtain in the other two shifts. We must be able to sell it abroad."

Many of the most important companies in the region are expanding their reach. For instance, the Corporación de Supermercados Unidos in Costa Rica opened several branches in Nicaragua, Honduras, El Salvador, and the Dominican Republic. Atlas Eléctrica exports to more than 24 Latin American countries. Dos Pinos, a large dairy products cooperative, has 60,000 sale locations throughout the region.

Many of the executives interviewed said that, given the slow advance of economic integration in the region, direct investment in Central American countries is one of the most effective alternatives to access regional markets. The job creation resulting from foreign investments is believed to offset the threat these investments might pose to national companies.

Business integration in Central America is advancing faster than political integration. As a result intra-regional exports alone are a misleading indicator of economic integration. Intra-regional investments in each country must now also be considered.

➤ Create strategic alliances

The seventh strategy businessmen are employing to obtain competitive advantages is to forge alliances with world-class companies. In fact, international companies pursue a similar market penetration strategy by teaming up with local companies and thus minimizing start-up costs and risks.

The following strategic alliances are examples of companies that have formed partnerships with international companies in order to survive and successfully compete in the new open economy: the Nicaraguan dairy company Eskimo with Yoplait, Atlas Eléctrica, with Electrolux, and a cement company owned by the Continental Group of Honduras with Honderbank.

Strategic alliances among local companies constitutes another defense strategy being used. For instance, domestic soap manufacturers in Guatemala have agreed to work with only one distributor to gain economies of scale and increase their distribution coverage.

Old habits die hard

While an increasing number of Central American businessmen are carrying out modernization programs, some still want to obtain new privileges, maintain existing ones granted in the era of closed economies, or even seek new privileges. "Central American businessmen have one foot on the free market economic model and the other one in the government offices," pointed out the president of the central bank of one of the countries in the region.

Different types of protection are sought. First, businessmen oppose tariff reductions and even request the reinstatement of import duties for certain products. The hike in import tariffs for dairy products from 15% to 39% established in Guatemala in 1999 is perhaps the best example of protectionist retreats. Alvaro Arzú, president of Guatemala at the time, pointed out that both businessmen and government officials were still struggling between full acceptance of the free market model and state intervention and the protectionist model: "The measure aims to protect 30,000 Guatemalan families participating in the [milk] business...My responsibility as president is to protect these families." The majority of the Guatemalan press echoed the president's sentiments. By contrast, business groups disagreed, pointing out that the decision to protect dairy producers represented a regrettable setback in the country's commercial policy.

Pressing the government to exclude certain sectors from free trade agreements (FTA) is another protectionist strategy employed by Central American businessmen. For example, at the request of the National Chamber of Agriculture and Food Processing, Costa Rica excluded poultry, dairy products and vegetables from the FTA it signed with Chile. The chamber published a full-page advertisement in one of the most influential newspapers in the country explaining the rationale behind its request. Among other arguments, the ad stated, "Chile applies nontariff barriers and subsidizes certain agricultural, cattle and food processed products which have not been seriously evaluated by our negotiators."

The success of the agricultural producers led some industrialists to pursue identical maneuvers. However, their efforts did not succeed, and they are now pressing the legislative assembly not to approve the FTA already signed with Chile.

Finally, some industrialists and farmers are asking the government to create special compensation funds to provide subsidies or to fund production conversion activities, especially for small and medium-size companies. Coffee, sugar and banana producers are the strongest advocates of subsidies to compensate them for low international prices for their products.

These efforts at protectionism are understandable. Not all sectors of the economies of the five Central American countries have benefited from the dramatic fall in tariffs and other measures that have opened the region's economies. There are "winners" and there are "losers." Those that have had the most difficulty with the new economic paradigm are those in traditional agriculture—coffee, bananas, sugar, and other such products—and those in the region's incipient industrial sector. And here is where demands for protection are concentrated. But even in these sectors, there are businessmen who ac-

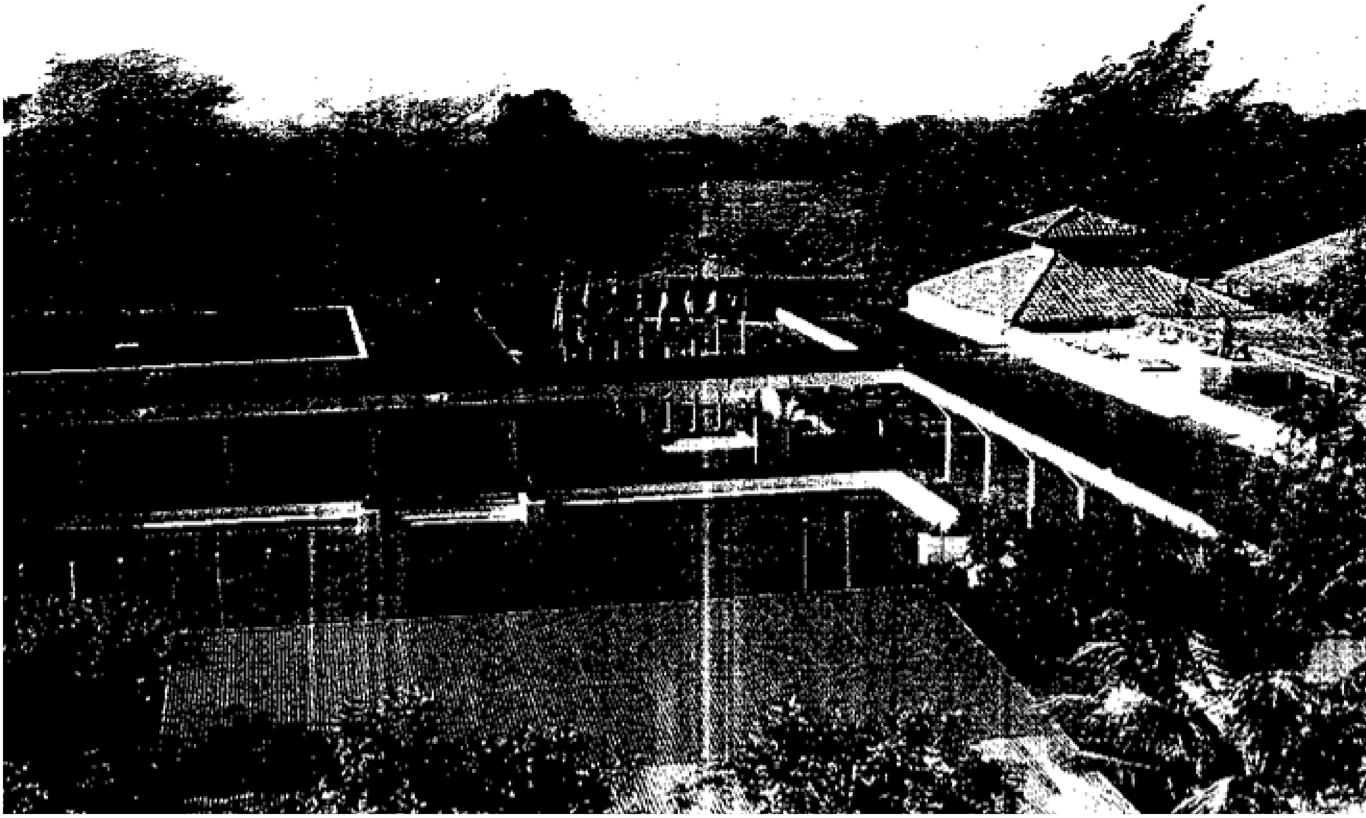


Photo: INCAE

Central American entrepreneurs recognize they must become better trained to capture new markets.

knowledge the inevitability of increased linkages to the international economy and are consequently busy preparing to compete successfully.

Moreover, trading partners—and the World Trade Organization (WTO)—are likely to apply pressure to end remaining protectionism.

Conclusion

In spite of some protectionist sentiment, the majority of the businessmen in the region has grasped the extent and consequences of the economic opening that has taken place in the area, a trend common elsewhere in the world. Central American entrepreneurs are busy implementing diverse strategies to increase their international competiveness. Others hope to identify and fill novel niches that are now up for grabs in the international economy. This is a time of enormous change and innovation for the private sector in Central America. The dangers are many, but so are the opportunities.