DEL MONTE CORPORATION

A Fruit and Vegetable Canning Operation In Mexico and a Pineapple Production and Canning Operation in Kenya

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A. PRODUCTOS DEL MONTE, S.A. de C.V.

I

Country Background - Mexico

The color and character of Mexico are difficult to capture and comprehend. The nation is an active compound of diverse and ancient indigenous cultures which, though diluted to impotency or wholly gone with time, have left their stamp on the physical structure, art forms, craft designs, rural clothing and village customs of the majority of Mexicans, especially the rural folk. Inextricably mixed with this legacy is the powerful influence of three centuries of Spanish colonial rule and four centuries and more of the pervasive impact of the Catholic Church. These imports provided a unifying language and a universal codification of values. At the same time, they introduced the "hacienda" system of land use and an extravagant social order which essentially disenfranchised practically all rural people, reducing them to a state of peonage which lasted 300 years, a yoke of underdevelopment still borne by all of Mexico.

The manner of Mexico is also deeply rooted in the success of the 1810 revolution of independence from Spain and the fierce sense of pride and non-alignment which marks Mexico today, in world affairs, and, in particular, as it tries to adjust to its entanglement with the economy, mores and politics of the United States. But the avid thrust of Mexico into the modern world really dates back to the 1910 agrarian revolution, which threw off the last vestiges of the "hacienda" system, returned the beloved land to "the people" as their rightful patrimony, and led to the 1917 Constitution which has guided the country ever since. And, while the Constitution does not provide for it specifically, it is most important to note that since 1917, Mexico has been led by one absolutely dominant political party, the Partido Institucional Revolucionario...the PRI. PRI attempts to house and harmonize the needs of all people, in all walks of life, leaving the question: In what proportions is Mexico a blend of democracy and autocracy?

Understanding Mexico...being able to distill from history the essences essential to a working understanding of the rules of behavior and law governing relationships between private enterprise and the Government of Mexico (GOM) has always been important but never easy for foreign investors. The financial crisis of 1982 thoroughly confuses the picture and makes the task that much harder. There is no better measure of the doubts and uncertainties generated abroad by the crisis than the decline of capital inflows from over U.S.$ 1 billion in 1982 to less than U.S.$ 200 million in 1983.

Some observers reckon that the financial crisis faced by Mexico and the manner of its alleviation will have as profound an effect as anything which has happened in the country since the revolution for independence. Certainly, the Government of Mexico (GOM) has taken drastic steps in its attack on the problem. Nationalization of the banking system; currency controls; sharp and continuing devaluations of the peso; major cuts in imports, particularly in the areas of capital goods, spare parts and luxury consumer items; significant decline in public works; withdrawal of a wide variety of subsidies; among many other actions, strongly influenced by the terms of an agreement with the International Monetary Fund, have yielded encouraging results in 1983.

Inflation is trending down, from well over 100 percent in 1982 to 80 percent in 1983, with a goal of 40 percent in 1984. National accounts are in a stronger position. Management of the huge external debt seems to be well accepted internationally. The government of President de la Madrid has strongly endorsed support for the further development of the "In-Bond Assembly (Maquiladora) Industry," both along the border with the U.S. and inland. In December, 1983, GOM officially created a national commission to facilitate and promote foreign investment (Comisión Nacional de Inversiones Extranjeras), within the Ministry of Commerce and Industrial Development. While few would venture a long-range forecast relative to the economy of Mexico and the durability of traditional support for a mixed economy, short-range indicators are modestly encouraging. After two years (1982 and 1983) of negative growth, it may be that in 1984 the economy will hold its own, setting up conditions for an economic recovery beginning in 1985.

Agriculture and agro-industry are deeply entwined in this context of change and uncertainty.

While the share of Gross Domestic Product (GDP) contributed by agriculture has declined from 14 percent in 1965 to an estimated 8.7 percent in 1982, it remains true that Mexico cannot hope to resolve its current and future economic and social problems without sweeping improvements in the performance of its agricultural sector. Roughly half the population is rural. Roughly half the labor force is employed in agriculture and related agro-industry. Basic foodstuffs are in short supply. Imports of wheat, corn, sorghum, vegetable oil, oilseeds to crush, non-fat dry milk, rice, and breeding animal stock, head a growing list of requirements. Import costs are indicative, e.g.: 1980 - U.S.$ 2.5 billion; 1981 - U.S.$ 2.4 billion; 1982 - U.S.$ 1.2 billion (a drop related to foreign exchange control rather than to need). Rural poverty continues to be the driving force of migration to the cities (and to the U.S.) and a major drag on the entire economy.

Constraints on improvements in agricultural performance are formidable. Of the total area (493 million acres), the Mexican Government considers 88 million arable, 195 million as range land and 110 million suitable for forestry. Actually, in 1983, President de la Madrid reported that the total harvested area the year before was estimated at 39 million acres of which

34 percent was irrigated. It is difficult to imagine how this farmed area can be greatly expanded. Money for infrastructure improvement is in very short supply. Water for irrigation is limited and though nearly 90 percent of public expenditures in the agricultural sector during the last 30 years went for capital and current costs in irrigated areas, further expansion is becoming more difficult and less cost effective. On the other hand, rainfall is poorly distributed seasonally and unless irrigation is available, most land is idle in the winter. Not only is rainfall seasonal, it is also highly variable and may exceed or fall short of "normal" by 30 to 50 percent in one out of three years.

Beyond the classic limitations on agriculture imposed by climate, soil, topography and other physical factors, the peculiarities of land tenure, agrarian law and the pervasive role of government are powerful forces affecting the future of farming and food processing in Mexico. Highlights of these forces may be summarized as follows:

1. Land tenure falls into two dominant patterns:

a. the "ejidal" system, which arose out of the 1910 agrarian revolution in an effort to help formerly landless peasants make a transition from centuries of serfdom to responsible participation in their new democracy. Ejidal land belongs to GOM and is considered part of the national patrimony. About one-half of all land and roughly one-half of all rural people lie within the system, the administration of which is the responsibility of the Ministry of Agrarian Reform.

Groups of farmers form a community, an "ejido," and each has a homestead, generally centralized and off the farmland. Some ejidos operate their land collectively and share in crop proceeds. Others (the majority) allow members to operate individually and freely. Most ejidal farms are smaller than 50 acres; the majority range from 3 to 25 acres.

Rights to land use can be passed on to a surviving wife or children, but the land can never be sold or mortgaged. Individuals, groups and an ejido itself can enter into supply or purchase or credit contracts, and may organize profit-making businesses. Recent changes in agrarian law allow for joint-ventures with private sector, off-farm partners, although in practice this law has been little tested. It is intriguing to note that the Bank of Mexico (the Central Bank), utilizing the financial and legal power vested in a group of trust funds for agricultural development, is actively searching for such joint venture opportunities. The lead agency of the Bank, in this regard, is FIRA (Fideicomisos Instituidos en Relación con la Agricultura).

It would be difficult, although not impossible, for an agro-industry to avoid involvement with ejidal land in any program of raw material procurement under contract.

b. The system of "pequeño proprietarios," or small-scale owners, which covers roughly 45 percent of all land and includes perhaps 45 percent of the rural population. In every sense, these owners govern their operations, except, of course, when and if they produce crops for which GOM establishes floor prices, e.g., corn, sorghum, beans, rice, sugar cane, coffee, among others...or, when and if, such farmers utilize public agricultural credit systems.

Farm size is well-defined by law. It varies up to several hundred acres, depending upon such variables as the crop grown, whether the land is irrigated, whether used for crops or as rangeland, among others. The majority of "pequeño proprietarios" are small to very small-scale operators, their farms ranging downward from 25 acres. An increasing number, however, operate units which are larger than the law provides and have become truly commercial, well-capitalized and highly mechanized units. This is accomplished by owners who control adjacent farms registered in the names of others who collaborate to evade the intent of agrarian reform. Some existing food processing corporations, both Mexican and international in origin, have found it convenient to contract for raw materials from these larger farms, with dubious propriety.

2. Agrarian law has a dominant theme, vital to appreciate: the land is the greatest heritage of the people and the benefits which derive from it

must in the end flow equitably to the people. True, Mexico has yet to achieve this equity. True, the law keeps changing. It is often confusing and contradictory. It is violated, often and too frequently without redress. Probably few people have ever read all the law or could act upon it with authority.

But agrarian law captures a large part of the spiritual character of Mexico and to grasp it, to incorporate it into the design of an agro-industrial venture, is to come a long way toward a good fit into the country. The law suggests why a "nucleus estate," as a self-owned source of supply for a food processor, would be at odds with policy. The law in its essence can guide a decision to work with small-scale farmers in a contracted supply system rather than with commercial farmers. In other words, as one scholar in agrarian law put it,

> "...the spirit of the law may be a far better light to follow in considering a foreign investment in agro-industry in Mexico, than the pathways to alternative structures defined by the codified rules..."

3. Government intervention is in evidence at every point along the food chain from farmer to consumer...from farmer to export market. The volume, nature and cost of agricultural credit is essentially dictated. Basic crops such as corn, sorghum, wheat, rice, beans, coffee, among others, are price-controlled, at least in the sense of price floors. Some foodstuffs, raw or processed, are also price-controlled. GOM manufactures or imports all fertilizer; it manufactures farm equipment and trucks; it operates the largest retail food chain in the country and subsidizes consumer costs in the face of competition from privately held supermarket chains. The railroads and airlines are public. GOM, in other words, is to be dealt with at every turn.

It is also true that Mexico has always taken great pride in the fact of its mixed economy. A wide variety of agro-industries, many owned outright or controlled by foreign private investors, do exist and have prospered in Mexico. Even during the current financial crisis and the extension of ever more GOM controls over the productive sector, there is much talk directed to assurances that a strong, competitive private sector must exist alongside dynamic public participation in manufacturing and marketing. The point for new investors in Mexico is, however, that no industry in the country has a more continuous or more sensitive interface with government that agro-industry.

In the early 1950s, the Del Monte Corporation entered Mexico and began its emergence as a major vegetable and fruit processor, a position it holds today. Along with all industry, Del Monte has faced serious problems as a result of the financial crisis precipitated in Mexico in 1982. However, the Corporation, in all its history of foreign investment (it has operations outside of the U.S. in twelve countries, half of them in what is called the "Third World") has never abandoned an investment. This policy is very much in evidence in Mexico, where a new top management team has put into effect a "Crisis Plan" to ensure survival and growth as the country emerges into better times.

II

Productos Del Monte, S.A. de C.V.

Enterprise Background

Productos Del Monte (PDM) is a wholly-owned subsidiary of the Del Monte Corporation, since 1979 a subsidiary of R. J. Reynolds Industries, Inc. PDM cans and bottles vegetables and fruits, the latter only sold in the form of jam. With the exception of canned white asparagus, which is exported to Europe, the entire product line is marketed in Mexico. Since its inception, investment in PDM has totalled approximately U.S.$ 40 million.

The cannery is located in Irapuato, in the State of Guanajuato, roughly 200 miles north northwest of Mexico City. Procurement of raw material and all manufacturing is centered in Irapuato. Overall company management, fiscal control, sales and government relations are located in Mexico City.

Raw material flows to the cannery from three different sources:

> One, from contract farmers located within a 30 mile radius of the plant, who supply roughly 80 percent of requirements. In 1983, material was received from 140 farmers, 10 of whom were "ejidatarios." The contracted area was 8,750 acres.
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> Two, from the open market which may, depending upon need and time of year, be anywhere in Mexico.
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> Three, from a wholly-owned subsidiary of PDM, Frutas y Verduras Selectas, S.A., which farms asparagus only, on 6 ranches, 4 of which are leased and 2 owned. The total area farmed is 625 acres. These ranches produced 25 percent of the asparagus canned in 1983; eventually it is planned that PDM will grow at least 50 percent of its needs. In such an event, PDM will take a major step toward operating a "nucleus estate" and will be unique among foreign-owned agro-industries in Mexico.

The decision to create a "nucleus estate," without using the name, is understandable and pragmatic, in terms of protecting a vitally important product line. Nonetheless, it places PDM in a predicament vis-a-vis public land use policy and the intent of agrarian reform. It may be broadly instructive to outline the origin and nature of the dilemma faced by the company.

> Ideally, cultivation of asparagus requires relatively large areas of contiguous land. In the case of PDM practice, 20 acres would be a minimum. Several hundred acres would be preferable. Equally important, asparagus farmers must be able to finance the crop. In 1983, per acre investment in starting production was about 400,000 pesos (U.S.$ 2500, roughly, based on an average exchange rate for the year) per hectare (2.5 acres) and, having made the investment, the farmer must wait until Year 4 after planting before a first harvest. The combined prerequisites effectively eliminate truly small-scale "pequeño proprietarios" and "ejidatarios" from participating in the benefits of cultivating asparagus.
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> The result has been that as PDM pioneered the crop and provided limited financial assistance, e.g., soft financing of planting stock, it contracted with the commercial farmers of the area who had the land and had access to the necessary credit. Experience has demonstrated that working with such farmers does not necessarily secure sources of supply.
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> It is an intriguing comment on human behavior, of relevance all over the world, that while PDM and its neighbors (e.g., Campbell Soup Company and Bird's Eye Foods, among others) introduced most of the vegetables grown in their area, the most successful farmers have become the most difficult in their contract relationships. As they became wealthy and expanded their farms in violation of the spirit, if not the letter, of the law, they became independent of market security, technical assistance, and credit offered by PDM. They tend to dispute prices; they at times break their contracts if prices at harvest rise beyond expectation. They have introduced an intolerable uncertainty into the flow of raw material.
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> Faced with this emerging situation, PDM had two choices. The more difficult one to confront, and the one decided against (although there is ample evidence that it can be managed in Mexico), was to catalyze the organization of groups of small-scale farmers and, then, to aggregate adjacent lands into suitable asparagus farms. This was judged too slow, too risky, and, likely beyond corporate competence. The second choice, the one made, was to both rent and acquire land, farm it, and exercise self-control over production, in the mode of a "nucleus estate," still, of course, contracting with some farmers with whom steadfast relationships were being maintained.

It may well be that the solution being used by PDM will demonstrate how to help resolve a general problem in Mexico, namely, how to increase agricultural productivity so that the goal of food self-sufficiency can be reached. On the other hand, depending upon commercial farmers who are truly at risk because of their wealth of land, and upon itself, may expose PDM to criticism over an apparent return to a colonial view of rural people and land use.

From its beginning, PDM has maintained an extensive Agricultural Department which provides technical assistance to contract farmers; seeks out new contract farmers as needed; searches for supplies in the open market; maintains and supervises the use of a pool of PDM agricultural machinery available for certain farm practices, e.g., pea harvesters; intervenes with and for contract farmers who may solicit PDM for credit assistance over and above that borrowed from banks; and, supports the Manager of Frutas y Verduras Selectas, S.A., himself the Manager of the Agricultural Department.

In terms of manufacturing costs and selling prices, PDM operates under continuously trying conditions. The raw materials purchased by the cannery are priced without GOM intervention. Each year, prior to contract negotiations, the Agricultural Department makes careful analyses, crop by crop, of on-farm production costs, which then serve to help establish a price which is fair and understandable to all farmers and absorbable by the cannery. It is a compliment to PDM staff that there is widespread acceptance of the integrity of the calculations and the honesty of cannery management in its efforts to ensure a reasonable profit to both farmer and company. Inevitably, the policy and procedures followed have meant steady increases in raw material costs.

On the other hand, in 1983, over 50 percent of the PDM product line was price-controlled, at levels generally inconsistent with rising costs of raw materials, manufacturing and marketing. This situation has narrowed considerably the margin between cost and income which, when combined with inflation and peso devaluation, has had a serious and negative impact on profit. For example, in 1983, while PDM made a modest profit in pesos, it generated a dollar loss of roughly 1 million. Communicating the stark realities of the interplay of all these forces to GOM, so that corrective measures will be introduced into public policy, even while managing the variables at play to reduce costs, surely presents PDM one of its most challenging tasks in the decade of the 80s.

History

Del Monte entered Mexico in the early 1950s, not as a manufacturer but as an exporter from the U.S., working through a Mexican distributor. By mid-decade, product acceptance encouraged the Corporation to select a site for a cannery in central Mexico, in a zone where public investment in infrastructure, with an emphasis on irrigation facilities, promised a flexible, diversified source of raw material. At the same time, between 1957 and 1960, PDM began investigations into suitable practices covering a wide range of fruits and vegetables.

By June, 1962, PDM completed its first pack, consisting of tomatoes, tomato products, and chiles. By 1982, 69 items were offered for sale. At the start of operations, PDM focused entirely on the domestic market. In part, this was a decision based on the promise of a rapidly expanding market among the urban middle class. The decision was also influenced by the fact that PDM marketing strategy had to find its fit into the worldwide network of production and distribution of its parent corporation, a factor of constraint on the growth and profitability of PDM which persists today. The one important break in this pattern came with the introduction of white asparagus into the line, which, as already noted, is exported to Europe, via the Del Monte marketing organization there.

Del Monte would seem to have entered Mexico at a most favorable time. During the late 60s and throughout the decade of the 70s (even after 1976, when the first devaluation of the peso foreshadowed the crisis of 1982), the economy of Mexico boomed. While poverty, low productivity and social inequity remained the hallmark of the majority of rural people and their kin who migrated to the cities (and the U.S.), rising income and expectations characterized millions of others clustered in the large cities very near to the cannery at Irapuato. Changing diets favored consumption of PDM products so there was a ready market, easily reached. Mexico flourished during those almost halcyon years. Did PDM?

Del Monte Corporation felt it inappropriate to reveal the profit history of PDM. It was pointed out, with justifiable pride, that for PDM to have operated continuously for nearly a quarter century is a clear signal that the investment was solidly based and was justified by events. However, a caveat was sounded, withal indirectly, that return on equity may not always have lived up to corporate expectations. This may have been tolerable in the past. The crisis of '82 raises new questions: Are the factors threatening private, foreign-owned agro-industries manageable; e.g., inflation, devaluation of the peso, price controls, import controls, among others? Does PDM have the opportunity to reduce costs, modernize its plant, expand its market, shift to more profitable lines, reduce dependency on price-controlled items?

For the immediate future, Del Monte Corporation and R. J. Reynolds Industries seem to have decided that PDM should stay; that the efforts of GOM to correct its financial course can be rationalized satisfactorily;

and, that there are a variety of challenging but feasible ways for PDM to improve upon its performance and prosper with Mexico as the country recovers the pace of its growth. Therefore, in 1983, a new management team at PDM set in motion a "Crisis Plan," based on six short and long-term changes.

1. Reduction in the number of price-controlled items in the product line.

2. Renovation of the cannery by building a capability to design and fabricate machinery and machine parts, at the plant. This project was initiated in 1983, under the guidance and tutelege of experts sent to Mexico from other Del Monte locations. The effort was herculean; results were very gratifying. The work of training and implementation will continue as intensely as possible. In combination with some easing of import restrictions promised for 1984 by GOM, the hope is that full operating efficiency can be attained in the near future.

3. Up-dating the marketing information base. A 1983 study revealed that the data base was inadequate and outdated, resulting in weak or non-existent distribution in large areas of Mexico and, perhaps, in export markets which might be penetrated without conflict with other Del Monte operations outside of Mexico. Corrective measures are already being taken. New data are being collected. Thirty-five product lines are being eliminated, even as new ones are being contemplated.

4. Up-dating and tightening quality control. Another study in 1983 noted that quality control measures had been neglected, with resultant operating losses, as well as damage to the consumer image of the Del Monte label. Both the facilities and techniques of quality control have already been greatly improved.

5. Initiating a search for new methods of packaging. Packaging has become the single largest item of cost in manufacturing. A can or a bottle may be more expensive than the ingredients contained. This may be one of the most intransigent of the problems being faced, even though Del Monte Corporation has been at the forefront of packaging innovations in the U.S. Not only is new packaging machinery costly, it is difficult either to finance or to obtain import licenses. As well, many new forms of packaging depend on materials no more practical to buy in Mexico than tin or glass. Still, management is determined to attack the problem.

6. Intensifying government relations, in a major effort to obtain concessions which would ease the squeeze on profits resulting from unrealistic price ceilings on certain canned vegetable products, especially those produced in large volume.

Outreach

PDM outreach is confined essentially to the procurement of crops from contract farmers, and is the responsibility of an Agricultural Department (AD). While AD no longer conducts crop practice research in a formal sense, it may, on occasion, conduct practical tests of new practices, already being applied successfully elsewhere. Because of their continuous contact with contract farmers, year in and year out, AD staff may, in an informal way, interact much in the same way as any good extensionist would to answer a broad range of technical and farm management questions. PDM as a company and AD as a technical resource have a fine reputation in the area of contracting, an asset which is carefully nurtured and guarded.

AD is staffed with a Director and eight other agronomists, augmented from time to time with new graduates of agricultural universities who serve as apprentices. Apprenticeship may or may not lead to a permanent AD job, but the graduate receives valuable hands-on experience, even while AD is given time to evaluate performance, should a staff vacancy occur. PDM has learned that AD must function as a close-knit team, and to do so, a basic requirement is good transportation and communication equipment. All full-time AD staff have, therefore, a late model pick-up truck, with two-way radio-telephone systems linking the central office at the plant and all vehicles as they circulate in the contract area. Each vehicle is also in communication with any and all others. The 1984 AD budget is 28.4 million pesos (about U.S.$ 168,000). As previously noted, the AD Director serves, as well, as Manager of Frutas y Verduras, S.A., and is supported by the AD staff, as needed.

Each agronomist is a crop specialist. It is his responsibility to contract the necessary supply and to provide technical assistance for each step in the crop cycle. At such times as an agronomist is between crop cycles in his special field, he assists another who may be at the peak of his work. In this way, every farmer is visited at least twice a week during his agricultural year. Specifically, AD services are as follows:

1. Technical assistance, on-farm. This activity is the highest priority. It can make or break a procurement program. If it is effective, it breeds responsible performance, respect between AD and its suppliers and loyalty over time as the ups and downs of farming encourage or discourage participation.

Technical assistance starts with an evaluation of the land being offered for a given crop and of the farmer himself. The area is surveyed, to be sure it is adequate and to facilitate calculations of costs of production, prices to be set in contracts, and income to be expected by the farm family.

Soil suitability and availability of water are determined. If the practice calls for the use of machinery from PDM equipment pools, is there access to the fields. If larger units of land are required than the farmer can offer, is it feasible to aggregate holdings with neighbors? As best he can, the AD agronomist assesses the character, farming skill and reputation of the farmer, as well as the ability of the farmer to finance his credit. This is an important consideration since it is PDM policy to keep to an absolute minimum the money tied up in providing credit. As will be seen, PDM does exercise flexibility and compassion in the provision of credit under emergency conditions, e.g., an unexpected insect attack demanding immediate control, but AD insists that in the first instance, farmers work directly with banks.

During a crop cycle, the AD agronomist offers constant guidance to ensure that each step in the recommended practice is taken on time, with care. The object of this supervision is to stimulate farmers to participate in each decision and to facilitate this role by educating the farmer as to the reasons behind the practice. If an emergency arises requiring additional credit, quickly, a farmer may solicit an agronomist, who, in turn, makes a determination of the validity of the request and what may be needed, e.g., how much of what kind of pesticide. The agronomist immediately makes his recommendation to the manager of AD, who, in turn, passes it on to the Production Manager of the cannery. The Production Manager is empowered to grant the credit, usually in-kind. PDM maintains a stock of agricultural chemicals and other inputs, which it purchases as cheaply as possible and dispenses at cost.

AD staff provide a myriad of other services, on-farm. If a farmer needs transportation help, the staff may locate and intervene in negotiations with private firms, required at harvest. If machinery is required from the

PDM equipment pools, the agronomist may expedite the order. If the design of a small-scale irrigation system to serve a group of neighboring farmers is desired, AD can help.

2. Technical assistance off-farm, which, of course, pays off only when transferred to the farm, is important but less structured in the work program of AD staff. There is a never-ending search for techniques to extend the productive season and increase productivity. In the former instance, the goal is to increase the number of months during which the cannery can operate; in the latter instance, the goal is more to bring the daily throughput at the cannery into optimum balance with capacity. Associated lines of inquiry are: how to bring contract production of all requirements ever closer to the cannery to reduce the subsidy on transportation costs; and, how to educate farmers to their real costs, so that price negotiations can be facilitated when contracts are up for renewal.

3. Facilitation of credit. As already observed, PDM contract farmers are expected to arrange financing directly with banks. In no case will PDM guarantee a bank loan. It will advise a bank, if asked, as to the existence and nature of a contract and will record PDM experience with a farmer-applicant. Over the years, area banks have come to value both personal commendations from PDM, and the fact that a farmer has a PDM contract. In general, this policy has served its purposes well and PDM management feels that farmers have truly benefited by their direct interaction with credit institutions. In any event, PDM has never faced a problem when seeking contracts with producers, although turnover does both complicate and add cost to the system, year after year.

Despite a basic policy which deflects most credit needs of contract farmers to the attention of banks, PDM does tie-up a considerable amount of money in various forms of credit and subsidies which, over the years, have been built-in to different crop production practices. In 1983, for example, roughly 400 million pesos (about U.S.$ 2.5 million) were in circulation as cash, value of seed, subsidies to transport costs, and subsidies of the cost of using PDM agricultural machinery. It may be useful to illustrate how a credit system, used in part as an incentive for farmers both to contract the sale of crops to an agro-industry and to adhere to recommended practices, quickly becomes large, complex and almost impossible to abandon or transfer to an external source like a bank. For example:

1. Most contracted crops require the use of imported seed. PDM buys the seed and, except in the case of asparagus, supplies it free to farmers. In 1983, exclusive of asparagus, PDM invested roughly U.S.$ 332,000 in imported seed. The case of asparagus is especially illustrative.

> Farmers buy asparagus planting stock from PDM, which imports the seed and grows it to transplant size in a company controlled nursery. This quality control is vital and permits PDM to guarantee performance, if all other steps in the production practice are followed. While PDM sells the planting stock at cost, nonetheless the farmer must invest about U.S.$ 1,000 per hectare (2.5 acres) at planting time or almost half his total investment in starting a new asparagus crop (by way of comparison, the total credit needs for pea production in 1983 added up to about U.S.$ 300, recoverable the same year, at a profit). The farmer must then wait to Year 4 for his first harvest. As an incentive, when PDM first introduced asparagus in the early 60s, the company agreed to sell the planting stock on credit. For the first three years, the farmer pays no principal and no interest. Beginning with his first harvest, interest, at the same cost of money to PDM, is applied and the loan becomes payable in 4 to 5 years.

2. Farmers are required to arrange and pay for transporting harvested crops to the cannery. PDM pays 50 percent of this cost, as a direct subsidy ...it has done so from the beginning of operations.

3. Farmers who use PDM machinery, e.g., a pea harvester, pay only 50 percent of the real cost to PDM of owning, maintaining, fueling and operating this equipment. Further, the availability of the machinery adds another burden of vigilance to the task of each agronomist who must see to it that farmers do not order out PDM machinery when they own equipment capable of doing the job, just to save money.

4. When aerial spraying of pesticides is necessary, as with sweet corn, PDM provides this service free. With other specialized chemical treatments, e.g., inoculation of pea seed, PDM also provides this service free.

5. Farmers pay nothing for the technical assistance services provided by AD.

The technical assistance and credit programs of PDM do work. Raw material of satisfactory quality and quantity generally arrive on schedule to the cannery. The beneficial contributions of PDM to the agricultural economy of the area are impressive and unquestioned. Still, as the company pushes ahead to implement its "Crisis Plan," to change in ways that will strengthen the whole operation, several questions, which arise out of the raw material procurement program, persistently puzzle management. For example:

- Is the methodology too costly relative to profit margins achievable in the product line...if so, how can outstanding cash balances be reduced, along with subsidies and the cost of AD itself? Has the chosen methodology led PDM into too paternalistic a mode vis-a-vis contract farmers...if so, how can the company achieve to a new, high level of shared responsibility and risk-taking with producers?

- Is PDM at risk because it depends so much on farmers who operate at margins of agrariar law because their farms

> are so large...can PDM afford to take a neutral position on this matter simply because it is customary practice and beyond any control by PDM? Is there additional risk of conflict with public policy due to the creation of Frutas y Verduras Selectas, S.A.? Would answers to these questions provide insights into methods PDM might use to relate procurement more closely to the development of small-scale farmers whose productivity, income and advancement are of elemental importance to Mexico?

It was significant that these same kinds of questions were threaded through conversations about PDM and other agro-industries of foreign origin, shared with experts in banking, economic analysis, agrarian law, government policy, and the Mexican ambience of political thought in this time of financial crisis. It was agreed throughout that companies like PDM are vitally important to the food economy of the nation. It was also suggested throughout that the industry could and should take more initiative in tapping the latent capability of small-scale farms to become a vigorous part of the commercial sector of agriculture. The significance of such initiative was emphasized many times by references to the belief of many in government that GOM should take a stronger, not a weaker, position in control over the productive sector.

Pay-Off

For the Company - No data were given to quantify the pay-off of PDM to the Del Monte Corporation over the years. Clearly, by whatever standards were used, the return on investment was sufficient to keep PDM in continuous operation for over 20 years and to justify the current determined effort to stay in Mexico in the face of great difficulty and uncertainty. Del Monte takes considerable pride in the fact that it has never withdrawn an operation from a country once the investment was committed.

In this sense, the sustaining power of PDM and its inherent strength with which to deal with Mexico in the 80s, seems to be a source of considerable satisfaction to the people of Del Monte. Also, in the qualitative aspects of pay-off, it is remembered with a deep sense of gratification that Del Monte was a pioneer in agro-industry in Mexico. As it learned, it taught. New crops and new skills were introduced, inculcated and acculturated throughout the area surrounding the cannery. PDM contributed directly and significantly to rising farm income. Jobs were created and a position of recognized integrity and fairness among the rural people won and kept.

For Mexico and the Regional Economy - The data speak for themselves. PDM employs 237 salaried, non-union people; 208 unionized permanent workers at the cannery; and as many as 1,300 seasonal workers in and around the cannery. In addition, Frutas y Verduras Selectas employs 35 salaried staff and up to 400 seasonal workers on its six asparagus farms. Direct payroll in 1983 amounted to Pesos 210 million (roughly U.S.$ 1.4 million). Also in 1983, farmers received Pesos 560 million (about U.S.$ 3.7 million) for produce received at the cannery; PDM also purchased Pesos 50 million (U.S.$ 330,000) in supplies and services from local businesses. No data were made available re tax payments and foreign exchange earnings, but over the years it might be expected that both have been significant. While there are no known studies of the subject, the multiplier or eddy effect of these large cash flows into the area economy from the cannery, year after year, must be among the important reasons for the vigorous economic growth of the Irapuato region.

For the People - A view of pay-off depends as much on the values and perspectives of the observer, as it does on the facts interpreted. There are two, fundamentally different, though not necessarily conflictive ways of analyzing the case.

1. One view perceives a variety of benefits resulting from the presence of PDM which are unequivocal and arguably benign. Several thousand people, never before so employed, receive regular income; in family terms, this means that some 15 to 20,000 family members share this good fortune. New skills have been transferred to contract farmers, as well as new concepts of farm management and new visions of personal capability. A one-channel, assured marketing system has been provided. Payments from sales are prompt and the bases of contract prices shared in understanding with all concerned. Competent, continuous technical assistance has been available. Emerging credit needs have been met. Dependency on bureaucratic machinery has been minimized.

PDM has contributed to a sense of security among its steady suppliers; to a sense of having a strong, knowledgeable representative in far-away centers of power...a local connection which in fairness to everyone's self-interest will somehow keep things going, good times or bad. In both qualitative and quantitative terms, the perspective of these observations projects a clear image of beneficial impact and raises the question: What more should be expected of a private, profit-making agro-industry?

2. Without detracting from the flow of benefits outlined above, a second view of pay-off looks at PDM in light of the question raised, or, put another way, in light of the development issues which the PDM experience brings into focus. This "second view" perceives that the raw material procurement system evolved at PDM, with its emphasis on the use of large-scale farms and its current trend toward self-control over supplies, e.g., the creation of Frutas y Verduras Selectas, S.A., may well generate a negative pay-off to the majority of rural people. The system encourages the buy-out of small-scale "pequeño proprietarios" and forces up the price of land. The system encourages commercial farmers to flout the intent of agrarian reform. The

system tends to discourage efforts to organize, train and lead small-scale farmers so that in the aggregation of their talents, intelligence and physical resources they can more dynamically participate and share in economic progress. The system may be retrogressive philosophically because it downgrades the potential of the Mexican "campesino," the country folk, and finds excuses to by-pass them in the process of commercialization of agriculture.

Discussions of the PDM pay-off to the people of Mexico, from the standpoint of integrated rural development, were not confrontational, nor were they held in an atmosphere of anti-business, romanticism or innocence. The Mexicans interviewed unanimously supported the existence of private agro-industry, exemplified by PDM. The realities of survival in the ambience of Mexico today were not minimized. The necessity of being competitive and earning a profit were well understood. Conversely, the realities facing Mexico impose certain unusual demands on the industry. Mexico must decrease its dependency on food imports. It must increase the productivity of small-scale farms which predominate the agricultural sector. It must alleviate the poverty and inequity which permeate rural life. It cannot continue to blink at violations of agrarian reform under pressure from a few and because of the questionable argument that large-scale, capital-intensive farming and ranching is the only answer to efficiency. Private agribusiness, it was said with some insistence, has a unique opportunity and responsibility to help resolve these difficult, seemingly intransigent national problems.

Note: A review of these complex issues, with both the President of PDM and the Production Manager of the cannery, brought out no fundamental disagreements. However, two things were made clear: one, since PDM relates to a relatively small number of suppliers, any long range value to Mexico of a shift to truly small-scale farmers would have to derive from the replicability of methodology employed. Any plan of action would require such a concept.

Two, at this moment in PDM and Mexican history, the cost of developing a prototype, as well as the time required, could not feasibly be borne by PDM alone, nor allocated from the workload of the company Agricultural Department.

Subsequently, the writers of this case discussed the matter with the Director General of FIRA (Fideicomisos Instituidos en Relación con la Agricultura), at the Central Bank of Mexico. It was learned that FIRA had been reviewing precisely the range of issues noted above and would be extremely interested in facilitating a shift by PDM (and any other similar enterprises in the private sector) to closer, long-range relationships with larger numbers of small-scale farms. FIRA support might take the form of grants-in-aid, soft loans, policy approval and, possibly, staff assistance.

The roots of FIRA's interest are intriguing to contemplate. In contradistinction to many people in GOM, some leaders of FIRA recognize very clearly the actual and potentially greater importance of the food processors in the private sector as engines of change. There also exists an appreciation that FIRA itself, holding both public funds and public policy in its trust, has an obligation to create and test innovative forms of partnership between the public and private sectors. As mentioned earlier in this report, one way FIRA has already responded to its charge has been to lead the search for investors who would enter into joint ventures of a profit-making nature with "ejidos." The idea of such ventures is entirely novel in Mexico and is now embodied in law.

Two tentative steps were taken leading, hopefully, to implementing action. One, the idea of a venture with FIRA was discussed with the President of PDM , who expressed keen interest in the possibility. Two, since implementation would require the participation of skilled, experienced professionals in the field of Mexican integrated rural development, contact was made with the General Manager of Coordinación Rural, A.C., a non-profit enterprise well known at FIRA, to determine interest and availability. Response was enthusiastic. The entire matter was left pending but with a commitment on the part of Coordinación Rural to develop a proposal in the near future, to serve as a basis for further talk with PDM and/or other enterprises, before returning to FIRA.

III

Policy Recommendations

The financial crisis in Mexico, precipitated by the inability of the country to service its foreign debt, starting in 1982, brought with it an almost bewildering array of policy changes and implementation plans, arising out of every institution in the country, public and private. GOM, naturally, has concentrated on financial matters relevant to inflation, foreign exchange earnings and control, and a balance between austerity and social disorder. Private organizations like PDM have focused on changes required to maintain income and competitiveness.

Within this context, however, few changes have been introduced likely to correct the food deficit or truly stimulate the agricultural sector of the economy. The goals of agrarian reform remain beyond the dreams of the great majority of rural Mexicans. Yet, the lack of dynamic development in rural areas is a fundamental cause of the "crisis of '82." Until this anchor on the economy is weighed, all other remedies being applied to the problems of the country will fail far short of their intentions.

To correct the deficiencies of rural Mexico clearly is a complex, long-term and difficult task. It is not likely to be accomplished by taking a single approach. But as a beginning, Mexico desperately needs demonstrations of novel techniques of integrated rural development which break away from bankrupt policies of the past, cast off old institutional and ideological constraints, and become applied nationwide. The case of PDM suggests one such innovative methodology, never before tried in Mexico, to be centered on private sector management, in collaboration with GOM and the U.S. Government via A.I.D.

The idea takes its inspiration from a unique set of circumstances:

1. In the area of raw material procurement by PDM, four U.S. multinational agro-industrial corporations are neighbors and, except for their product lines and marketing methods, operate in very similar ways and share many common concerns. They are PDM itself, Green Giant (Pillsbury), Campbell Soup Company, and Bird's Eye Foods (General Foods). They all use contract farmers as primary sources, with an emphasis on larger, commercial units. They all carry a staff of agronomists, provide technical assistance, and are highly regarded in the rural community. Their combined payrolls, purchases of farm produce, and payments to local businesses send a large cash flow into the area. Alone or in concert, these companies form a natural base of operations aimed at capitalizing past achievements to ensure that the small-scale farmers, their families, and their communities share equitably in the benefits of investment in agro-industry and move on to new high levels of development.

2. In the same area as the companies, at least three national programs of rural development, sponsored and financed by the Mexican private sector, have long operating experience at the village level, among small-scale farmers. They are all open to collaborating with industry, to put their skills and experience in joint venture with the human resources of the industry. These three are: Coordinación Rural, A.C., a subsidiary of Ingenieros Civiles Asociados, S.A.; the Mexican Development Foundation (Fundación Mexicana para el Desarrollo), financed by a broad cross-section of all Mexican business and industry; and, the Banco Nacional de Mexico (nationalized along with all private banks in 1981) which has a credit and technical assistance program at over 2,000 sites throughout the country. These organizations can greatly enrich the experience of industry and help answer the questions

most likely to preoccupy management: How is the job done? What skills are needed? How long does it take? What will it cost? What is the pay-off? Is it too political? Is it appropriate for privately-held, profit-making enterprises to take responsibility for long-term, integrated, rural development programs?

3. FIRA, a division of the Central Bank of Mexico and a powerful public force in rural development (see page 24) has already expressed a desire to collaborate with agro-industry to accelerating rural development. FIRA approval itself would be prerequisite to action; too, FIRA could be important in gaining policy approval at the highest levels of GOM. While unlikely to be adequate, FIRA does have financial resources with which to help back an industry-sponsored program.

It is therefore recommended to GOM, PDM and the U.S. Government that every effort be made to bring agro-industry operating in the same area as PDM, rural development specialists serving programs sponsored by the private sector of Mexico, and FIRA together, as quickly as possible. The objective of this interaction would be to facilitate and accelerate the organization of a novel, private sector rural development program, which, if successful, could serve as a prototype for adaptation to all parts of Mexico and for export abroad.

B. KENYA CANNERS LIMITED

I

Country Background - Kenya*

Agriculture is the backbone of the economy and lies at the heart of social and political life in Kenya. Currently, even in the face of a recent decline in relative importance, the agricultural sector provides nearly 40 percent of the Gross Domestic Product (GDP), 34 percent of the inputs into manufacturing, 65 percent of non-petroleum exports, and 65 percent of total employment. In a country having few natural resources aside from land, people and wildlife, and almost no mineral deposits other than soda ash, gemstones, limestone and fluorspar, the vital importance of vigorous growth in agriculture and agribusiness to the future prosperity and stability of the nation is clear and pressing.

The agricultural sector is dominated by four characteristics of particular importance to investors.

1. Ninety-nine percent of the farms and ranches are privately owned, even though tribal culture is strongly manifest in rural Kenya.

About half this land belongs to about 3,000 so-called "large farms," ranging upward from 20 to well over 40,000 hectares (1 hectare - 2.5 acres). These farms yield 45 percent of marketed production. The other half is the property of approximately 800,000 smallholders, 70 to 75 percent of whom farm less than 3 hectares. These farms have become increasingly important to the agricultural economy since independence and now account for 55 percent of marketed production and 80 percent of all production.

An intriguing development has been the transfer of ownership of some purchased large expatriate farms to groups of smallholders organized into either

*This same statement is included in the case report covering the Mumias Sugar Company. It is repeated here for the convenience of the reader.

companies or cooperatives. In either case, part of the land is divided into individually owned small farms and part is farmed as an estate, with paid management.

Increasing productivity on smallholder land is of the highest priority in Kenyan planning. Land tenure realities and the pressing need for more food production exercise a pervasive influence on public policy, popular attitudes, and the design of public and private investments in agro-industry.

2. <u>Kenya exhibits one of the highest rates of population increase in the world</u>. Officially designated at 3.3 percent a year, the figures of 4.0 to 4.2 percent are more widely held. This is bringing a steady increase in pressure on the land as indicated by a World Bank estimate of decline in the amount of good farmland per capita from a 1970 figure of 0.88 hectare to 0.36 hectare by the year 2000. Too, the decline in good farmland per capita has forced agriculture and animal husbandry into marginal areas, with serious negative impact on soil erosion and water conservation in the same vicious cycle which plagues nations throughout the world. While not the sole factor at work, population pressure on the land surely contributes to a slowdown in farm production growth from an annual rate of 6 percent in the seventies to a current rate of 2.4 percent.

3. <u>Improved agricultural practice on smallholder farms is inhibited by the very high cost of all chemical and machinery inputs, weakly structured credit systems, traditional practices, and inadequate pricing and marketing policies</u>. Further, despite high levels of unemployment and underemployment in rural areas, there are acute shortages of labor throughout the country at critical times in a crop rotation. Among the myriad reasons for labor shortages are: more children spending more time in school; very low wage for hard work; traditional patterns of the distribution of labor; and migration to urban centers.

4. Finally, and very importantly, GOK is a powerful and pervasive force affecting practically every aspect of commercial agriculture and agribusiness. It fixes prices and the cost of labor. Public corporations may compete with private enterprise. Marketing Boards control much of the domestic and export market. GOK dictates the movement of foreign exchange, the Africanization of management, the requirements of training, to name but a few of the interventions of the public sector.

Yet, despite first appearances, GOK exhibits considerable flexibility and pragmatism. Granted that negotiation is never easy and is always slow, it is, nevertheless, always possible. The structure of but a few existing agro-industries best illustrates the point.

> Some ventures are parastal and managed by public corporations, e.g., the Kenya Tea Development Authority; other parastatals are managed by foreign partners, e.g., the Mumias Sugar Company. CPC International has been granted the first commercial exception to the rule that all grain must be purchased from GOK and can now negotiate for maize at the farm gate. East Africa Tannin Extract Company (LONRHO-UK) wholly owns and operates a 46,000 hectare diversified farm-ranch, which helps support a central manufacturing complex. East Africa Industries (Unilever) is developing a source of vegetable oilseed using land leased from absentee owners and managed under contract to private, profit-making companies. Kenya Canners, Ltd. (Del Monte) leases long term its entire 22,000 acre estate (10,000 in pineapple) from GOK, but owns and operates a cannery and controls all export marketing.

Two of these enterprises have been isolated for more detailed analysis, namely, the Mumias Sugar Company and Kenya Canners, Ltd. This report highlights the latter.

II

Kenya Canners Limited

Enterprise Background

Kenya Canners Limited (KC) is a subsidiary of the Del Monte Corporation, in turn a Division of the Food and Beverage Group of R. J. Reynolds Industries, Inc. Del Monte owns 95 percent of the equity. The Development Corporation of Kenya owns 2 percent; 3 percent is owned by 24 individuals, one Englishman and 23 Kenyans. Del Monte has invested U.S.$ 36 million in the enterprise, to date.

The unity of KC is comprised of three distinct elements: the estate, the cannery, and the areas of housing.

The estate is an area of 22,000 acres leased on a long-term basis (48 years, renewable for an equal term) from the Government of Kenya (GOK). Specifically, the land use pattern is as follows:

- 10,000 contiguous acres are under pineapple cultivation, under the sole management of KC. It is judged that no further extension of the pineapple plantation will be feasible. Expansion of production, therefore, will depend upon the development of an outgrower program, now under consideration.
- 1,000 acres are cultivated for coffee, a well-established crop in the region.
- About 2,000 head of cattle are grown-out, fattened on cannery waste; a small breeding herd is maintained. However, KC does not consider itself permanently in the cattle business and plans to eliminate this activity in the years ahead. The breeding herd will be kept as a source of meat for employees.
- In areas not otherwise suitable, KC is developing a reforestation program, with three objectives in mind: to supply charcoal to

employees, to serve as an erosion control system, and to provide lumber. In support of the program, KC operates a tree nursery. This type of land preservation, yet multi-use forestry project, is of keen interest to GOK.

The cannery and its associated facilities, e.g., Training Center, shops and offices, is a modern plant with a throughput capacity of roughly 170,000 MT of raw pineapple a year. Management estimates this input could increase as much as 15 to 18 percent, with modest changes, and feels that the market for this increased production is available. This perceived marketing opportunity, combined with production limits of the plantation, have stimulated the interest now manifest in the development of an outgrower program.

The areas of housing, distributed around the cannery within reasonable walking distance, incorporate some 3,300 houses owned by KC and provided free to workers in the factory and on the plantation. Historically, the distribution of housing has been based on a combination of factors, e.g., position, length of service, and need. Those who must or choose to live elsewhere, receive a housing allowance of 15 percent of base salary.

KC employs 6,000 people at the peak of the season; 5,500 on the average: 2500 are regularly employed in production and engineering, training, research and development, and various other functions of administration; 3,000 to 3,500 are utilized on the plantation and in other areas of agricultural activity.

No exports go to the U.S. All canned goods are sold to and through Del Monte International into European, Middle Eastern and other foreign markets. KC also sells a small amount of fresh fruit to the GOK Horticultural Crops Development Authority, for air-freighting into European Markets. The Authority fixes the price of fresh fruit which, nonetheless, is profitable for KC since the fresh product brings a higher net return than does the canned. It is significant to note that despite the wide range of GOK marketing boards and the extensive involvement of GOK in price controls, KC markets its canned goods free of price control or any other government intervention. Presumably, this is in recognition of the fact that canned pineapple is now a major foreign exchange earner for Kenya, and that Del Monte is best able to maximize sales and protect the competitive position of KC products. KC management notes that it is currently earning over Kenyan Shillings (KS) 300 million a year in foreign exchange (U.S.$ 22.2 million at the rate of exchange current late in 1983 - KS = U.S.$ 0.074).

History

Kenya Canners Limited was first organized in 1949 by Theodore West, a British businessman and C. W. P. Harries, son of Mrs. O. M. A. Harries, the pioneer in Kenya who developed pineapple for the fresh fruit market of the country (circa 1910) at Thika, about 30 miles east-northeast of Nairobi. The Company struggled along until 1958, when it was taken over by the Tancot Group, an established East African company. Tancot launched an expansion program which increased the cannery potential to over 20,000 MT per year of pineapple and mixed vegetables. However, all raw material procurement was based on outgrowers in the Thika area. Apparently, the outgrowers were not properly organized, were not provided the necessary technical assistance or financial support, and were not suitably located. In any event, the enterprise was in very poor condition by 1965.

At that time, KC entered into an agreement with Del Monte to manage the Thika cannery. At the same time, Del Monte contracted with GOK to investigate the potential for expanding pineapple cultivation and processing, both for export of canned goods and for marketing fresh fruit locally. By 1968, Del Monte decided to exercise its option to purchase the majority shareholding of KC. This decision was facilitated by GOK which had acquired the defunct Anglo-French Sisal Estate at Thika, for long-term lease to KC. The Government then went on to purchase three more large estates, all more or less contiguous to the ex-sisal plantation, laying the foundation for a decision by Del Monte, in 1972, to implement a major expansion program, including the construction of a new cannery. It is important to note that unlike the situation at the Mumias Sugar Company (see separate case report), where many hundreds of farmers were bought out and displaced, no smallholders were involved in the leasing of land to KC.

Since the early 70s, KC has gone on to become a successful and important part of agro-industry in Kenya. It has brought thousands of acres of land from abandonment to a high level of productivity. As noted, KC offers employment, housing and other benefits to some 6,000 people. The Company appears to have established good relationships with its two unions, the Kenya Plantation Workers and the Food and Allied Workers Union. Despite occasional gossip heard to the contrary, GOK seems to hold KC in high regard and manifests no effort to participate financially or to seek for control.

More than anything else putting pressure on KC in its effort to remain competitive in world markets is inflation, tied to import controls. As was heard throughout Kenya, tin plate costs have gone up 400 percent over the past several years. Tires, fuel, spare parts, energy, along with many other basic items, have also increased dramatically in cost. KC has done everything it could to decrease plantation costs and increase efficiency at the cannery, but it remains a serious question for Del Monte as to whether or not GOK will take the necessary actions to reduce the risk to manageable proportions (see the Productos Del Monte case from Mexico for an identical problem Del Monte faces there in canning vegetables). Negotiations on the subject are constant these days. KC management could not reveal the substance of these talks except to indicate the generally held belief that the industry was too important to endanger.

One corrective measure offered to all exporting industries by GOK is the "export compensation scheme." Prior to 1982, the scheme meant a 10 percent rebate on the FOB value of exports to a given level; plus an additional 15 percent if this first level was exceeded. In 1982, in an economy move, the Government eliminated the rebate. There was such an organized resistance to this decision by industry that the incentive was reinstated in 1983 and made more attractive by increasing to 25 percent the rebate on exports exceeding the 10 percent level.

While this success in getting GOK to reinstate the export compensation scheme was encouraging to KC, management is concerned that Kenyan industry, foreign controlled or not, has no truly effective voice with which to address GOK. The Kenya Association of Manufacturers is weak. The Kenya Chamber of Commerce is not highly regarded. The Federation of Kenya Employers tries to confine itself to matters of employment and wages. Finally, there is the Investment Advisory Council, set up by GOK to facilitate entry of foreign capital and help in the search for local joint venture partners. It remains true, however, that negotiations on critical issues such as duties charged on imported tinplate for cans, depend on individual companies doing the job.

Outreach

Outreach takes a variety of forms at KC. For example:

people of Kenya. Some of these were organized into companies, others into cooperatives. In some instances, those who purchased shares established small-scale invidivual farms; other shareholders remained absentee and organized production around professional management. Many cases reflect a combination of methods in the practice of land use, e.g., part of the owned area is divided into small farms with resident operators; the remainder operated as a corporate farm, under paid management, the profits (if any) divided in proportion to the shares held.

One such enterprise, a cooperative, lies about 15 miles from the KC estate. The area owned is about 8,000 to 10,000 acres. There are approximately 1,000 shareholders, some resident on farmsites or homesites, many more living elsewhere. The primary cash crop is coffee. The cooperative members have aggregated a large area for this purpose and it is operated professionally, under the terms of a contract with a coffee estate management company. In its search for acceptable outgrower sites, KC observed that roughly 2,000 acres of Cooperative land, in one block, was not being utilized and might well be suited for pineapple. With approval of the Cooperative Board, KC set up a 5 acre test and demonstration plot, which did prove the area to be potentially valuable and within the capability of the Cooperative to bring into production, with technical assistance provided by KC. The transport distance to the cannery is reasonable; the road access acceptable.

As of early 1984, the situation is:

a. A KC two-man team, comprised of the Director of Research, Training and Agricultural Extension (an expatriate with many years of experience in Kenya with pineapple) and the Manager of Personnel and Industrial Relations (a Kenyan, with a Master's degree in Business Administration, earned in the U.S.), have been working with the Cooperative. At the moment, their's is the task of evolving a satisfactory contract for production and sale to KC. From the perspective of KC, it is felt that the agreement should cover a minimum of 10 years, technical assistance to assure proper practice, and, possibly, other forms of assistance such as the provision of a pool of machinery, were it not economically feasible for the Cooperative to own, operate and maintain such equipment.

b. The Cooperative Board of Directors has full responsibility to find the credit financing needed for the project. Based on its own operating costs, KC estimates that it will require roughly KS 10,000 (U.S.$ 740) per acre invested to the first harvest, 18 months after planting. To move ahead prudently and within the bounds of possibility, KC has suggested that the project be started with 250 acres.

Note: There the matter rests. It remains to be seen with what energy and what success the Cooperative proceeds to find the necessary credit. The situation is one that raises several policy considerations, particularly relevant because of the involvement of a U.S. corporation. These notes in no way take exception to the actions of KC with this Cooperative. They are legitimate, prudent and creative. However, the circumstances suggest several considerations bearing on the role of private enterprise in the development of rural areas of Third World countries.

a. If it is important to the future income of KC to obtain the pineapple from Cooperative land... and, if it is true that the Cooperative members cannot themselves afford to take the risk with their own capital and will take all the risk if they borrow the money, then is this an equitable arrangement when one compares Del Monte resources with Cooperative resources? Granted that KC is leading the Cooperative to an excellent new source of income and that by establishing a one-channel marketing system, with technical support, it reduces the risk to the Cooperative. However, what KC has invested in a 5 acre test is as nothing compared to the investment in 250 acres by the Cooperative.

b. On the question of what the Cooperative can and cannot afford to risk, it would seem logical that KC ask the question and help find an answer. The impression was taken away that the nature of the Cooperative membership was not clearly identified--who are they, where are they, what social and economic level do they represent, what responsibility might they be expected to accept? With such a data base, the reality, as well as the fairness, of asking the Cooperative to raise the money, might be better tested. The fact that professional management is hired to run the coffee estate may or not be indicative of what the Cooperative can or should be able to do re financing the pineapple project.

c. KC is indeed helping to create an exciting opportunity to accelerate rural development, touching the lives of several thousand people, and building a model that might be widely applied, in Kenya and elsewhere. If, upon further investigation, it were to be shown that KC cannot take on the burden of financing the credit needed; and, that the Cooperative either cannot or should not accept the risk, might not this be a perfect entry for the USAID Mission in Kenya to enter into a joint venture with KC? AID might invest in the credit, using a deferred repayment schedule, with soft interest terms. KC could then accelerate and manage the system. The training and guidance given to the people could be intensified, hastening the shift to them of full responsibility. The question here is: Who takes responsibility to bring these forces into play? It is suggested that KC is the logical and proper center of responsibility... first, to be sure of the facts, to avoid any error in judgment as to who can do what; second, to negotiate with USAID, whose current emphasis in Kenya is to foster the role of private enterprise as a force for rural development.

Beyond Kenya, the KC case is a reminder that similar lines of thought and action are relevant to almost any outgrower scheme, if there is an immediate decision by the core enterprise that contracting farmers should take the financial risk of change, when change is first introduced.

2. Education. KC has created a fine school system associated with a private enterprise in Kenya. Five schools have been built and are maintained by KC. Four of these are at the elementary grade only and after being built, are run by GOK, which pays the teachers and covers all other costs. One

school carries on through secondary level. This latter institution is wholly owned and run by KC, which pays all teachers and finances any deficits at the end of the year. In recent years, this deficit financing has averaged KS 250,000 a year (U.S.$ 18,500, present value). Enrollment in all five schools is about 1250-1300; 93 percent of these were children of employees in 1983. The KC private school, on the contrary, had 240 pupils in 1983, 25 percent children of employees and 75 percent children of people from all over Kenya. This school charges a tuition in an effort to attain to self-sufficiency and emphasizes a curriculum permitting graduates to enter universities throughout the world. There are plans to so structure the educational program that graduates may plan their university careers in Kenya or overseas. This unusual and considerable investment in and direct responsibility for the education of children of employees and Kenyans generally is a matter of great price and satisfaction at KC: it is an outreach regarded with considerable favor in GOK.

In another area of education, KC has encouraged its Director of Research, Training and Agricultural Extension to work closely with nearby Kenyatta Agricultural School in the development of its curriculum, as an aid to generating a practical, problem-solving and critical view of Kenya's rural problems. This is done purely as a public service.

3. Research. Also as an outreach of a public service nature, KC finances a series of demonstrations aimed at providing to small-scale growers of fresh pineapple for sale in local markets, information on the costs and benefits of different kinds of practice, e.g., using or not using fertilizer with different proportions of ingredients; using herbicides or not; applying water or not, among other arrangements of variables. Field days are utilized

to follow the course of growth and yield and to communicate the varying rates of return on investment of both time and money. The entire emphasis of this outreach program is on fresh fruit production and marketing. The project is not intended to build a reservoir of potential outgrowers for the KC cannery.

4. Housing, Medical Care and Other Services. As noted earlier, KC provides 3300 housing units to its employees. These units are distributed about the cannery/plantation compound to form several areas of concentration, in the semblance of communities. This housing is provided free. Each area is served by a medical dispensary, staffed with aides who have been trained to perform simple healthcare functions. A corporation doctor makes the rounds of these dispensaries daily and takes care of more serious matters. Medical care is also free. It is estimated that over the last 12 years, KC has spent KS 35 million (about U.S.$ 3.5 million, using an average exchange rate of 10 KS to U.S.$ 1) on its programs of education, housing and medical care.

Each housing area is also served by a store, privately managed by the successful bidder for the opportunity. Once the management is settled, KC does not intervene in the business. This system of supply for the basic needs of thousands of households was subject to query: Would it be better, in every sense of development, for the worker families in each area to own their store and share the benefits of profit? It may be understandable but it was regrettable that KC had been and remains reluctant to take on the burden of organizing and training the people to take on the business of purchasing, pricing, fiscal control, distribution of dividends and all else that would be required of a sound, well-run venture.

There is so much to be gained. It would generate a significant saving (or earning) for each family; 1,000 families buying their essential foods and household goods, e.g., soap, candles, pots and pans, dishes, among dozens of other simple items, surely generates a very large cash flow in the course of a year. With such purchasing power and attendant possibilities for wholesale buying, moderating mark-up, low overhead charges (building KC supplied), many forms of advantage are attainable by the people. Further, in the long term, an even more significant developmental gain is possible if the people are more participatory in such economic and social projects as the store represents. The impact can be great and cumulative on personal attitudes; on a sense of participation and achievement; on a sense of the meaning of capital, savings, and investment; on an appreciation of organization and mutual responsibility; on being honest and responsible. Without trying to exaggerate the human development impact of several stores, it is nonetheless true that development is a complex process which achieves its ends by integrating a multitude of gains, each arising from a modest activity. Giant steps forward are rare in development. A chance to take a small step, if not taken, is a regrettable loss. It would seem reasonable to suggest to KC that as a first pass, the way the stores have been integrated into the life of the workers at KC be reappraised...what would it take to do it differently...at what cost...at whose cost...with what benefits which might justify a change?

5. Training. KC participates in the National Apprentice Training Program. For this purpose, a Training Centre has been in operation for the past 14 years. The facilities and organization of the Centre must be approved by the Ministry of Education. The system is characterized by the following features:

a. The cost of maintaining and carrying out the programs of the Centre is partially borne by a levy of KS 4 per MT of agricultural product. GOK is authorized to pay back 60 percent of this levy, based on satisfactory performance. The pay-back by GOK does not cover all costs. KC subsidizes the difference.

b. The Centre provides a 3 year program for craft apprentices and a 4 year program for technician apprentices, the latter being at a higher level of skill and leads to a greater starting salary and increased job status. The net cost of a 3 year program has been about KS 17,000 per student (U.S.$ 1,258, currently).

c. The courses are comprised of the inputs of GOK, the apprentice and KC. GOK controls the basic context through the Ministry of Labor and the Federal Directorate for Training. The Company certifies the apprentices and directs the Centre and its staff.

d. Graduate apprentices are not obligated to go to work for KC. Of the first 220 to be trained (14 years), 170 have gone elsewhere; 50 work for KC. Lately, this trend appears to have been reversed. For example, in 1983, it was expected that 23 of the 27 trainees would go to work for KC. Part of the reason why so many now stay is that the program includes 20 weeks of hands-on experience in the cannery. Since pineapple processing machinery and supporting maintenance is unique in Kenya at KC, students are attracted to jobs which have become familiar and cannot be replicated elsewhere.

e. There is an apprentice hostel provided at no cost to the student. A tool box is also given to each student. KC can claim half the cost from GOK; the apprentice buys the box at half-price, paying for it over 3 years.

Pay-Off

For GOK - The pay-off to GOK has been positive and constructive from the beginning. Past failure in efforts to bring pineapple production and exports to commercial success had failed; KC made it work. The cost to GOK of acquiring the land leased to KC has been a good investment and the major financial risk in the enterprise was taken by Del Monte. Unproductive land is now fruitful. Steady employment has been created for 6,000-6,500 people, enhancing the quality of life for many thousands more who are members of workers' families. U.S.$ 22 to 30 million a year has been earned in foreign exchange. KC has been meticulous in financial reporting and in its adherence to tax law.

KC has contributed a model educational facility, well worth replication elsewhere in the country and its Training Centre meets every standard set by the Ministries of Education and Labor. In all honesty, it is difficult to see how GOK could be critical of the returns on its original invitation to Del Monte to help Kenya develop its pineapple potential.

For Kenya Canners and the Del Monte Corporation - No figures were given which would quantify the pay-off to KC or Del Monte. The longevity and vigor of KC would seem to say that return on investment has been sufficient to sustain the enterprise.

For the People - The pay-off to the people who work at KC has been considerable. Some would say that they more than match what should be expected of a foreign enterprise; 6,000-6,500 people have jobs and they and their families have security and improved quality of life beyond any hope before KC arrived. Housing, schooling, and medical services are better and immediately available. Upward mobility on the job is fostered by the Apprentice Training Program and in other ways. KC pays out some KS 60 million directly in salaries each year (U.S.$ 4.4 million), in addition to the millions of shillings spent by KC to subsidize housing and other social services. The workers, their families, their unions...all are treated with respect. As will be suggested below in the section on "Policy Recommendations," some challenge can be made to the adequacy of those benefits shared by the people in terms of human development goals.

III

Policy Recommendations

To the Government of Kenya

1. In general, the policies of GOK, as they affect KC, are reasonable in light of circumstances and are non-constraining, with one exception, that is, the rationality and speed with which new regulations are calculated and issued bearing upon import duties and export duties.

Manufacturing costs for all industry have risen sharply in recent years. In the case of agro-industries like KC, which export their entire line in cans, a rise of 400 percent in the cost of imported tin plate, strongly affected by import duties, becomes a threat to survival. Indeed, the East Africa Tannin Extract Company, Ltd. (LONRHO-U.K.) in Eldoret, Kenya, has recently been squeezed out of world markets for canned mushrooms because of can price, even after setting in operation one of the most efficient, low-cost systems of production in the world. Tied to tin plate costs, in an inverse way, is the question of export duties and whether or not additional rebates can be used more creatively to alleviate the impact of importing irreplaceable manufacturing inputs.

The policy recommended to GOK is basically directed to procedures rather than to substance. GOK and the managements of export industries are in constant negotiation on matters of mutual concern: reducing foreign exchange outflows; increasing GOK revenues; maintaining the competitive position of Kenyan exporters; protecting jobs; promoting new foreign investment; keeping the transfer of technology and skills to Kenya a lively, enriching process; among others equally important. What seems to happen is that analytical procedures used by GOK often lack rationality and seem to take too long.

Regulations need to be issued quickly and frequently in order to sustain a balance between costs and competitiveness. Management claims that data which are clear, current and accurate are being supplied to the appropriate Ministries; what is needed is the force of a policy which minimizes delay, and which pin-points decision-making on very specific issues affecting very specific industries. Global policies and industry-wide regulations are, it is said, simply not functional.

2. In terms of rural development, as was recommended at the conclusion of the case of the Mumias Sugar Company in Kenya, GOK needs to exercise dynamic leadership if the full benefits of agro-industrial investments are to be realized. But GOK should recognize the likelihood that no investor or prudent manager is likely to risk scarce resources on an extended socio-economic development program unless encouraged by public policy which makes the will of Government unequivocal. In a pragmatic way, GOK should also reckon with worldwide experience which suggests that the will of Government will be ineffective unless backed by collaboration in financing and the allocation of other resources necessary to facilitate the task and make it feasible to entertain.

To Kenya Canners

1. The major policy concern of KC is to maintain its products at a competitive price in the different markets it serves. Management is well aware of this fact and needs little instruction in the matter. There is constant effort to interact with GOK. The efficiency of the plantation and the cannery has improved steadily. However, there are two additional matters of policy which might well receive closer attention in the search for lower costs and long-range stability. Both tie-in closely to the role KC might play more forcefully than in the past in stimulating rural development.

a. KC management noted that with a relatively minor new investment, the cannery could put through more pineapple than the plantation is likely ever to produce, and that the market is there for the product. Logically, this implies development of an outgrower program, and KC is working on this, as described earlier in the text.

The policy recommended is that full attention be focused on the implications of an outgrower program for rural development, not just as a means of obtaining more fruit and increasing the cash flows into selected rural areas. Granted that the first emphasis of an integrated rural development plan might correctly be placed on growing fruit and demonstrating the gain in income made possible. But the concept and urge of the development process goes beyond land use and income. It engages itself with community improvement; diversifying the economic base; organizing rural folk so that, in the aggregate, their intelligence and physical resources combine into more productive and competitive enterprises, whether for business or pleasure...whether to protect health or to open up the world for upcoming generations...whether to particip.te in the political process or to enjoy the fruits of personal achievement. It is development in the broadest sense of human affairs that Kenya needs most, just as KC may need more pineapple to prosper.

b. A related and also a long-range policy matter concerns the future envisioned for the 6,000 people who work on the plantation, in the cannery and among the service departments which together form KC. KC has deeply affected their lives. Their cultural roots have been refreshed and stimulated. The quality of their lives has been enriched. The notion of upward mobility has been put into their heads. KC is the engine of change, not the GOK, which surely is the way they see it. It will be to KC that in the future they will look for the fuel to energize the steady climb to higher aspirations. This is the way it seems people think and feel under any similar circumstances; the evidence from project after project in every country of the world bears this out with poignant certainty.

People, including those who stepped out of the most primitive background, will not stand still once their sense of the possible has been roused...and, no matter the thanks given to those who helped them take the first step, appreciation will go begging if the second step is denied.

The KC environment, while benign in so many ways, is nonetheless definitely limiting to upward mobility, for the majority. It might be predicted, therefore, that sometime down the time line, if nothing is done beforehand, some agitation will foment, demanding more: more pay; more benefits; a faster outreach...and KC could be vulnerable, as all foreign companies with large plantations and factories at their core could be. The landless may demand some land. All may demand a bigger share of the profit. Some may demand a share of ownership. There is no need to write a scenario of chaos or gloom. But human history is so replete with documented support for the possibilities of trouble that it would seem a sound recommendation to KC that it adopt policies which help anticipate the changes in attitude and behavior likely to occur over time, and in the political ambience of Kenya, which will allow management to respond creatively and promptly.

<u>To the U.S. Government</u>

> Note: The following points are taken, essentially verbatim, from the case report covering the Mumias Sugar Company, also in Kenya. Mumias and KC share many of the same achievements, problems and opportunities. Insofar as U.S. policy can or might take advantage of the presence of these two enterprises in Kenya to accelerate rural development in the country, what can be suggested for Mumias is relevant to KC. For the convenience of the reader, the text from the Mumias report is repeated below.

If the policy implications for GOK and KC are defensible and acceptable, then logic suggests certain policies vis-a-vis agro-industrial development in Kenya which might well be emphasized, namely:

1. With reference to agro-industries already in existence in Kenya, U.S. aid might be extended programmatically to ensure that any opportunity

created for vigorous integrated rural development is not lost. This policy would be independent of the source of capital in the venture. Rather, it would emphasize the importance of well-managed, profitable, rurally-sited enterprise in catalyzing socio-economic progress. For example, in the case of KC, U.S. aid might focus on the needs and potential of the Cooperative farm being considered by KC as the site for its first outgrower program.

In point of fact, every one of the more than ten agro-industrial enterprises studied or contacted briefly in Kenya, evidence exciting opportunities to build on their commercial success to new heights of extended benefits. Yet, not one company was prepared to take financial and operational responsibility without the full policy support of GOK and without financial support arising outside of their business cash flows. On the other hand, no one with whom the idea was discussed was disinterested in the possibility of a joint venture with aid agencies which would not detract from the profit-making function even while it risked beyond traditional corporate limits on activities in development.

2. Beyond capitalizing on development opportunities generated by existing agribusiness, it would seem desirable for the U.S. aid agency to relate as closely as possible to investors considering new investments in agriculturally-related, rurally located enterprises. This would help ensure that feasibility analyses included the costs of integrating the production function with the function of development. In this way, the implications of success in economic terms could be examined for their impact on people and the opportunities to be anticipated relative to area socio-economic dynamics. Further, such early collaboration between public and private investors could help in the invention of the means to blend corporate and developmental objectives into a harmonious, financially viable management system. All this would require strong policy

backing on the part of the U.S. Government, both to influence acceptance of the approach by GOK and to ensure adequate financial resources for the country AID Mission.

3. A policy in support of training Kenyan professionals in a very wide spectrum of fields has always been basic to U.S. aid. This policy might well be extended to include rural development as an adjunct to agro-industrial enterprise. It may be timely to give recognition to worldwide experience which suggests that agronomists or other technicians, economists or other social scientists, or politicians however skilled, do not necessarily make good managers of integrated rural development. This is likely to be even more the case when development goals are integrated with those of a profit-making agro-industrial system. Therefore, training for the field needs to grace rural development and enterprise development with their own unique professional character and provide special training suitable for the task.