Lei's International Cafe: Costa Rica Environment Analysis

LEI ZHENG
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ABSTRACT: This paper analyzes the feasibility of establishing a coffee refining and packaging factory in Costa Rica for a fictional company, Lei's Corporation. Costa Rica's geographic, political, economic, and socio-cultural characteristics are evaluated in terms of their potential impact on the proposed business venture.

Lei's Corporation is an international import and export company. Its headquarters are located in New York. It has offices in Shanghai (China), Hong Kong, Singapore, and London. It has been in business for only five years but is constantly growing. Last year, before the Hong Kong handover, the company opened a brokerage house in Hong Kong and they realized a especially large profit on the stocks it invested. Now, the owner of Lei's Corporation wants to obtain fixed assets in the form of plants and factories. Noticing that the corporation does not have any branches in South America, and having heard that Costa Rica is a beautiful small country whose economy and politics are relatively stable, the owner of the company decided to have one subsidiary in Costa Rica. Knowing that Costa Rica is a coffee exporting country the owner decided to open a coffee refining and packaging factory. The plan is to buy coffee from local plantations and to sell it worldwide through the network already established by Lei's import and export company. In order to make her company become well known, the owner decided to form an alliance with some of the tourist companies. They will hold factory tours, let tourists sample the coffees produced at the factory, and sell gourmet coffee in its gift shop.

By refining and packaging coffee within the country, Lei's Corporation can utilize Costa Rica's natural resources and Costa Rica will benefit from increased value of the products. Therefore, the owner of Lei's Corporation believes the operation will be welcomed by the host country. Furthermore, she thinks that if this factory is successful, she may want to open some cafes or restaurants and eventually make them into a business which is internationalized like MacDonald's. With this long-range possibility, she decided to name this new segment of her business *Lei's International Cafe*. Noticing that Costa Rica has a large rural population and its income level belongs to the lower-middle-income economy (according to the World Bank Classification), the management decided to put the factory in a rural area near San Jose, the capital of Costa Rica. Even the owner herself was interested in the project, since she has never been to Costa Rica. To be sure this is a sound investment, she asked the management to write an analysis of this foreign environment. The following analysis will thoroughly examine Costa Rica. It will consist of examining the geography, political environment, economic environment, and the socio-cultural climate of Costa Rica.

LEI ZHENG is a senior majoring in Finanace and Management. She wrote this paper for D300, *International Business Administration* taught by Dr. Linda Blodgett.

GEOGRAPHY

Costa Rica's geographical characteristics provide Lei's International Cafe an ideal environment for a coffee refining and packaging plant. The fact that Costa Rica is located in Central America (EWY:976) makes it readily accessible to the United Sates, Canada, and parts of South America. Colombia and Brazil are giants in the coffee exporting business; therefore, export to South America might not be feasible. Two of Costa Rica's long coastlines (NEB: 671) are directly accessible to ships. The Pacific Ocean provides Lei's International Cafe a shorter route to export to Asia and Oceania, and the Caribbean Sea provides Lei's International Cafe an opportunity to export to Europe and Africa. Costa Rica is close to Lei's Corporation headquarters in the United States making it possible for the top managers to pay more attention to this new venture.

Costa Rica is a small country — even smaller than West Virginia in the U.S., only 19,730 square miles (NEB:671). Due to its small size, it will be easier for Lei's Corporation management to understand its culture, social environment, and political and judiciary systems. Lei's Corporation realized the importance of having knowledge about a host country and having a global perspective. However, it has never been involved in manufacturing. Lei's Corporation will bear the entire financial risk associated with this new wholly owned subsidiary. Thus, the management will be eager to learn about Costa Rica in order for them to succeed. The size of the country makes it possible for the management to master the new business in the international environment. Furthermore, the Corporation is thinking of operating in a rural area near San Jose which means the site will be located in the narrowest east-west band of the country. This will reduce the delivery cost for the company from the factory to both the Pacific and the Caribbean ports.

The topography of Costa Rica shows nearly one-third of the country is covered by forest (USG: xxi). With the global "green movement," people have begun to demand healthy and high quality food. Coffee consumers want high quality and organically grown coffee. The country's forest makes it possible to have clean air, which is an very essential factor for the production of high quality agricultural products like coffee. The Meseta Central is the area which has a dense population (NEB: 671) and most of the manufacturing (NEB: 672). Therefore, Lei's International Cafe will locate itself in the rural area near San Jose on the Meseta Centra. This will provide jobs for the rural people and will reduce competition for the company. The Meseta Central is a chief coffee growing region (WB: 1082), which will make it cost effective for Lei's International Cafe to obtain raw materials. The only disadvantage of this location is that the site is located in the highlands, the mountains roads might increase the difficulty of delivering products from the factory to the coasts.

Costa Rica's tropical climate is good for agriculture. The Meseta's special natural resources — rich volcanic soil, sufficient rainfall, and moderate temperatures, provide the exactly right environment for coffee to grow which explains why it is the chief coffee growing region. Of course agriculture depends heavily on the weather over which human beings have no control. Bad weather might decrease coffee production which would hurt Lei's International Cafe exports.

Coffee is not only Costa Rica's chief crop (NEB: 672) but it is also the traditional chief export for the country. This means the country is very experienced in growing coffee and its coffee has good reputation abroad. It will be a strong supplier for Lei's International Cafe. Costa Rica's good coffee reputation will make the consumers confident about the quality of the ingredients even though they know nothing about this new producer —Lei's International Cafe. These days the coffee growers in Costa Rica are turning away from using chemicals towards organic methods to woo more buyers (TR: 42). The elimination of chemicals makes the coffee taste better and reduces the expense of growing it (E2/1/97: 43). Locating a processing factory in the country will help the country to better utilize its resources and will add value to the exported coffee.

POLITICAL ENVIRONMENT

Costa Rica is a politically stable country and is known as the "Switzerland of Latin America" (Cinde:1). This ensures a secure business environment for Lei's International Cafe. Costa Rica is a Democratic Republic (WB: 1080) like the United States, which means that the country's government is balanced between individualism and totalitarianism. All citizens 18 years and older may vote (WB: 1081). This type of political system provides an extensive social safety net. As a result, Lei's International Cafe would not have to worry much about extensive employee benefits since the government will provide health care, welfare, and other primary services to all wage-earners and their dependents. The government holds elections every four years and the candidate cannot stay in power for two consecutive terms (NEB: 673). This eliminates the temptation to make political decisions for re-election. Since Costa Rica is a small country, the management of Lei's International Cafe will be able to maintain a close relationship with government officials. However, the management should concentrate on building a good reputation in the society instead of getting involved in politics in light of the four-year term limit for all government officials.

The majority of government officials in Costa Rica are chosen from two major political parties. The Social Christian Unity Party is business-oriented and the National Liberation Party is concerned with social issues (NEB: 673). Lei's International Cafe should maintain positive relations with both parties. Understanding that Lei's International Cafe will further Costa Rica's economic development, the Social Christian Unity Party will be willing to support the operation. In addition, having a close relationship with the Social Christian Unity Party will give Lei's International Cafe the insights into the country's future development and how the operation can fit into Costa Rica's long-range plan. Since the National Liberation Party is largely responsible for health, education, and welfare reforms, Lei's International Cafe should fulfill its social responsibility to obtain the support of the PLN. To have a successful business, the management not only needs to manage the business well, but also needs to manage its social responsibility well.

Costa Rica's attitude towards business promotes Lei's International Cafe operation. The government encourages foreign investment, especially if it complements the domestic production of goods exported beyond Central America (LN). The goals of Lei's International Cafe are therefore in line with the government's objectives. The government encourages privatization and permits all forms of foreign investment (MM:20). This leaves more choices for Lei's Corporation to decide what kind of form will fit better. Lei's Corporation has the money to invest and plans to initiate a wholly-owned subsidiary; however, they have no knowledge of this new country and new type of business. Hence, the government attitude towards business leaves more ownership options for Lei's International Cafe.

Lei's International Cafe is processing and exporting coffee; therefore, the specific trade and investment laws which are related to the operation of the business will be important. Being a US investor, Lei's International Cafe can benefit from the funding assistance (up to 50%) and insurance provided through the Overseas Private Investment Corporation (LN: 11). Using debt is always a good idea, even though it might increase the risk of the company, since it will also increase the rate of returns. The goods exported from Costa Rica are duty-free to the USA (LN: 11). Thus, Lei's International Cafe can reduce the cost of exporting to the US and have a high markup. Since Lei's International Cafe is an industrial processing and trading company, it is qualified to locate itself in the highlands free-zone where it will enjoy investment incentives such as import exemption, tax holiday, and even the freedom of currency control (LN: 12). One of the risks of operating overseas is the foreign exchange risk. In the highlands free-zone, the company will have more freedom of managing its risk even though it might not be able to completely eliminate the risk. It is crucial for Lei's International Cafe to get an exporter license and be sure to deposit its export profit in the central bank within a week (LN) in order to have a smooth operation.

Reducing tariffs is the world trend and objective. Costa Rica has joined many different regional and commodity associations and is actively participating in reducing tariffs (ACS). As a producer in this country, Lei's International Cafe will automatically benefit from this reduction.

The fact that the country does not have armed forces (EWY: 978), and that the President of the country won the Nobel Peace Prize (EWY: 977) proves that Costa Rica does not have much external tension and is a politically stable country. Unfortunately, the peaceful nature of the country has attracted refugees from Nicaragua. The increasing number of refugees has caused Costa Rica's relationship with Nicaragua to become strained (EWY: 977). As the January 1996 news reported, two European women were abducted close to the Nicaragua border (EWY: 978). In order to reduce the political risk, even though most of the indicators show that the country is stable, Lei's International Cafe should definitely not locate near the border of Nicaragua. The current President, Jose Maria Figueres, is a member of the PLN (LN event: 8). In accordance with that party's objectives, encouraging new technology, one oil-fired electric generating facility was canceled in favor of a new geothermal plant (TR: 42). The halting of the development of a non-sustainable Pacific coast resort hotel (TR: 42) showed that the government is concerned about social welfare. New hotels will reduce the country's unemployment rate, yet non-sustainable resort hotels will result in a high future unemployment rate. The government decision to eliminate an environmentally hazardous paper mill and port shows that the government is also concerned about environmental issues. Thus, with this government track record in mind, Lei's International Cafe should have a long-term operating plan to show the government its genuine interest in this investment. At the same time, the factory should have pollution control equipment to meet the government's requirements. Fortunately, Lei's International Cafe is just a coffee refining and packaging factory, and so it should not have too many environmental problems at the first step. By building a pollution control facility, the company will be a good environmental protector. Thus, a knowledge of the current political events will help Lei's International Cafe avoid unnecessary conflict with the government.

ECONOMIC ENVIRONMENT

Costa Rica's economic ideology shows the government is playing a role in the economy. The country tries to intervene in credit markets (MM: 24), but it also encourages competition and advocates privatization (LN: 16). The government employs the industrial policy, which means that it oversees the economy and supports target industries with subsidies and tax brackets. One good example of this is Costa Rica's new strategy of attracting foreign investment for the processing of locally-produced products (LN: 16). The new strategy perfectly suits Lei's International Cafe's goal to operate in Costa Rica.

According to the World Bank categories for economies, Costa Rica's $2,487 per capita annual income (LN facts: 5) leaves the country in the lower-middle-income category which is from $726 to $2,895. Yet, Costa Rica still has the largest per capita income among Central American countries (LN facts: 5). The country's income distribution is fairly even and it has a large middle class (USG: xxiv), which is a sign of being an Organization for Economic Cooperation and Development (OECD) country. The fact that Costa Rica has the highest living standard in Central America, the lowest population growth rate, and a long average life expectancy (E1/11/97: 42) make the country more similiar to an industrialized nation than a less developed country. Costa Rica is turning from agriculture to refining and processing agricultural goods, but its predominate sector is still agriculture, forestry, and fishing (LN). Costa Rica should therefore be categorized as a less developed country, but it is definitely becoming a newly industrialized country. Lei's International Cafe, a First-World country investor, will certainly help Costa Rica's economic development and should be welcomed by the government.

Three modes of transportation exist in Costa Rica for people to easily access it: road, water, and air. Currently, the secondary roads are in poor condition (TAN: 2), but fortunately the government does have a plan to reconstruct them (TR: 44). We could expect in the near future that all the roads should be in fairly good condition. The standardized electric power (USG: 72) and an excellent telecommunication system shows that Costa Rica has a well-developed infrastructure geared for production and planned for growth. This provides a basic condition for Lei's International Cafe to start its operation. The two major ports, Puerto Limon on the Carribean and Puntarenas on the Pacific (USG: 172), are close to the proposed factory; thus, it should provide the business with more efficient delivery of its export goods.

The quantity of coffee production is increasing accompanied with the decrease in coffee processing (LN:22) show this is very good timing for Lei's International Cafe to come in. Nevertheless, the International Coffee Organization put a quota on Costa Rica's coffee export (LN: 21) and there is a big competitor — Cafe Britt — existing in the market. Cafe Britt serves both domestic and international markets and offers tours of its roasting plant (JBR: 23). This is exactly what Lei's International Cafe proposes to do. Offering the same products and services will be a stress factor to Lei's operation. A more thorough investigation showed that so far Cafe Britt has only established its distribution offices in US, Canada, and Europe. Thus, leaving the Asian and African markets for Lei's International Cafe. Furthermore, Lei's Corporation was originated as an import and export company. Hence, it has a very well-established network and global distribution system. Lei's International Cafe could market more heavily in the Asian market. At the same time, it could try to differentiate itself from Cafe Britt in the US, Canada, and Europe markets by using either product differentiation strategy or cost leadership strategy. It will be a very competitive game and it is hard to say who will be the winner.

Even though Costa Rica is a small politically stable country with a reputation as the "Switzerland of Latin America," its currency, the colon, is definitely not a hard currency as compared to Switzerland's Swiss Franc. The record from 1993 to 1997 shows that the colon is devaluating. The government is actively intervening in the foreign exchange market. It sets up multiple rates (EWY: 980). More precisely there are two rates, the official rate for all foreign trade transactions and the legal parallel rate for all other foreign currency operations in order to show the priorities for the economy. Lei's International Cafe should be aware that the colon is a soft currency and the government also has restrictions on foreign exchange. In order to reduce the exchange rate risk, it would be wise for the company to purchase local resources and hire local employees, and thus all the payment could be paid in colon which reduces some of the currency exposure. The company could also consider short hedging in the foreign exchange market as another alternative.

The large level of foreign debt and negative balance of payments (EWY: 981) gives negative impact on the Costa Rica's economy grading. However, the government is also aware of this problem. As part of the economic ideology, the government has pursued an aggressive policy of export diversification with non-traditional exports (LN: 15). Lei's International Cafe will export coffee which is refined and packaged. This will add value to the exported coffee and reduce the negative balance of payments.

The current economic problems show the economy is not healthy right now and politics need to be implemented in several areas. However, the government does see the problems and is ready to adjust for them. The new policies and investment incentives attract various investors from different areas. Big companies like Intel spent $300 million to locate in Costa Rica (LN event:2). Some Asian textile manufacturers own five private free-zones in the country (LN: 12). All of these actions proves the foreign investors are confident that Costa Rica's future economy will be prosperous. *The Art of War*, a famous Chinese Book recently used for business strategies, states "If you know the enemy and know yourself, you need not fear the result of a hundred battles. If you know yourself, but not the enemy, for every victory gained you will also suffer a defeat." Thus, Lei's International Cafe, knowing the current host country's economic problems and knowing its strengths and weaknesses should foresee victory.

SOCIAL-CULTURAL ENVIRONMENT

Costa Rica has four ethnic groups — White and Mestizo, Black, Indian, and Chinese (LNfacts:2). These diverse groups have a high degree of ethnic and linguistic homogeneity and lack antagonism towards each other. This reduces the internal tension and increases political stability. Government tolerates all forms of worship, thus reducing the conflicts between religious groups. All these will reduce the political risk for Lei's International Cafe's operation.

The languages favor Lei's International Cafe. Even though the management of Lei's Corporation are from different nations, the official language for this corporation is English. Now in this host country, the most widely used language in the business community is English (LN), so that Lei's Corporation management can certainly reduce the risk of language barrier problems. Nevertheless, the management should keep in mind that even using the same language, communication errors still can occur. However, the host country's use of English is certainly a plus for this new investment.

Costa Rica's education system creates a highly skilled, low-cost labor force, and a well-educated middle class (LN:1) can provide Lei's International Cafe with quality laborors. According to 1995's estimation, Costa Rica has 95% literacy and it is the highest in Central America (EWY: 979). The high level of literacy makes communication easy, and even makes it possible for Lei's International Cafe to select someone who has coffee processing knowledge and also management skills to run the factory.

Social organization shows that Costa Ricans are becoming more and more independent as families move towards becoming nuclear. The support of the extended family has weakened, and the problem of a high rate of divorce further fragments the network of emotional security and stability of people in the society. As an organization which is made up of people, Lei's International Cafe should also emphasize unity, and management should care for their employees and build a good relationship with them. Let the employees feel the factory is just like a second home for them. As a matter of fact, the statistics show if the employer and employees have a good relationship, it can result in high productivity.

The level of social mobility suggests that San Jose has expanded outward to incorporate surrounding towns (NBW: 671). This shows that Lei's International Cafe locating in a rural area near San Jose is the correct strategy. As we know, rare things have more value. Lei's International Cafe will be one of the few pioneers who invest in a rural area and will be given more attention by the local government, maybe even have special preference. This gives Lei's International Cafe a motivation to "go."

The employer-employee relations show the private sector is very stable in terms of possible strikes (FLT). Even if they have labor unions, they do not strike. The essential reason might be those workers are afraid of losing jobs. As mentioned before, it is important for a business who wants to efficiently and effectively achieve its goals to have good employer-employee relationships. There is a possibility of a public sector strike which could also influence the private sector. However, so far that has not been the case. Lei's International Cafe happens to be a privately owned business. In this case, with careful screening and selection of its management, it should be able to create a good working environment and maintain well-communicated employer-employee relationships with managers and a human resources department which pays attention to the employees.

RECOMMENDATION

Lei's International Cafe should go to Costa Rica for a number of reasons. First, the host country's geographic, economic, political, and social conditions are suitable for the company. Costa Rica is rich in resources therefore it can provide sufficient and high quality raw material —coffee, an efficient labor force for production, and the low-cost, highly-skilled and well-educated labor force for a management team which is an exceptional criterion. The convenient location for air and ocean freight transportation services, and the size of the country makes it suitable for a company with global strategy like Lei's Corporation. The factors that Costa Rica has a) low political risk, b) government favors foreign direct investment and supports investors with various incentives, c) well-developed infrastructure, and d) low language barriers spur Lei's International Cafe to locate in Costa Rica. Secondly, the company is suitable for the country. The new company will provide Costa Rica with wide potential opportunities of economic benefits, such as introducing appropriate technology to the host country, hiring local production crew to create jobs for Costa Rica. Originating from an import and export company, Lei's Corporation maintains an active network system that enables the company to export products all over the world. This unique feature of the company will benefit Costa Rica's balance of payment. Third, adding a new type of venture will diversifie the business risk for Lei's Corporation.

According to the opportunity / risk matrix, this project will be graded as a high opportunity and low risk project which is at the upper right quadrant and the decision will be to accept the project. Based on the country attractiveness / company strength matrix, this project will be graded as low company strength (since it only has capital and global experience), and high country attractiveness (since the country has land, labor, infrastructure, political stability, and government attitude favors FDI) which simply means to invest upon given opportunity.

The only two difficulties the company might encounter would be an unstable economy and a big potential competitor. Thus, the time to invest in Costa Rica is crucial, the sooner the better. It should go into the business before its competitor, Cafe Britt, fully establishes its reputation in the world markets. It should be a wholly-owned subsidiary, whereby, the company could enjoy more profit and have more control over the business. They should hire and train local managers to manage the firm to reduce the risk of a new endeavor in an unfamiliar environment.

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