MEXICO AND IBM:
A NEW LOOK AT STATE-TNC
NEGOTIATION AND BARGAINING POWER

by

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ABSTRACT

The imbalance of bargaining power between the state and the transnational corporations is re-examined in the context of the recent negotiations between Mexico and IBM. In 1984-1985, IBM negotiated with Mexico to establish a microcomputer manufacturing facility in Mexico; Mexico's Foreign Investment Commission initially rejected IBM's investment proposal, but reversed their decision after IBM promised a considerably larger investment package.

The case illustrates how a developing country is able to enhance its bargaining position vis-a-vis the TNC by exploiting sources of bargaining power. Four sources of bargaining power are examined—the relationship of the parties, knowledge and information, the role of competition, and the institutional arrangements for negotiating with foreign investors.

The case suggests that the relationship of the parties is a fundamental source of bargaining strength, but its influence can vary to the extent that the firm is already established in the country, whether the firm will produce for export or the local market, and to the extent that the state has targeted the industry as a priority. The role of knowledge and information is also fundamental—it allows the state to offset the uncertainty of the investment and raise relevant issues that might otherwise be overlooked.

The role of competition, often noted as a source of bargaining power, is relevant, but difficult to take advantage of. The state must enhance its competitive position as well as find ways to induce competition among firms. Finally, the author advocates coordination of the state's negotiating and decision-making institutions, but there may be political and case-specific constraints to a coordinated strategy. A new model for organizing industrial development policy-making is suggested.

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INTRODUCTION

"The position in foreign direct investment today is something of a standoff, such as frequently occurs in bilateral monopoly. Both parties would benefit from getting together and working out mutually advantageous arrangements."

--Charles Kindleberger

Economic Development, 1958

Kindleberger’s 1958 comment on the position in foreign direct investment has inspired many researchers to re-evaluate the "standoff" between the transnational corporation (TNC) and the developing country state. Traditionally, the TNC has been dominant in state-TNC interactions because of its greater flexibility and access to resources unavailable to host countries. More recently, an overall decline in foreign investment, particularly in Latin America, has triggered competition among host countries for foreign investment, potentially strengthening the TNC’s position.[1] New evidence suggests, however, that a traditionally weak host country has learned over time to enhance its bargaining position by exploiting various sources of bargaining power during its negotiations with TNCs. In this thesis, I examine four sources of bargaining power in the context of Mexico’s negotiations with IBM in 1984-1985. The four sources of bargaining power discussed include the relationship of the parties, knowledge and information, the role of competition, and the institutional arrangements for negotiating.

The current scenario in foreign direct investment would not predict that these sources of bargaining strength could
improve the bargaining position, and therefore, serve the
development objectives, of a developing country like Mexico. The TNCs’ traditional bargaining power and the overall drop in total foreign investment over the last five years provide a dim prospect for a country that relies on foreign investment to trigger growth and industrial development. Mexico, like many developing countries, continues to be concerned about preserving national sovereignty and guarding its domestic economy from the adverse effects of foreign investment by applying strict restrictions on foreign investment. But, deteriorating economic conditions have forced Mexico to be more flexible during bargaining encounters with TNCs and less restrictive with foreign investment laws and regulations.

Fortunately, this scenario did not hamper Mexico’s ability to improve its bargaining position and achieve its development objectives during its negotiations with IBM. In my view, at least four sources of bargaining power enabled Mexico to satisfy its interests in the negotiations. However, despite its success, Mexico took advantage of some of these sources less effectively than it could have.

First, while IBM offered Mexico the productive capacity to spur non-oil exports and improve its balance of payments position, Mexico relied upon its fundamental source of bargaining strength—a market and investment incentives that proved to be very attractive to IBM and enhanced Mexico’s bargaining position. Mexico’s bargaining position
was further enhanced by the near-certainty of its future relationship with IBM. This motivated the parties to build a good working relationship and make commitments to reach agreement.

Second, while lack of information and negotiating skill is often cited as a determinant of a weak bargaining position for the state, Mexico’s knowledge about its own interests, the concerns and interests of IBM, and the characteristics of the investment projects proved to be a source of bargaining strength. The agreement demonstrated Mexico’s ability to skillfully satisfy competing interests, set appropriate precedents, and correct project issues that might have weakened its position in the long run.

Third, competition among computer firms and among developing countries is often noted as a significant source of bargaining power in state-TNC negotiations, but it is a slippery concept. The case demonstrates how difficult it can be for the state to exercise this source of bargaining strength. While Mexico benefited from the competitive nature of the computer industry, it did not fully exploit the opportunity to enhance its bargaining position by failing to increase or improve its alternatives. Mexico’s perceptions of its own competitive position were also influenced by IBM’s representations that the firm’s interest was flagging.

Finally, experts recommend that one of the most important ways to enhance the state’s bargaining position in its interactions with foreign investors is to coordinate
institutions and organizations within the government. In Mexico, a partially coordinated strategy is in place. Decision-making is centralized at a high level, but separated from the negotiating and implementing authorities. In the case of IBM and Mexico, the split between the decision-maker and the lower-tier officials has led to an uncertain outcome. In sum, though the case for coordination is strong, there may be political and case-specific constraints to implementing such a strategy.

In Part I, I examine the role of bargaining power in state-TNC negotiations and provide a definition of bargaining power drawn from the negotiation literature. In addition, I discuss the four sources of bargaining power that provide the framework for the analysis in greater detail. Part II presents the case of Mexico’s negotiations with IBM in 1984 and 1985 over the expansion of IBM’s manufacturing facility for microcomputers. The story was constructed based on interview material, newspaper and journal articles, and other background source material. It highlights the role that public exposure, competing interests, and political tactics can play in state-TNC negotiations. The conclusion re-examines the four sources of bargaining strength and the extent to which Mexico was able to exercise its potential bargaining power vis-a-vis IBM. In an epilogue, I recommend a possible organizational model and negotiation strategies to allow states to more fully take advantage of sources of bargaining strength.
Notes to Introduction:


The 1986 report shows that since 1981, when world foreign investment peaked at $52.2 billion, world foreign investment has dropped in 1984 to $48.5 billion. While United States and other areas of the world have seen more modest declines, Latin American foreign investment has dropped more than 55 percent from 1981 to 1984.

See also Dennis Encarnation and Louis T. Wells, Jr., (1985).
PART I: SOURCES OF BARGAINING POWER

"Give me that which I want, and you shall have this which I want..."
--Adam Smith
The Wealth of Nations

Bargaining Power

The issue of bargaining power is central in all negotiations, particularly between developing country states and TNCs. Three propositions describe why bargaining power is at the heart of state-TNC negotiations: (1) the TNC has more flexibility than the state; (2) the state will continue to rely on transnational corporations to trigger their industrial development; (3) given the inevitability of the relationship between the TNC and the state, the state will attempt to exert control over the activities of the TNC.

The greater flexibility of the TNC in state-TNC interactions puts the state at a disadvantage. A "basic asymmetry" characterizes the relationship: the TNC has the ability to relocate to other parts of the globe while the state is committed to its "turf."[1] In addition, the TNC's activities can limit options available to the state. The oligopolistic nature of industries in which TNCs are involved leads to market and demand distortions in host countries. Where there are few sellers, the actions of any one firm can have a large impact on industry output or product price, and therefore, can bar opportunities for local entrants and limit the options available to host country consumers.[2] Finally, the TNC has access to a
global pool of resources and knowledge unavailable to the host-country. It has developed risk-minimizing strategies that allow it to bear the costs of uncertainty more effectively than a local (host country) firm or government.[3]

Host countries rely on foreign investment as a stimulus to achieve national industrial development goals. Despite the asymmetry, limitations, and uncertainty, developing countries continue—with increasing frequency—to include foreign investment components in their industrial development plans. They are reluctant to give up the benefits that transnational firms can provide.

Thus, a tension is created within the state between its reliance on the TNC and its desire to exert control over TNC activities. This tension magnifies the importance of bargaining power and makes it imperative that states improve their bargaining skills.

The tension created within the state is best understood in the context of Raymond Vernon's "problem of multiple jurisdictions." While developing countries rely on foreign investment to contribute to a significant share of their national output, transnational corporations have global concerns and will not necessarily be able to single-mindedly address the concerns of any one state.[4] Moreover, because host countries are the links in the network of a TNC's global operations, the economies of each state will be influenced by the activities of the others.[5] Competition between states for foreign investment also contributes to
the overlap of economic influences across states.

The problem of multiple jurisdictions, i.e., the increasing globalization of economic interests, affects countries and firms alike. The state wants to exert greater control over the activities of TNCs within the state jurisdiction, while the TNC wants as much flexibility as possible. Nevertheless, both host country governments and foreign investors will agree that economic and financial considerations must often give way to political and tactical considerations in state-TNC negotiations.[6]

Researchers often define bargaining power in state-TNC negotiations in terms of the structures that limit or expand bargaining power. The negotiation literature provides a more operational definition: bargaining power is the ability to influence the other side's perceptions and favorably affect their decisions.[7] Since the state's intent is to reap more of the benefits of foreign investment by exerting control over the foreign investor,

"The degree of control that national entities can exert over a potential foreign investor is determined, to a large extent, by the relative benefits that both parties perceive resulting from the investment. The prospective investor's perception of the opportunities derived from participating in the local economy will influence his attitudes toward accepting certain conditions that he may normally view as potentially restrictive....Similarly, the host country may be willing to lower its demands...to the extent that it views the foreign investment as convenient, necessary, or imperative to its national development goals." (Emphasis mine.)[8]

Lopsided negotiation is not inevitable. A wide margin can exist for the state to improve its bargaining position
vis-a-vis the TNC. Insofar as power imbalances between states and TNCs exist, the desire among developing countries to balance the sense of unequal power will remain strong. By orchestrating their sources of power effectively, states can improve their bargaining positions.[9] The following section describes four sources of bargaining power available to the state.

Sources of Bargaining Power

Most analyses of bargaining power begin with a simple buyer-seller model and assume that each party has two sources of strength—what they are willing to offer and what they are willing to accept. These are sources of both strength and weakness in a bargaining relationship. My discussion begins with this fundamental understanding of the negotiating relationship. In negotiations such as state-TNC negotiations, the transaction between the parties does not end after the "sale", rather the parties expect to interact over a period of time.[10] The prospect of a future interaction motivates the parties to build a good working relationship during the negotiation which can be a source of strength. In addition, by anticipating a future relationship, the parties will make greater commitments to reach agreement.

A second source bargaining power is the skill, knowledge and information each party brings to the negotiating table.[11] The adage that "knowledge is power" rings particularly true to state-TNC negotiations. The more
knowledge the state can accumulate about its needs, those of the negotiating parties, and the facts of the case, the better the state can do in generating proposals that will be hard to argue against. Knowledge of precedent and knowledge of "facts" are both important. Skill comes into play in identifying potential issues, raising them as negotiable items, and bargaining wisely.

The role of competition can be an additional source of bargaining strength. In the context of state-TNC negotiations, competition relates to the "power of alternatives and the "power to influence perceptions."[12] Having an alternative to the negotiated agreement is a source of bargaining power because it gives the state or the TNC a "backup" in which its interests can be satisfied if an agreement is not reached. The ability to make the other side perceive of itself as one of many alternatives can enhance the bargaining power of the negotiator.

Finally, the ability of a party to organize itself effectively can provide a source of bargaining power. The TNC is generally regarded as focused in its interests while the state is not. The state has diverse interests and positions to protect.[13] Yet, various coordination arrangements can be used to overcome the weaknesses associated with internal conflict or confrontations.

Relationships: Now and in the Future

In what has become a classic description of the state-TNC negotiating relationship, Charles Kindleberger
characterizes the bargaining over an investment project as a bilateral monopoly. In effect, each side possesses resources that the other side wants. One buyer and one seller bargain over the price of the investment. The lower limit of the price is that for which the TNC is willing to go abroad, and the upper limit of the price is the opportunity cost to the state of foregoing the investment. The price at which the parties settle lies between these and is a function of their relative bargaining strengths.\[14\]

Although descriptive, this one-buyer, one-seller bilateral monopoly concept needs to be elaborated in order to identify the party's perceived advantage and, therefore, source of bargaining strength. This is best done by defining the transaction in two different ways (See Figure 1a). If we define the transaction as the sale of a TNC's productive capacity to the host-country, then the TNC, as seller, possesses the resources that the developing country state wants: access to capital, technology, and export markets along with marketing skills and experience. A review of these resources indicates the TNC's advantage and ways in which their increased flexibility may manifest itself in the host country.

Traditional analyses propose that transnational firms have been an important source for moving international capital. Countries have relied on foreign investment to supply capital for industry as well as build capital markets in the host country. Often, transnational firms do not
necessarily bring in new capital when they invest in a country, but appropriate local capital in order to establish their enterprises.[15] In either case, the transnational corporation is able to access and offer capital for investment in ways host-country firms are not able to do.

Another resource TNCs possess is technology and technological skills. Several negotiable issues are associated with technology and the transfer of technology.[16] These include: restrictive financial or practical conditions imposed on the technology by the TNCs; the concentration of R&D in the TNC's home country; the appropriateness of the technology; and problems with "dumping" of old technology on new markets.[17]

Restrictive TNC practices occur when a TNC ties the transfer of technology to the purchase of its goods or services, restricts subsidiaries from entering into agreements with host countries that involve competing or complementary technology, or reserve the technological

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<table>
<thead>
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<th>FIGURE 1. BILATERAL MONOPOLY</th>
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<td><strong>DEFINITION OF THE TRANSACTION</strong></td>
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<tr>
<td>(a) DEFINITION 1:</td>
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<tr>
<td>Sale of Productive Capacity (capital technology, access to markets)</td>
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<tr>
<td>(b) DEFINITION 2:</td>
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<tr>
<td>Sale of an Investment Opportunity (Local market, labor, land, incentives)</td>
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components of the production process to its own "imported" managers and technicians. [18] Because a TNC has greater access to scientific manpower and financial resources to promote innovation and new technology R&D investment tends to be concentrated in the host country. Finally, a TNC often uses foreign markets to produce and sell obsolete product lines. Apple Computer, for instance, when it began production in 1984 in Mexico was producing its 1977 model of the Apple II. The 1977 model has survived in Mexico because of an insulated market, but in the United States, the 8-bit Apple II cannot compete with the more powerful 16-bit machines. [19]

A TNC also has an advantage because of its access to export markets and its marketing skill and experience necessary to distribute the exports. TNCs control the markets "downstream" from the productions sites. In addition, a TNC will have an advantage if its products compete on the basis of product differentiation and brand loyalty rather than price. TNCs tend to rely on marketing strategies that emphasize superior quality, unusual packaging, or other special features that make a product unique and can strengthen brand loyalty among consumers. This product differentiation strategy enables a firm to create and maintain barriers to entry, therefore, making the access to the industry difficult and cutting down the number of alternative products or firms for the state to choose from.
In Mexico, the steroid hormone industry was dominated by pharmaceutical TNCs. [20] Steroid hormones are more familiar as products such as oral contraceptives or as cortisone products.) These firms established subsidiaries in Mexico to process the raw materials available there and produce intermediate steroid materials to export back to the parent company. Marketing strategies emphasized sophisticated product differentiation to exacerbate high barriers to entry, and concentrate profits at the end of the production line back in the home country, effectively eliminating the possibility of host country firms to compete. The effectiveness of their strategy is demonstrated in the product prices: between 1949 and 1968, the price of the intermediate material produced in Mexico dropped from $3.00 per gram to $0.08 per gram; the parent company's cost to produce a cortisone-derivative pill was one and a half cents; the cost to the consumer was thirty cents. [21]

By defining the transaction as the sale of an investment opportunity, the buyer-seller characterization of foreign investment negotiations can be reversed (See Figure 1b). Now, the state, as seller of the investment opportunity, possesses the resources that the TNC wants access to, primarily labor, land, and investment incentives such as tax breaks, and markets.

Low-cost labor has traditionally been the resource that TNCs look for in investment opportunities abroad. Familiar symbols of this host-country "resource" are the maquiladoras
Foreign investors were given free land, electricity, and tax incentives—as well as low labor costs—to establish these plants in Mexico.

The potential market, however, is a powerful resource for which host countries have an strong advantage. The perception of the size and strength of the market in host countries encourages foreign investors to pursue investment opportunities in those markets. For example, in 1982 after the Mexican government decreed its new computer policy requiring foreign firms to assemble locally, there were only 16,000 units installed in the country. It was reported that up to a half of the total units had been smuggled into the country. Nonetheless, the perception of astounding growth in the computer market led no less than forty-five firms to submit applications for setting up assembly operations. In September 1983, the Mexican government placed restrictions on the Mexican auto manufacturers in order to force manufacturers to produce more efficiently by taking advantage of economies of scale. In spite of increased restrictions, the six firms that produce in the industry are very hesitant to leave. Mexico remains potentially one of the world’s largest markets. Thus, the state is also in a position to press for favorable investment terms from the TNC.

Unlike simple buyer-seller interactions in which the end of the transaction is the end of the relationship, the
parties in the state-TNC negotiation expect to interact over a future period of time. Both state and TNC look for profits as well as an arrangement with trouble-free longevity.[26] Since the parties expect their relationship to continue, the way in which they bargain (and their relative bargaining strength) is likely to change.[27] The knowledge that there might be a future relationship alters the present negotiation.

The power of a good relationship becomes apparent here.[28] The parties who intend to have a future interaction will be more likely to see the value of building a good relationship. Open communication channels and establishing a good working relationship become more important to the parties. Favorably affecting the other side’s decisions can result from the openness and ability to communicate with the other party.

During the negotiations, the state and the TNC are also more likely to make commitments to reach agreement. The expectation of a long-term alliance necessitates decisions that lead to agreement—the "take it or leave it" position is less likely to be used.

Three variables can affect how much influence the relationship of the parties has in the negotiations. First, the state-TNC working relationship may be more influential as a source of bargaining power when the foreign investor is already present in the host country. In such a case, there is near certainty that the parties will continue to have a relationship and future encounters.
Second, a TNC subsidiary producing for the local market is more likely to be influenced by its relationship to the host country than one producing for export. Parent firms in the home country of an export-producing TNC will assume close control over the production and distribution of subsidiary exports, particularly those that are highly differentiated.\[29\] Firms producing for the local market, however, will have more autonomy from the parent firm, and will be more interested in a good working relationship with the host government.

Finally, the influence of the relationship will also depend upon whether the state has targeted the industry as a development priority. The state will be more interested in building good relationships and making commitments for those industries it sees as strategic.

A comparison of two Mexican case studies can illustrate the influence of these variables. The steroid hormone industry was not strategic to Mexico’s development priorities; all the TNCs had entered the market with relatively little negotiation, if any; and the subsidiaries all processed raw materials entirely for export back to the parent. Gereffi writes:

"...the steroid hormone industry was specialized (to the point of being exotic), export-oriented, and successful. The prevailing mood was to 'leave well enough alone' rather than to strike a better bargain."\[30\]

In this case, a good working relationship was not an active bargaining strategy, but benign neglect on the part
of the Mexican government.

By contrast, the automobile industry was a strategic industry, a priority for the government. The intent of the firms, by government decree, was to produce for the local market, and the two leading firms, Ford and GM, were already established operations in the country at the time the bargaining began. The working relationship and the commitment to reach agreement was more obvious for this case.[31]

Knowledge and Information: Revealing the Issues

Negotiation experts and consultants have often focused on the accumulation of knowledge and information-sharing as a source of bargaining strength for the state.[32] Central to this idea is the role uncertainty plays in state-TNC bargaining and how, as uncertainty dissipates over time, the bargaining positions of the two parties shift. There are two primary and contrary hypotheses that discuss how uncertainty alters the bargaining positions of the parties over time. Both begin with the assumption that the "unknowns" associated with a foreign investment project are numerous, particularly in the initial stages of investment.

One hypothesis states that foreign firms gain favorable terms from the state when they enter the market as compensation for taking on the risks associated with the initial investment. However, the state's bargaining power grows once the operation is successfully in place, other alternatives for the state open up, and the technology
becomes stabilized. This shift of bargaining power in favor of the state was introduced by Raymond Vernon as the "obsolescing bargain."[33] A contrary hypothesis suggests that a manufacturing firm may be at its weakest at the time of the negotiations since the government controls the rules of the game. After the investment is made, these firms have the ability to forge alliances with the domestic industrialists and, over time, strengthen their bargaining power against the state.[34]

Both these hypotheses suggest that bargaining power is dynamic—that the balance of bargaining power shifts and changes over time. What is important for this discussion is that the state must be aware of the possible dynamic associated with different firm and industry conditions at the outset of the negotiations. Gathering information and using it effectively to offset risk and uncertainty is one key to gaining bargaining strength. To improve its bargaining position before and during negotiations, the state can accumulate knowledge about its interests, those of the parties involved, and about the project characteristics.

Understanding the possible dynamic associated with different industries at the outset of the negotiations can help the government negotiators raise issues that might otherwise be overlooked. Rarely will a state-TNC negotiation be a single-issue negotiation based upon the "price" of the investment as proposed by the simply buyer-seller model. Dunlop suggests that even when cost is the issue, it can be decomposed into more than one issue such
as, in the case of foreign investment project, the type of project financing and the sequencing of the investment. [35]

Other issues related to the "price" of the investment agreement are ownership; industry structure including market share and the number of firms allowed to compete in the industry; the level of local content required in the manufacture of the goods; import and export permits or quotas and trade balance requirements; tax incentives or regulations; and other restrictions and incentives relating to firm performance.

The number of negotiable issues may be numerous and allow more possibilities for trading concessions, promises—and threats—in order to reach an agreement. Yet, without knowledge of the range of possibilities and constraints, the negotiation might be limited to the priorities of one party or the agreement will not reflect what will, over time, be concerns of the state.

Two specific examples of of knowledge and information are discussed. Knowledge about precedent-setting can increase a party’s understanding of potential constraints in the negotiation. Precedents set at previous negotiations or inherent to particular government or corporate policies may bind a party to certain issues. For example, the TNC cannot ignore the way in which agreements registered in one country will be viewed in other countries. In addition, corporate executives and government officials will be concerned about avoiding political liabilities associated with any
precedents that are set in the current negotiation. The more a party permits (or must permit) a precedent to constrain their decision-making flexibility, the more likely will strong positions characterize the bargaining.

Sometimes precedents are used by a party as a negotiating strategy. A TNC or host country might maintain that if it agrees to a particular demand in this situation, it will be obliged to do so in every situation. "The quintessence of this particular gambit is the most favored company or most favored government provision."[36]

Accumulating knowledge about precedents set prior to a negotiation and identifying the parties' concerns over precedent-setting enables the negotiators to address issues that might otherwise send incorrect or damaging signals. More options will be generated to expand the range of possible solutions.

Knowledge about the project characteristics can determine the strength or weakness of the parties in the negotiation and over time. Some characteristics include the size of the investment, the technology associated with the investment, and the type of industry. In situations where the state is in a weak bargaining position, it can impose rules to strengthen its position.

Over time, projects that require large fixed investments will tend to leave the foreign investor vulnerable to host country demands.[37] Generally, such large fixed investments are associated with extractive industries. The terms to gain entry in the host-country
usually are very favorable for the TNC, over time the investment is perceived as a "hostage" of the state and the state is able to exert greater control and make larger demands on the TNC. [38]

Manufacturing industries tend not to be associated with large initial capital investments so the bargain "obsolesces" in favor of the firm rather than the country. [39] Yet, the ratio of fixed investment to total investment for an automobile manufacturer will be significantly larger than that for a microcomputer manufacturer. The recent revamping of the Ford plant in Mexico to produce Topaz models was $40 million. [40] By contrast, Apple's investment in its joint venture in Mexico was only $600,000 in the first year. [41] The firm with a small fixed investment will be less vulnerable to host-country demands over time since less investment can become captive of the host. Based on this logic, Ford will be less likely to leave Mexico than Apple because of its sunk investment.

Generally, the less stable the technology associated with the investment, the weaker is the state's bargaining strength. [42] It has already been noted the general advantage TNCs have over technology in foreign investment. The more changeable a technology, the greater the risks involved in committing an investment such technology.

A TNC is more likely to have the scientific and financial resources to take advantage of a fast-paced
technology, but, if the state recognizes its potential weakness, it can try to remedy the situation by policy or rule changes. Grieco demonstrated that the Indian government was able to react quickly and effectively to the rapidly changing technology associated with the computer industry in the seventies; it was able to recognize the shift in the technological emphasis from large computer systems to small systems and engineer its computer policy goals to accommodate the change. In effect, the stability of technology may not be a variable in determining the potential bargaining strength of a state if the state can muster its scientific and financial resources to make educated decisions about the technology. Over time, industrializing countries—particularly those Grieco terms "assertive upper tier" countries like India, Brazil, and Mexico—have not been as vulnerable to the technology variable in determining its potential for bargaining strength.

Understanding and gathering information about these project characteristics enables the state to identify those issues that will improve their bargaining position over time.

**Competition: Generating Alternatives and Shaping Perceptions**

The role of competition is often noted in studies as a potential source of bargaining power. However, other case studies have shown that Mexico has not often been able to take advantage of the presence of competition.
The central notion of why competition can be a source of bargaining power is the notion of a good alternative. By having a good alternative to a negotiated agreement, a party may be able to satisfy its interests even if an agreement is not reached. This increases its bargaining power in the negotiation. Competition among states or firms expands the number of alternatives for the other side. A highly competitive investment environment among foreign firms is a potential source of bargaining strength for the state because greater numbers of firms increase the number of alternatives available and allow the state to play the firms demands off one another. In India, the growing international competition in the 1970's between small-system computer companies and the proliferation of semiconductor and component manufacturers interested in selling to new markets gave the Indian government additional bargaining power. The government was able to make demands on TNCs since it had other firms to turn to.

Knickerbocker has documented evidence that suggests foreign investment tends to occur in industries characterized by oligopolistic competition. Even then, the host country may be able to take advantage of competitive behavior between firms as a source of bargaining strength. When a firm in an oligopolistic industry first makes a move to enter a foreign market, the other firms in the oligopoly display what is known as "oligopolistic reaction." It is a defensive investment strategy for one firm to match the actions of another so that no one firm can undercut another.
The result is a burst of competitive investment during a relatively short period of time. If the host country recognizes the increased level of competition, it can be "window of opportunity" for improving the country's potential bargaining strength.[50]

This "window of opportunity" may be lost to governments after some of the firms are invested. However, if the oligopolistic structure of the industry repeats itself in the host country, the state may be able to rely on the defensive investment dynamic among firms to enforce government demands. As long as one rival firm responds to government edict, others in the oligopoly will also respond.[51]

Today, the role of competition is even more important as a source of bargaining power because of the drop in total foreign investment over the last five years. The total amount of new foreign investment in Latin America dropped over 55 percent between 1981 and 1984. Foreign investment in the world is increasingly the reinvestment of retained earnings rather than new investment.[52] At the same time, competition among governments for foreign investment is increasing. Governments are "actively vying for the opportunity to serve as hosts for foreign firms."[53] Countries must improve their position relative to other countries demonstrating attractive investment climates.

Therefore, just as competition among firms for a particular investment project gives a country bargaining
strength, so too does competition among countries give bargaining strength to the TNC. Encarnation writes, "Foreign enterprises, from their perspective, have much to gain from the increased competition among countries for investment."[54] For example, a firm that is courted by several countries for its investment will benefit from tax breaks, grants, and other investment incentives.

While real competition is important as a source of bargaining strength, the ability to influence the other side's perception of competition plays an important role as a source of bargaining strength. Heightening the perception of the other side's competitive position is a tactic that can increase bargaining strength.

Organization: Reconciling Competing Interests

Because of the increased competition among countries, firms will now take into consideration, along with the costs of investment, the costs of negotiating in a country.

"Negotiations may be long and thus costly in management time. The outcome of the negotiations, or subsequent implementation of terms agreed to, may be so uncertain as to repel attractive investors. The failure of governments to establish appropriate structures and procedures may thus diminish the level and type of investment sought either by the firm or by the host government."[55]

What are "appropriate structures?" The idea that governments should consider their institutional negotiating arrangement in order to increase their bargaining strength vis-a-vis the TNC is not a new concept. In the seventies, critics of foreign investment for developing countries made
recommendations to encourage countries to achieve a unified front vis-a-vis the TNC and improve their capacity to achieve a broader policy perspective for each investment considered. By centralizing and coordinating decision-making, they argued, a host-country would be able to gain more favorable terms from an investment. Encarnation and Well's findings indicate that the very strategy suggested by critics of foreign investment is today the one that invites more foreign investment.[56] Different decision-making arrangements, however, have different costs and benefits. For example, coordinating decision-making and negotiating functions can result in accommodating the wider policy perspective of the government while "diffusing" decision-making may allow a specific agency to accumulate expertise in a particular industry.[57]

Central to the idea of improving bargaining strength through institutional arrangements is that the state is not monolithic. Most authors will agree that TNCs are successful at maintaining a focused, unified perspective vis-a-vis the state. Corporations like IBM that are very centralized and coordinated in their management and operations will be particularly likely to present a unified front during the bargaining. The preferences of the state, however, are likely to be divided and shift over the course of the negotiation as events occur and decisions are made.[58] This can be a disadvantage for a host country government in negotiations with a more focused TNC.

The Mexican government has tried to coordinate their
negotiation structure by establishing the Foreign Investment Commission comprised of the seven ministries in the government. The benefit of such an interagency board is that interministerial conflict is reduced since all ministers consider the impacts of the investment from the wider policy perspective. The larger policy issues, the impact on the investment climate, and the impact on other investors are considered.

However, while decision-making is coordinated, negotiation and implementation of foreign investment decisions are separate activities that occur in the Ministry of Industry and Commerce. The industry groups in the Ministry of Industry and Commerce can muster technical expertise for specific industries, contribute to the government’s organizational learning, and prevent bribery and "deal-making" that can occur when one agency has complete control over the decision-making.[59]

However, a price is paid for separating the decision-makers from the implementors because the investor’s negotiating costs may be increased. Foreign investors may fear a lack of efficient follow-through of investment decisions. Separating decision-making from negotiating may result in competing interests within the government. The larger policy issues may, in fact, undermine the interests of other agencies and their constituencies.

These four sources of bargaining power only represent the potential power available to the state in negotiating
with the TNC. Actually achieving greater bargaining power and—remedying the lopsided negotiation—depends on the skillful manipulation of these and other factors.
Notes to Part I: SOURCES OF BARGAINING POWER


[10] John T. Dunlop, (1984), Chapter 1, "The Negotiations Alternative in Dispute Resolution" is a nice overview of the influence of the market and of government regulation as "methods" for dispute resolution which has very similar overtones for state-TNC negotiations.


[19] A "bit", or a binary digit, is the basic building block for the operation of the computer. 8 bits make up a "byte" which can be translated as one typed (ASCII) character. A "8-bit" machine can process 1 byte (one "character") at a time while a "16-bit" machine can process 2 bytes at time and so forth. Thus, the more blocks of bits that can be processed at once, the more powerful the computer system.


[22] Kozimierz Z. Poznanski, (review article, October 1984), estimates that while 10,000 computer units were installed in Mexico, 5100 computer units were smuggled into the country in 1981. Wall Street Journal (March 22, 1985) estimate at fifty percent of installed units were smuggled into Mexico, page 25.


[32] Roger Fisher, (1985); United Nations Economic and Social Council (February 8, 1985), page 8, 16-17, 21, (exchange of information) 28; Thomas W. Walde, (January 1981); David N. Smith (after 1975?) on information sharing.


[36] Charles J. Lipton, (1980), page 15-16. Lipton suggests that if one party uses this gambit, the best solution is to counteract with the same. See also Dennis J. Encarnation and Sushil Vachani, (1985), page 158.


[41] Business Week, (March 12, 1984), page 42.


[44] Ibid, page 75-76.
Gereffi cites three reasons why Mexico did not use the period of oligopolistic reaction (its point of greatest strength) to get a better bargain from the transnational corporations: corruption limited Mexico's strength, Mexico had not targeted the industry as strategic, and the steroid hormone industry was export-oriented. These reasons are linked to the influence of the relationship as I have noted earlier in the text, i.e., see note [30]. See also Douglas C. Bennett and Kenneth E. Sharpe in their article "Agenda-setting and Bargaining Power: The Mexican State versus Transnational Automobile Corporations," (1979), page 77.


[47] Ibid.


[50] See note [45].

[51] Douglas C. Bennett and Kenneth E. Sharpe, (1985) p. 224-225 show how the oligopolistic competition is transplanted among TNC auto industrialists in Mexico, how the competition manifests itself and the government's increased ability to use it to its advantage.

[52] See Introduction note [1].


[54] Ibid, page 49.


[56] Ibid, page 73.

[57] Ibid, chart pages 75-76.


PART II. MEXICO AND IBM

"...the heady atmosphere of negotiations for high stakes in a heated political environment..."  
--Louis Wells. (1977)

A. INTRODUCTION

On January 19, 1985, the Mexican Foreign Investment Commission (FIC) rejected IBM's proposal to manufacture microcomputers in Mexico. The proposal promised state-of-the-art product and manufacturing technology, reliance on local suppliers and, most importantly, foreign exchange earnings of over $500 million per year. IBM has had a strong corporate policy of operating only wholly-owned subsidiaries. Because IBM insisted on 100% ownership of its Mexico operations--the antithesis of Mexico's legal requirement that all foreign enterprises have majority Mexican ownership--its proposal was rejected. Exemption from the "Mexicanization" rule required special permission which the FIC was not prepared to offer. The issue of ownership became the focus of substantial public controversy following Mexico's decision to reject IBM's initial proposal.

Mexico's decision to reject IBM's offer followed a period of controversy within the Ministry of Industry and Commerce between two lower tiers of officials. The office of the Undersecretary of Foreign Investment liked IBM's proposal while the office of the Undersecretary of Industrial Development opposed it. Dr. Jose Warman,
director of the government's electronic industry overseer group within the office of Industrial Development, was responsible for the development of Mexico's computer industry program from its inception in 1981. He felt IBM's entry into the Mexican market would undermine the development and growth of the microcomputer industry in Mexico. Journalists picked up the story from disgruntled officials in Warman's office.[1] Much of the leaked information focused on the potential loss of Mexican sovereignty and the unfair monopoly advantage that IBM would have over indigenous companies if it were allowed to come into the market as a wholly-owned subsidiary.

The controversy mushroomed beyond the ranks of the federal government. As a result of the media attention, a private sector lobby called AMFABI (Asociacion Mexicana de Fabricantes de Bienes Informaticos) organized to oppose IBM's proposal. Made up of small, independent manufacturers and joint-venture firms led by Apple de Mexico and Microcomputadoras-HP (the Hewlett-Packard affiliate), AMFABI argued that IBM should have to follow the same rules as the rest of the microcomputer industry. Alligning itself with nationalistic concerns, AMFABI argued that IBM's entry under a special arrangement would affect the ability of other manufacturers to grow.[2] One Hewlett-Packard spokesman said:

"The investment desire in this industry is clear, and Mexico has gotten very respected companies to participate here as minority partners. (IBM) should follow the same rules as the rest of us."[3]
Even the Mexican Congress got involved in the IBM debate. The united Communist and Socialist parties spoke out against the IBM proposal.[4] To the dismay of those inside the government who had engaged the Communist and Socialist opposition, the statements of the Communist and Socialist parties resulted in unifying the more powerful government party, the PRI (Partido Revolucionario Institucional), in favor of the proposal.[5] Congressional involvement is important as a symbolic event in domestic politics and heightened public awareness of the controversy; in the end, though, the Congress carried little weight in the rest of the IBM negotiation. Labor, "a pillar of the PRI," was a very minor issue in the negotiations.[6]

IBM was a known entity in Mexico. Their existing wholly-owned subsidiary manufactured office equipment (the Selectric III typewriter) and minicomputers (System/36) in Mexico for the local market and for export to Latin American and Asian markets. Their $6.6 million proposal to produce IBM-PCs, PC-juniors, and PC-XTs and ATs involved the expansion of their facility near Guadalajara. Thus, their proposal represented, primarily, more export earnings for the country rather than substantial new capital investment.

IBM had been in Mexico for fifty-five years and took advantage of its commendable corporate record to fight for its proposal. Advertisements and public statements boasted IBM's contributions to industrial development in Mexico, their support of local suppliers of parts and components,
and IBM's commitment to export-earnings through production of quality products that can compete in world markets. Their exports, IBM claimed, went to thirty countries in Latin American, the Far East, and quality-conscious Japan. Between 1982 and 1984, the company had generated export earnings for Mexico of $50 million and purchased local parts and components worth $2.5 million.[7] On the other hand, $2.5 million was not necessarily something to boast about. Those opposed to the IBM proposal argued that the company had a poor record of using local suppliers.

IBM tried to build a coalition with local suppliers and distributors to press for a favorable FIC decision. Though these groups knew they would benefit if IBM got what it wanted, they were not willing to assume an active role on the company's behalf.[8] It is likely that they saw the possibility of gaining even more favorable terms if they remained silent and IBM was forced to accede to the government's demands.

At the January meeting of the Foreign Investment Commission, the office of Industrial Development presented a report demonstrating that a favorable response to IBM's proposal would undermine the success of the domestic computer industry. The FIC, under pressure from the government officials who strongly opposed the project, rejected IBM's proposal. This moved the negotiations into a second phase.
B. ANALYSIS OF THE CASE

The Buyer and the Seller

The Mexican government. Mexico’s approach to negotiating with foreign investors is designed to take account of the competing interests of the separate branches of government. The goal is to improve Mexico’s bargaining position by coordinating interests across the various ministries and to ensure that conflicts within the government team would not work to the advantage of the foreign investor.

The President of the Republic dominates government decision-making in Mexico. Though greater pluralism and delegation of authority has been encouraged recently, when the President chooses to intervene, he becomes the chief decision-maker (See Figure 2). In the case of the negotiation with IBM, the President did not intervene until after the FIC’s initial rejection of IBM’s proposal. In the end, the President made the final decision.

Seven ministries are represented on the National Foreign Investment Commission (NFIC): Interior, Foreign Affairs, Finance and Public Credit, National Resources, Industry and Commerce, Labor and Social Welfare, and Programming and Budget. The NFIC is required to set conditions of investment wherever an action deviates from the rules of the 1973 Foreign Investment Law (See Exhibit I). The Law states that a Mexican partner must hold at least 51% of the controlling interest for enterprises in specified industries in Mexico. The state maintains that
Figure 2. Organization Chart for IBM Negotiations.

President de la Madrid

National Foreign Investment Commission

Interior Finance

Interior Public Credit

National Resources Social Welfare

Foreign Affairs Industry & Commerce Programming & Budget

Minister of Industry & Commerce

Undersecretary Undersecretary Undersecretary
of Foreign of Foreign of Industrial
Trade Investment Development

Director of Director of Director of
Foreign Foreign Computer
Investment Industry

(Mario Espinoza (Jose Warman) de los Reyes)

Note that IBM's proposal is first presented to the Foreign Investment branch of the Ministry of Industry and Commerce. Negotiation and implementation occur within this Ministry. Final decision on foreign investment proposals is made by the Foreign Investment Commission.

forcing foreign investors to share equity allows it to reap more of the economic benefits from economic growth. The state wants Mexican companies to retain a significant proportion of corporate earnings and acquire managerial control.[9] IBM requested FIC exemption from the 100% ownership stipulation.

While the FIC is the coordinating and decision-making body, actual negotiations are handled by the Ministry of Industry and Commerce. The ministry is organized into three branches. They are the Undersecretaries of Foreign Trade, Foreign Investment, and Industrial Promotion. Each agency has developed separate expertise and negotiating skill with respect to its particular responsibilities. From the foreign investor's perspective, however, the three-part structure, as well as the separation between the Ministry and the FIC is problematic. For example, when the IBM negotiators asked for additional import permits as part of their overall investment agreement, the official in the office of Foreign Investment replied that though he had no objection to allowing IBM more permits, it was not his responsibility to make such a decision--it was the responsibility of the Undersecretary of Trade.[10]

The Mexican private sector. In 1985, the chief manufacturers of single-user microcomputers were Apple de Mexico, Printaform and Denki (both national firms), Micros-HP (Hewlett-Packard), Croxico, (Cromemco), Micron and Mexel (national firms). Apple de Mexico alone produced and sold
8,550 single-user units. The remaining 15,285 units sold in 1985 (a total of 23,835 valued at $59.3 million) were shared by the six other producers. The Mexican manufacturers, led by Apple de Mexico and Micros-HP (Hewlett-Packard), were not prepared to sit on the sidelines during the negotiations. Yet, national entrepreneurs are traditionally left out of industry negotiations in Mexico. They were not consulted during the negotiations; the Mexican government took responsibility for articulating their concerns.

Other segments of the Mexican private sector affected by the negotiations were local suppliers (producers) of parts and components and local distributors of computers. Supplier firms have an expressed interest in upgrading their operations and increasing their business to local manufacturers of computers and saw themselves benefiting from the IBM investment. At present, no quality, high technology products such as semiconductors or circuit boards are produced domestically, although these producers have a potential advantage in the production of "passive" components such as cables which are heavy parts for the firms to ship from abroad. Other components include plastic, fiberglass, and aluminum pieces and cabinets for the computers.

The approximately 400 local distributors of computers are very important to the sale and marketing of computers in Mexico. Distributors work with several product lines and need to train and support computer purchasers in a much more
comprehensive way than has been necessary in the United States.[13] IBM is restricted from owning its own distributorship, but has a vested interest in providing financial and technical assistance to those distributors that sell and support their products for the home market.[14]

**International Business Machines.** In 1985, IBM was the world’s seventh largest industrial company with total receipts from sales of over fifty billion dollars. Of the top ten companies, only IBM and General Electric (at tenth) are not automobile or oil companies.[15] IBM holds 70 percent of the world’s mainframe computer market, approximately 40 percent of the market for minicomputers, and, since 1983 when the IBM-PC was introduced, IBM has aggressively captured up to 60 percent of the personal computer market.[16] In the view of some industry observers, it is less IBM’s technological superiority and more its efficient manufacturing, management, and marketing strategies (IBM can rely on name-recognition better than other firms) that give IBM its competitive edge.[17] IBM’s products set the standard for the world’s business computer industry; other firms survive by manufacturing IBM compatible machines and software or by carving out a special market niche that IBM has not penetrated.

IBM has developed a reputation for being a good corporate citizen as well as a clever political operator. IBM employs almost entirely local professionals in its
foreign subsidiaries. In addition, IBM keeps staff employed as government liaisons to stay abreast of emerging issues that may affect the company. During the Mexican negotiations, these individuals kept in constant contact with top level officials. Politically and financially, IBM sees it as in its interest to identify a country's industrial development needs and target its projects to accommodate those needs. IBM also publicizes its intentions. Months before IBM presented its first proposal, Rodrigo Guerra Botello, the president of IBM Mexico, advertised IBM's interest in Mexico's well-being: "the most important thing is to produce exports and foreign exchange for Mexico."[18]

**Competing Interests**

IBM's interests. IBM offered its first proposal in March 1984. At a meeting with Mexican officials, IBM presented it--the "Office of the Future"--a total business system with typewriters, wordprocessors, tele-communications devices, and, of course, microcomputers.[19] In the same month, IBM announced in the United States the company's plans to triple its 1983 output of microcomputers and to spend $500 million to expand production capacity and conduct further R&D on small systems. Plans included doubling a one-machine-per-fifteen-second pace of production.[20]

IBM proposed new investment in Mexico totalling only $6.6 million dollars; IBM would produce microcomputers by
expanding its existing facility. Of the total $500 million dollars the company proposed to spend worldwide on small systems, the $6.6 million it proposed to spend in Mexico was only one percent of the total. An apparent "drop in the bucket"; yet, IBM's interest in Mexico was very much linked to its global strategy. At the time, IBM had four other microcomputer manufacturing plants in other parts of the world: Boca Raton, Florida; Wangaratta, Australia; Austin, Texas and Greenock, Scotland.[21] A new facility on the Pacific Ocean would be of great strategic importance for IBM given its interest in increasing exports to Latin America, the Far East and back to North America.

IBM saw several advantages to expanding their Mexican operation as the next manufacturing site. Brazil had a market three of four times that of Mexico's, but Brazil was closed to IBM. The Brazilian Informatics Law permits only national computer companies to produce and sell microcomputers, minicomputers, and peripheral equipment in Brazil. Argentina, with its strong labor unions and other non-Latin American countries like South Korea seemed politically risky. Unlike these countries, Mexico has a history of very little labor conflict and remarkable political stability.

Mexico also offered other advantages to IBM. Mexico was close to corporate headquarters. IBM's New York corporate headquarters is only a four hour plane ride from Mexico City. An operation in Mexico would also be relatively easy and inexpensive since it involved the
expansion of an existing facility as opposed to construction of an entirely new plant. IBM had the testing rooms, equipment, and a core of management personnel already in place.[22] In addition, the United States solare was very strong at the time when the Mexican peso was devaluating.

Though the Mexican market was small compared with Brazil's market, it was growing. Infotext's 1985 market study for the microcomputer industry in Mexico projected units sales increasing at a compound average growth rate of 44 percent per year from 1985 to 1990 rising to more than 225,000 units in 1990, a market value of over $285 million.[23] Demand for IBM-PCs was particularly strong—especially among government and large business users who represent the fastest growing segments of the market.

In terms of corporate strategy, a precedent set in one country matters for IBM's global operations. Thus, IBM pushed hard on its policy of establishing a manufacturing plant on a wholly-owned basis. "Because a single government's actions can affect other parts of a company, few multinational managements can safely ignore the implications of business-government negotiations in any one country."[24]

IBM's commitment to maintaining consistent policies throughout the world was demonstrated by its withdrawal from India in 1978 because of government pressure to share equity in the operations.[25] Consistency in policy is of greater interest to IBM than participation in any particular market.
Linked to IBM's interest in maintaining consistent corporate policy is their interest in maintaining a "good corporate citizen" image. In June 1984, the European Economic Community announced it intended to charge IBM with abusing its dominant market position in Europe, thus stifling competition, but IBM negotiated a settlement soon thereafter. Negotiations centered on the issue of whether IBM would be forced to disclose proprietary information regarding its technology in order to remain in the European community. IBM's fight to clear its name was captured in one IBM observer's statement, "Whatever IBM is agreeing to, you can be sure that there are strategies, tactics and business practices that will work against the EEC." [26] Ultimately, IBM agreed to provide competitors with timely information about their newest technologies so that their machines could be made compatible with IBM machines. This agreement was reported to have significant implications for IBM's technology and marketing strategies.[27] In Europe, IBM successfully fought the antitrust charges: by July 1985, the EEC announced that IBM was satisfactorily carrying out the terms of its agreement in Europe.

Mexico's computer policy. Internal conflict over IBM's proposal emerged between the offices of the Undersecretary of Foreign Investment and the Undersecretary of Industrial Development. Officials in the latter branch, particularly Dr. Warman in the electronics industry group, strongly opposed the IBM proposal on the grounds that the fledgling
domestic industry needed to be protected. The conflicting interests are symbolic of the broader Mexican economic policy controversy between import substitution industrialization and export-promotion strategies.

Between 1977 and 1981, demand for computers had grown 35 percent. Mexico imported all of its small computers with 95 percent coming from the United States. Industry officials believed that the growth in computer imports was exacerbating Mexico's trade deficit which rose 17 percent to $4.8 billion in 1981.[28] At the height of this computer boom, the Mexican officials in Industrial Development announced their new computer policy. The rules were straight-forward and based on the 1973 Foreign Investment Law requiring majority Mexican ownership of manufacturing enterprises. Firms would be required to assemble minicomputers and microcomputers locally. Microcomputer operations would be required to "Mexicanize." Companies were expected to match imports with exports within four years of operation and firms had to sharply increase the value added by Mexican production. Mexico imposed stringent quotas on further imports to back these objectives (See Exhibit II).[29]

By the beginning of 1982, approximately forty-five U.S. computer companies had rushed to apply to produce computers and peripheral equipment locally. Among the firms that established minicomputer assembly plants in Mexico were IBM, Burroughs, NCR, Wang Labs, Hewlett-Packard, Mohawk Data Sciences, Basic Four Information Systems and Prime
Enthusiastic demand projections for computers in Mexico led to the rush to claim market shares. Even with the 1982 economic crisis when sales of computers dropped forty percent, investors were optimistic. The market was expected to grow fifteen percent annually in 1982 and 1983 and twenty-five percent annually after 1985. Between 1983 and 1985, the number of units sold increased more than 375 percent.[31] Dr. Warman proudly emphasized the fact that the industry remained largely Mexican owned.[32]

After equity requirements, local content and a firm's trade balance are the two key requirements that the overseers of the electronics industry closely monitor. Local content requirements are the country's way of ensuring the development of the domestic industry as well as saving foreign exchange. The computer policy requires that for each computer manufactured in Mexico, 35 percent of its parts and components be domestically manufactured, increased to 45 percent over four years. Since parts and components produced in Mexico are generally uncompetitive on the basis of price and quality in comparison to imported parts and components, firms would prefer to import their entire stock of parts and components.

The government monitors the computer industry by issuing import permits for those parts and components unavailable in Mexico—the expensive electronic components. A firm's survival depends upon its ability to obtain import
permits for the components necessary to build computers.[33] A firm may be able to negotiate whether "content" will be measured in terms of quantity or value. A firm may also obtain more import permits for exporting goods at least equal to the value of those it imports, thus rewarded for meeting trade balance requirements. Most firms have been able to meet the local content requirements by limiting their imports to the most expensive electronic components unavailable in Mexico.

Though the government pressures microcomputer manufacturers to keep Mexican list prices aligned with U. S. prices, low volumes of production and domestic content requirements limit a firm's ability to compete in terms of price and quality on the international market. In Mexico, price differentials (between Mexico and the United States) are high—between 25 and 300 percent—according to one Commerce official.[34]

Smuggling of cheaper microcomputers from across the border remains a serious problem.[35] Since Mexico shares a 2,000 mile border with the United States where almost all of Mexico's computers come from, it is not difficult to imagine that smuggling occurs. One observer suggested that contraband units could amount to as much as 50 percent of the total units installed. In addition, many units are assembled in garage-style operations by individuals who wait patiently to obtain import permits. They buy microcomputers in the United States, ship them to the border where they are
disassembled, cross the border, and re-assemble them to sell as locally manufactured computers.[36] "Screwdriver technology," as one observer notes, continues to plague the quality of units produced in Mexico and, therefore, the industry itself.[37]

Meeting trade balance requirements is virtually impossible. "Passive" components that can be produced even somewhat less-expensively in Mexico are exported to try and balance imports with exports. Only a firm such as Hewlett-Packard that operates its joint-venture in cooperation with its wholly-owned minicomputer subsidiary appears to be able to approach the export targets determined by the level of imports through transfer pricing arrangements.[38] The export targets effectively encourage firms to inflate the prices of their exports which will make them less competitive still.

The problems and ambiguities within the Mexican microcomputer industry are a result of expensive local content requirements and the need for local producers to import the most expensive components--printed circuit boards and integrated circuits--from abroad. Officials in the Industrial Development office feel strongly that these problems can be solved in the long run by building the industry from the bottom up--by developing a semiconductor industry in Mexico. Unfortunately, in the last few years, the semiconductor industry in the United States has declined sharply. Japanese firms have been tremendously successful in producing high volumes of very powerful and cheap
circuits. Compounded by an overall slowdown in the computer industry, the prospect was poor for developing a Mexican semiconductor industry that could effectively compete in price and quality with "internationally sourced" components.[39]

According to the officials in Industrial Development, these problems indicated that the Mexican computer industry needed continued government protection. Allowing IBM entry into the market without enforcing the joint-venture requirement would give the company a competitive advantage that could force all smaller producers out of business. IBM’s entry would undermine the potential for success of the Mexican-owned industry and raise questions about the legitimacy of the computer policy itself.

**Mexico’s foreign investment policy.** The year after the computer policy decree was announced in 1981, President de la Madrid began his term of office. The new sexenio (six-year Presidential term of office) coincided with another massive devaluation of the currency. Private banks and their holdings had been nationalized just before the change in office. With a foreign debt of over $50 billion and in desperate need of foreign exchange, Mexico sought to liberalize its foreign investment rules. A Mexican economist, quoted in the Wall Street Journal in June of 1982, explained the issue this way:

"Allowing more foreign investment is the only way Mexico can get hold of large amounts of money without getting on its knees and begging to the banks."
Since 1982, the Mexican government has publicly reiterated its interest in attracting foreign investment. Yet, after years of Mexicanization and very restrictive and protectionist trade policies, few observers were convinced of Mexico’s intentions to liberalize.

The computer industry policy was a case in point. Mexico’s intention to encourage foreign investment appeared contradictory to its Mexicanization policy. In fact, in 1984, the government did offer Apple Computer, Inc. and Hewlett-Packard exemption from the Mexicanization equity requirements and offered them a chance to operate in Mexico with 100% ownership. To the surprise of some analysts, Apple and HP refused. Investing as a minority partner is one form of risk-minimization strategy that TNCs adopt. In fact, at the time, Mexico was only beginning to show signs of economic recovery. Said one Apple executive: "We prefer 49% of something viable right out of the chute rather than 100% of something more risky."[40] The end result was a computer policy implemented as intended by Industry Development officials with equity, local content, and trade balance requirements intact. The computer policy was in conflict with the new foreign investment policy.

By 1984, there was mounting pressure for Mexico to prove its commitment to liberalize trade and foreign investment. In February 1984, to encourage more foreign investment, Mexico announced that while the 1973 Foreign Investment Law would remain in effect, the ownership rules
would be relaxed for "priority" industries, favoring firms that produced for export. One of these industries was high technology electronics. [41] It was this announcement that spurred IBM to formulate its March 1984 investment proposal.

After several months of redrafting and minor changes, IBM formally announced its Mexican investment proposal at its Armonk, New York corporate headquarters on October 25, 1984. There was great speculation about the details of the proposal and the debate within the Ministry began in earnest. Unofficially, the Mexican government was prepared to accept the proposal if IBM was willing to increase its local content from 35 percent to 50 percent. A preliminary authorization on the IBM proposal was scheduled for the November 19 meeting of the Foreign Investment Commission. On that Monday morning, however, the Pemex natural gas tanks exploded in the Tlalnepantla suburb north of Mexico City. The deaths of over two hundred and fifty people took precedence over the IBM decision for the frenzied Ministers who arrived at the FIC meeting.[42]

A decision on IBM's proposal was delayed until January. During the period of delay, the controversy resumed. The ensuing debate moved back and forth between the issue of ownership as required by the computer policy and ownership allowed under the new foreign investment policy. After the January rejection other issues arose as well.
C. BARGAINING AND NEGOTIATION

The Aftermath of the Rejection

Despite the rejection, both sides desired to keep negotiating. It had been almost a year since IBM first made its "Office of the Future" presentation and proffered its initial proposal. A few preliminary redraftings had been passed back and forth before IBM's October announcement. After the announcement, the company pursued a highly visible promotional campaign. Yet, when the proposal was rejected in January, both sides realized that all possible avenues had not been explored.

Not only were both sides willing to keep negotiating, after the official rejection, but both appeared committed to reaching an agreement. Neither was happy with the alternative of "no deal," nor were they willing to write off IBM's existing operations in Mexico. The official reason for the rejection was that what IBM offered to produce was already available in Mexico. The Foreign Investment Commission stated "there are companies manufacturing these computers and using mainly national capital."[43] However, no other small computer manufacturer in Mexico could offer export earnings of over $500 million. IBM's technology, volume of production, and ability to produce and market goods competitively on the world market were beyond what the government could force any local producer to achieve given their past performance.

IBM, on the other hand, saw leaving Mexico to find another site for their PC manufacturing facility as a worse
fate than being subjected to Mexican delays and restrictions. IBM had already invested considerable resources in the negotiations in Mexico and felt that it would lose its claim to a potentially large and growing market. Though IBM may have considered abandoning its Mexican expansion, in the end, it saw Mexico as its best option in Latin America.

During the spring of 1985, John Akers, IBM’s president, visited President Alfonsin of Argentina and suspicion grew that IBM was reconsidering Mexico in favor of Argentina as the site for a new microcomputer manufacturing plant. However, an Argentinian site would put IBM in the position of possibly losing its 45 percent share of the mainframe computer market in Mexico. For Mexico’s part, if IBM established a plant in Argentina, Mexico would, ironically, have had to buy IBM microcomputers from Argentina due to the Mexican-Argentine trade pact, effectively undermining the original goal of Mexico’s computer program to restrict imports of microcomputers.[44] One Commerce official said IBM and Mexico had already traveled a long, hard road and neither was willing to give up.[45]

Deescalating the Conflict

In order to proceed, the government needed to address three concerns. First, both sides needed to pull the negotiations out of the public eye. Second, the overblown issue of ownership needed to be deflated. Third, the parties
needed to find ways of reconciling their competing interests.

Low visibility. The parties were successful in lowering visibility in the second phase of the negotiation. IBM made a decision to keep quiet about the negotiations in progress. This met with the approval of the Mexican officials involved. The highly public exposure had created an atmosphere difficult to work in for both parties.

IBM's intention had been to publicize in order to buy the pressure of public opinion to bear on the bureaucracy. IBM's publicity appeared to be more defensive, however, than opportunistic. As a result, the press--primarily editors and correspondents--had taken a critical stance toward IBM. This is not uncommon in developing countries where the press often reflects nationalistic concerns.[46]

On the government's side, the escalation of the public debate had gotten beyond their control. Expectations on both sides of the issue were raised in the media that could have ended in disappointment and possible embarrassment for various Mexican officials.[47] The rejection released the tension within the government and allowed both sides to proceed again with fewer political liabilities.

The substance of the agreement (See Figure 3). IBM initially limited the agenda for the negotiations to the issue of ownership. IBM's first proposal for a wholly-owned subsidiary was a document of only a few pages accompanied by
Figure 3. THE FIRST AND SECOND PROPOSALS

<table>
<thead>
<tr>
<th>JANUARY PROPOSAL</th>
<th>JULY PROPOSAL</th>
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<tbody>
<tr>
<td><strong>I. Similar conditions held for both proposals:</strong></td>
<td><strong>II. Key differences</strong></td>
</tr>
<tr>
<td>* 100% wholly-owned subsidiary.</td>
<td>*Exports 88-89% production</td>
</tr>
<tr>
<td>* Production of 603,000 microcomputers over five years.</td>
<td>*Local Content 35% by end of the first year. 50% after fourth year.</td>
</tr>
<tr>
<td>* IBM pledges to limit the time gap between the introduction of a new line of Personal Computers (PC) in the United States and its arrival in Mexico to six months.</td>
<td>*Level of Investment $6.6 million expansion of existing facility.</td>
</tr>
<tr>
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<td>-- over 5 years with $35 million into local R&amp;D</td>
</tr>
<tr>
<td></td>
<td>-- provide $11.5 million in financial &amp; technical assistance for new semiconductor plant</td>
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<td></td>
<td>-- $20 million to develop local suppliers.</td>
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<td>-- $13 million for dealers &amp; distributor networks for those PCs sold to the public.</td>
</tr>
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<td>-- other funds for university support and software development center.</td>
</tr>
<tr>
<td><strong>Employment</strong></td>
<td><strong>Employment</strong></td>
</tr>
<tr>
<td>80 direct jobs</td>
<td>240 direct jobs</td>
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<tr>
<td>800 indirect jobs</td>
<td>1460 indirect jobs</td>
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Source: Business Latin America, August 21, 1985; Interviews.
a short market study justifying the level of output proposed. The proposal included vague descriptions of IBM's importance for the industry and IBM’s contribution to Mexican economic development. IBM did not analyze the cost differences between expanding its existing facility versus starting from scratch. The Mexican officials wanted to know much more about how IBM intended to implement its proposals regarding level of output, exports, local content, trade balance, price differentials, technology, and marketing. In many respects, the first proposal was merely a trial balloon.

Other issues needed to be added to the agenda. If IBM were allowed 100 percent ownership, what could it (should it) offer in return? IBM presented its second proposal in March, one year after the initial proposal. The Mexican officials countered with a proposal of their own three weeks later. Essentially the Mexican government was willing to authorize IBM’s entry if the company agreed to further contingencies such as higher export levels and local content requirements.

Other issues assumed greatered importance: level of exports, local content requirements, development of the industry in Mexico.[48]

The level of exports was key. Forcing IBM to export a large percentage of its output served a dual purpose—satisfying both foreign investment interests and computer policy interests. In the rejected proposal, IBM proposed to
export 88 to 89 percent of its output. The Mexican officials pushed for a greater percentage. In the end, IBM agreed to export 92 percent of its production, leaving approximately ten or eleven thousand computers a year to sell on the domestic market. While still a substantial market share, this limited IBM's participation in the local market.

Local content was a second priority. IBM's first proposal matched the computer industry program requirements of 35 percent local content by the end of the first year and up to 50 percent by the end of the fourth year. In the fall, the Mexican officials suggested to IBM that its proposal might be approved if it increased the local content of its products to 50 percent the first year. In the final agreement, IBM was required to achieve 51 percent domestic content in each computer by the end of the first year and 82 percent by the end of the second year.

Forcing IBM to produce under high domestic content requirements presumably led to bargaining over the number of import permits the firm would be allowed. Since IBM intended to export most of its production, the goods needed to be competitively priced—a somewhat impossible task given that the most expensive electronic components are not available in Mexico. An alternative, of course, was to build a new semiconductor production facility. Details are sketchy, but despite the disagreement within the government regarding the viability of a Mexican semiconductor industry, IBM promised to pay for the construction of a semiconductor
technology facility which the government will run. The semiconductors are intended to be available for industry-wide use.[49]

Related to local content was IBM's investment in creating a network of local suppliers and distributorships. Following the Ford Motor Company model for the development of local suppliers of auto parts in Mexico, IBM was expected to invest in the development of local computer parts suppliers.[50] For instance, one Mexican supplier called Mitel made an arrangement with IBM to obtain machinery and technology that it lacked to produce cables for the industry.[51] Ultimately, with a fifty-one percent local content requirement, it is in IBM’s interest to invest in producing cheaper, quality parts and components locally.

IBM is restricted from owning distributorships in Mexico. Thus, it must invest in distributorships without equity participation. IBM will distribute its products through established distributors that not restricted to selling IBM machines exclusively. Improving domestic marketing and sales operations in Mexico, is, again, in IBM’s interest. In addition, IBM promised to promote international distribution of local suppliers' products. IBM agreed to include Mitel’s cables in its product catalog distributed worldwide.[52]

Smaller concessions ranging from a redefinition of the number of jobs IBM expected to create to delivering one hundred IBM-PCs to the Ministry of Programming and Budget to
help modernize the operations. However, "concession-adding" during this stage antagonized IBM’s representatives. While the Mexican officials pressed for more on each issue, the IBM representatives claimed they could not afford to add to the proposal. In addition, it seemed every agency in the government began sending in requests for items to be included in the agreement.

Yet, IBM did not want to jeopardize the agreement. While the bargaining continued in the Ministry of Industry and Commerce, the negotiations moved up to a higher level of decision-making, namely, the office of the President.

**Decision-making.** By centralizing the negotiations and decision-making at the Presidential level, circumventing the Ministry of Commerce and the FIC, Mexico was able to speak with a single voice. Moreover, the broadest possible policy perspective was maintained.

In the spring of 1985, despite the previous year’s hopeful recovery, the Mexican economy was in a fragile position. Mexico was in the process of renegotiating its debt with a number of foreign banks. Oil prices were falling, inflation was on the rise, exchange rates were uncertain, and the country was not meeting the IMF’s austerity targets. On April 1, Mexico reached agreement with its commercial creditors to renew the terms of its $48.7 billion debt. But, Mexico continued to be under pressure from the IMF.

Presumably unbeknownst to IBM, United States Secretary
of State George Schultz played a role during this period. During a visit to Mexico, Schultz commented to President de la Madrid that one way for Mexico to demonstrate to the IMF its commitment to generating foreign exchange would be to approve the IBM agreement.[53] Host countries perceive very close liaisons between the United States government and private foreign investors. Though the reality of such liaisons is debated, the TNC draws an important source of bargaining strength from such perceptions.[54] Schultz' passing comment to President de la Madrid certainly reinforced such perceptions and probably influenced the final decision on the agreement.

As noted above, Mexican officials suspected that IBM corporate headquarters was considering the possibility of switching to other Latin American markets. Such suspicions contributed to the perception that Mexico was, indeed, competing with other countries around the world for limited foreign investment opportunities.

Meanwhile, IBM's presence did not seem to stifle the interest of other firms considering the Mexican market. In May 1985, two companies--Tandy and Sperry Corp.--signed joint ventures in Mexico to produce personal computers for the Mexican market. Both companies decided to comply with Mexicanization rules.[55] These firms, by choosing to produce for the domestic market emphasized that Mexico's market was still considered a potentially "hot" market, and that the environment was still a competitive one for the industry.
By June, the decision was apparently made within IBM to obtain agreement in Mexico rather than to look for an alternative. Larry Ford, the director of IBM's Latin American operation, came to Mexico and met with President de la Madrid. The President was wise to wait until IBM sent one of its chief decision-makers. Several times prior to this meeting, the IBM subsidiary president, Rodrigo Guerra Botello, had tried to meet with the President, but was not received.[56] De la Madrid knew that regardless of what was said or agreed upon, Guerra would need approval from the corporate headquarters in New York.

The meeting with Larry Ford presumably "clinched" the agreement. De la Madrid strongly advised that IBM agree to the concessions proposed by the government in order to be exempted from the Mexicanization rule.[57] The President also strongly advised the Mexican officials and the FIC to reconsider IBM's proposal.

The Agreement

At the July meeting of the Foreign Investment Commission, the Ministers reversed their earlier decision. A low profile was maintained even to the end--the press release included the new IBM decisions among six decisions made by the FIC. IBM headquarters in Armonk, New York was not aware of the decision at the time it was made.[58]

Under the so-called "Compromise Program", 92 percent of IBM's output must be exported and and 51 percent local content must be achieved by the end of the first year. IBM's total
capital investment was increased from $6.6 million to $91 million. Part of this $91 million will cover the cost of the semiconductor venture. A local supplier network will be created, distributors will be trained, and IBM will provide educational and technical assistance through the university in Mexico.

IBM is now free to begin expanding, but details must still be worked out. Mexican officials feel that they got the main elements of the agreement that they wanted—a transnational producer with worldwide distribution channels to export Mexican products on the world market and the development of local suppliers and distributors while limiting IBM’s presence on the Mexican market to protect the domestic industry. In addition, Mexico demonstrated its seriousness about liberalizing its foreign investment rules.

From IBM’s standpoint, the agreement probably met the firm’s expectations though at a substantial cost in terms of time and dollars. The company was able to maintain 100 percent ownership of the subsidiary, implement a global manufacturing strategy, and demonstrate their willingness to negotiate as good corporate citizens.

Though most industry observers expected Mexico to reverse its decision and allow IBM to enter the market, they were generally surprised about the considerable increase in the level of investment that IBM needed to promise. Critics argued that IBM’s promises were less meaningful than they appeared, that Mexico was only able to gain concessions from
IBM on the marginal issues.

The case of IBM in Mexico illustrates how the Mexican state was able to enhance its bargaining position vis-a-vis a potentially powerful TNC. A good working relationship was maintained, important and relevant issues were raised, competing interest were dealt with, and precedents were skillfully managed. Mexico benefited somewhat from competition, but also was strongly influenced by IBM’s leadership position in the industry and the company’s representations of hedging its interest in Mexico. Finally, by circumventing lower-tier authorities, the final decision was made using the ultimate coordinating strategy—centralized the decision-making at the President’s level.
Notes to Part II: MEXICO AND IBM


[4] Interview, Allen Krause, (Spring 1986); Jim Austin, taped interview of Mario Espinoza de los Reyes, (October 1985).

[5] Ibid.


[13] Tim Berry, (July 1985), page 6. According to this report, distributors "are the key to sales, service and support in Mexico."


The estimates of IBM’s microcomputer market share range from 45 percent to 60 percent. *Business Week*, (July 15, 1985) estimates 60 percent.


*Business Week*, (November 14, 1983), page 64; UNCTC report (August 1984) outlines IBM’s technology, marketing and sourcing strategy. IBM tries to source components locally as much as is possible.

Jim Austin, taped interview of Mario Espinoza de los Reyes, (October 1985). This is not inconsistent with general hypotheses of IBM’s product strategies in which it has been most successful as a competitor of office system/workstations. Such products accounted for approximately one fifth of its revenues in 1983. UNCTC (August 1984), page 22.


*New York Times*, (October 26, 1984), Section 4, page 1.

Interview, Allen Krause, (Spring 1986).

Tim Berry, (July 1985), page 50.

Dennis J. Encarnation and Sushil Vachani, (1985), page 158.


*New York Times*, (April 26, 1984), Section 4, page 1. A formal complaint had been filed against IBM in 1980 alleging IBM had abused its dominant position in the mainframe market.


*Business Week*, (May 17, 1982), page 45.

Mainframes required more complex technology and were excluded from these rulings; Mexico continues to import them. Recall that IBM assembled the System/36 minicomputer per Mexico’s computer policy rules—it did not need to Mexicanize that segment of its computer operations.

*Business Week*, (May 14, 1983), page 64.

Tim Berry, (July 1985), page 37 for market projections.
Ibid, Executive Summary page 3.


Jim Austin, taped interview of Mario Espinoza de los Reyes, (October 1985).

Interview, Allen Krause, (Spring 1986); Jim Austin, taped interview of Mario Espinoza de los Reyes, (October 1985). See Part I note [22].


Interview, Allen Krause, (Spring 1986).

Telephone interview, Tim Berry, May 1985.

One semiconductor industry expert has noted that the estimated cost of establishing a new semiconductor plant is over $100 million dollars. An Intel plant in Texas, still not producing at capacity after three years, has cost over $200 million, says this expert. Telephone interview, May 1985.

Business Week, (March 12, 1984), page 42.

Quarterly Economic Review, (1985, Annual Supplement), page 19; during this time, Mexico was implementing the components of its new "open door" policy. New technology agreements demonstrated its interest in promoting high technology investments. The Integrated Export Development Program was announced giving significant incentives to manufacturers of exports such as tax breaks and import rebates for exported production. Import liberalization continued. The 82 percent of purchases that required import permits would be decreased to 57 percent by the end of the year; the cumbersome system would be streamlined by switching to automatic licenses that covered a year of imports and open-ended licenses for spare parts and components up to a limited dollar amount. Business Latin America, (February 22, 1985, February 27, 1985, and May 1, 1985.)

Jim Austin, taped interview of Mario Espinoza de los Reyes, (October 1985).


Wall Street Journal, (March 22, 1985), page 25; Business Latin America, (May 15, 1986) notes that the Argentinian trade pact can be an opportunity for supplier companies.
IBM had already satisfied Mexico's technology requirements. The company had already promised to manufacture its newest products in Mexico six months after their introduction to the United States market. Since March 1984, IBM had discontinued production of the failed IBM-PCjr. But, most industry observers speculated that IBM was developing new microcomputer designs. After the agreement was announced, IBM executives confirmed they would be manufacturing the System 51 in Mexico, their newest line of small systems. New York Times, (July 24, 1985), front page.


Jim Austin, taped interview of Mario Espinoza de los Reyes, (October 1985).

Ibid.

Interview, Allen Krause, (Spring 1986).


Interview, Allen Krause, (Spring 1986).


"I don’t think there really are any bargaining chips vis-a-vis IBM. IBM just folds up and goes someplace else."
--Jagdish Bhagwati, quoted in Wall Street Journal after Mexico rejected IBM’s proposal.

The case of IBM in Mexico illustrates that a developing country can tap various sources of bargaining strength during its negotiations with a transnational firm.

The Relationship: Mexico and IBM

The interaction between Mexico and IBM exemplifies the fundamental relationship between the state and the TNC: each possesses resources that the other wants. IBM, as seller of its productive capacity, possesses capital, technology, and above all, access to export markets. Mexico’s goals are to develop its domestic computer industry and to generate exports, particularly non-oil exports. IBM’s offer had the potential to achieve both goals.

Mexico, as seller of the investment opportunity, offered a potentially giant market that is very attractive to IBM and other computer manufacturers. Mexico’s potential market is its most powerful source of bargaining strength because IBM and other firms will not risk losing a market share in a potentially lucrative market. Furthermore, IBM sees Mexico as a trade liaison with other Latin American and Pacific markets—Mexico is a foothold into the rest of Latin America. IBM needs to negotiate and operate in good faith with Mexico in order to take advantage of Mexico’s trade
relations with the rest of Latin America.

The idea of the potential market counterbalances, to some degree, the asymmetry between state and TNC since the country's "turf" is precisely what is attractive to the TNC and what the TNC would like access to. All other sources of bargaining strength for Mexico build on this fundamental resource.

Mexico was further able to enhance its bargaining position because the parties anticipated their future relationship. Mexico's rejection of IBM's first proposal demonstrated their ability to exercise their bargaining strength. While such a move might have threatened the possibility for an agreement—and there were some suspicions that it, in fact, did—Mexico felt in a strong position to continue to demand changes and concession. The Mexican officials maintained an open, communicative environment in the second stage to maintain the relationship. They also made clear representations to the company to indicate their commitment to reaching agreement.

The three variables that may have affected how influential the relationship was all worked to Mexico's advantage. First, because IBM was already established in Mexico, there was scarcely any doubt that Mexico and IBM would continue to interact. This near-certainty motivated the parties to build a good working relationship and make commitments to lead to agreement. For example, though the concession-adding process aggravated IBM representatives,
they maintained a cooperative stance. Mexico gained bargaining strength and was able to continue making demands for the agreement since IBM was not willing to jeopardize the future relationship. IBM made an attempt to maintain good relations with the Ministry of Industry and Commerce even while circumventing their authority.

Second, that IBM was producing for export may have lessened its dependence on the Mexican government rules. Yet, Mexico’s relationship with IBM as exporter was not weaker because IBM also had a minor interest for manufacturing for the domestic market and has a significant vested interest in developing the domestic parts and components industry. Large business and government demand for IBM computers will rapidly absorb the ten or eleven thousand microcomputers that IBM is allowed to produce for the domestic market. IBM may see stepped-up demand for their units as an opportunity to renegotiate their arrangement at some future date.

Third, because Mexico has targeted the computer (electronics) industries as priority industries, the importance of reaching agreements and building relationships with IBM and other firms is therefore highlighted and worked to Mexico’s advantage in these negotiations.

Knowledge and Skill: Raising Issues

This case may support either of the two competing hypotheses of how uncertainty alters the balance of bargaining power over time in a state-TNC encounter. On one
hand, the hypothesis that the state was at its weakest during the negotiations suggests that once IBM sinks its investment, and uncertainty dissipates, the state’s bargaining position will improve and the bargain will obsolesce further in favor of the state. On the other hand, the hypothesis that a manufacturing firm is at its weakest at the time of entry contributes to the scenario that Mexico was in a strong bargaining position during the riskiest and most uncertain stage of the investment, but its bargaining power will diminish over time. This hypothesis suggests that IBM will establish ties with local industrialists and its bargaining power will increase against the state.

It is too soon to tell how the balance of bargaining power will shift. Mexico was in a relatively strong position which could wax stronger or wane relative to IBM. During the negotiations, Mexico was able to set the rules for IBM’s proposal and the agreement. Mexico also demonstrated its knowledge about the other party and the project characteristics which allowed it to raise issues besides ownership as important to the bargaining agenda.

For example, each party was concerned about the precedents that could be set by the negotiation. Mexico knew of IBM’s previous exit from India and Nigeria due to those countries’ strict equity-sharing regulations. Mexico also knew of IBM’s concern to maintain a consistent corporate policy of 100 percent ownership across countries. Thus, Mexico used IBM’s notable bottom line to raise other relevant issues. Mexico had the freedom to be flexible on
its rules as well as to impose new rules. The state could demand concessions in return for exempting IBM from Mexico's ownership rule. In the end, IBM did set a precedent. It demonstrated its willingness to negotiate at a high cost to be allowed to manufacture in a country. Most industry observers were surprised by—and will remember—the level of investment that IBM ultimately conceded to Mexico.

For Mexico's part, reversing the IBM decision served to satisfy the competing interests within the government and demonstrate the power of sending signals. While ensuring that those in charge of the domestic computer industry gained the concessions they felt were necessary for protecting the existing producers, the IBM decision was a signal to the world that Mexico was serious about its intention to liberalize foreign investment per its new "open door policy." By exempting IBM from the equity requirements, Mexico proved its willingness to accommodate foreign investment.

However, the President also skillfully eliminated the possibility of political or practical liabilities in future negotiations with TNCs by announcing that the IBM proposal had been decided on its merits as a priority industry and that all investment decisions in Mexico will be decided on a case-by-case basis. In other words, while strong signals were sent, no ironclad precedents were set.

Mexico knew it would benefit from a large level of investment. IBM's initial investment was only $6.6 million. A low level of investment would have favored IBM's
bargaining position over time since a lower level of investment leaves the firm less vulnerable to demands from the host country and more flexible to exit. However, the fourteen-fold increase in the final investment from $6.6 million to $91 million was a demonstration of how Mexico was able to anticipate a potential weak bargaining position and change it into a strong one. IBM's large investment may slow down or even eliminate IBM's ability to exit easily. Thus, Mexico was able to target a characteristic of the project that would have favored IBM over the long run and impose demands that would alter the bargaining relationship.

**Competition: Mexico’s Options and Perceptions**

The role of competition among countries and among firms can be a source of bargaining strength for the opposing side because more alternatives allow a party more flexibility in the negotiations. The competitive environment for both firms and states is a potential source of bargaining power, but it is a slippery concept. It is difficult to exercise this source of bargaining strength. It requires not only determining the level of competition among firms, but also the competitive status of the state among countries.

In this case, neither party had a particularly strong alternative. Mexico could not enforce high exports from the firms already in the industry. IBM did not have other markets, other than Brazil, that looked as promising and Brazil was closed to IBM and other foreign firms.
Furthermore, Mexico seemed only vaguely aware of its true competitive position, based primarily on general feelings about its investment environment. After the initial rejection, one business expert remarked in the Wall Street Journal, "Right now, investors think a lot of other countries [that] are more competitive and don’t seem to have the drawbacks that Mexico does.”[2] IBM was able to further these perceptions by delaying with its own internal negotiations and making appearances that it was actively exploring other sites for the investment.

To Mexico’s advantage, computer firms still demonstrate competitive behavior in the industry. Mexico initially benefited from this competitive "window of opportunity" after its 1981 computer decree when so many firms rallied to enter the Mexican market. While IBM had a particular advantage over the other firms in the Mexican computer industry because it was offering to produce for export rather than solely for the domestic market, Mexico still benefited from industry-wide competition. The January rejection was an attempt to influence IBM’s perception that Mexico could rely on other firms who, unlike IBM, chose to play by its rules. That Tandy Corp. and Sperry Corp. signed their joint venture agreements just two months before the final IBM decision was made, reinforced that perception.

Bennett and Sharpe point out that Mexico did not take full advantage of the period of competitive behavior when it bargained with the automobile manufacturers. Nor did Mexico take advantage of the period of oligopolistic reaction in
the steroid hormone industry according to Gereffi.[3] The evidence is not convincing that Mexico was able to make demands of IBM on the basis of competition for this case either.

Mexico might well have taken the opportunity to bargain with Apple de Mexico, Micros H-P and the other existing firms to create a better range of alternatives and thus strengthen its bargaining position vis-a-vis IBM. But, the government found it difficult to bargain with the very firms whose interests it felt pressure to protect during the negotiation. And since Mexico has only a vague picture of how it competes with other countries, it possibly underestimated its bargaining position vis-a-vis the established firms. Mexico would do well to take stock of its competitive position for each industry and important investment project. The government may find that Mexico is to Latin American countries as IBM is to United States computer firms—a leader among the competition.

Organization: Undermining Potential Bargaining Power

The striking similarity between IBM and Mexico can be extended to their organizational styles. Achieving parity between the leaders worked in this case for making a decision given the extended and heated situation. Yet, this fallback arrangement has implications that may be detrimental for the outcome. The more centralized the control, the less flexible are the rules of the game.

Furthermore, executive decision-makers risk
undercutting the decisions of lower tier officials or managers. As noted, there are some officials who feel that the agreement is unstable since the "details" are still being worked out. While the decision was made by the executive branch, the responsibility for implementing the agreement still lies within the Ministry of Industry and Commerce. The potential for a lower level agency to impose its power administratively during implementation is increased, particularly for a situation in which the second tier of officials so strongly opposed the proposal.[4] That the President referred the negotiation and implementation back to the Ministry of Industry and Commerce and the formal decision to the FIC was a supportive action that may ease potential difficulty later. Yet, the possibility for slow and inefficient implementation can adversely affect what might otherwise be the obsolescing of the bargain in favor of Mexico.

Not surprisingly, there remains a great deal of uncertainty about the implementation of the agreement. One Mexican official feels that the agreement is unstable. He notes that IBM has not yet followed through on some of their unwritten promises. For instance, IBM agreed to advertise locally through the Mexican Chamber of Commerce and has not done that yet.[5] The government is investing very little energy in holding IBM to its promises. As far as the Mexican officials are concerned, the agreement has been struck and it is IBM's responsibility to live up to it. IBM, on the other hand, is probably counting on slow implementation
efforts by the government. IBM's strategy, suspects one observer, will be to change the nature of *compromisos* from promises IBM had to make to gain FIC approval to concessions subject only to formal applications from the Mexican officials.[6]

The intention of the Mexican computer industry officials was to protect the existing industry from an overwhelming IBM presence. There is still much speculation about whether this will undermine the Mexican computer industry. The fastest growing markets in Mexico were small and large business segments for which IBM machines will likely be favorites.[7] Apple de Mexico may be able to maintain its lead in the educational market in Mexico, while Micros H-P may be able to rely on a solid customer base of Hewlett-Packard mainframe and minicomputer buyers.[8] Most industry observers believe Apple de Mexico, Micros H-P and the other firms will renegotiate the terms of their investments with the Mexican officials.

The other smaller distributors may be able to continue selling IBM compatibles, but all of the manufacturers will need to improve their production and pricing policies in order to compete with IBM. IBM promised to keep their price differential between ten and fifteen percent. Recall that price differentials for the other firms ranged from 25 to 300 percent. Mexico hopes that IBM's presence will actually induce some "constructive competition" into the Mexican computer industry, but it remains to be seen.
During the Mexico-IBM negotiation, industry observers viewed it as a test case for Mexico's ability to prove its liberalization intentions. The test case analogy can be drawn here as well for proving the ability of developing country states to enhance and exercise sources of bargaining strength. Mexico has signalled that it has recognized possible sources of bargaining strength and has improved its ability to exercise them during TNC negotiations. At the same time. Mexico did not take full advantage of these sources of bargaining strength.

Because, traditionally, TNCs are more powerful, and because of the overall decline in new foreign investment, Mexico and other developing countries have strong incentives to improve their bargaining skills and strategies for foreign investment negotiations. Clearly these states want to gain more favorable terms from the foreign investment agreements since these agreements have broad implications for industrial and economic development in the country. In other words, improving negotiating skills means meeting development objectives.

One aspect of improving negotiating skills is the ability to more effectively take advantage of sources of bargaining strength. One practical model for industrializing countries to achieve this goal is to establish an Industrial Development Authority. The Industrial Development Authority can set up offices around
the world--in the United States, Europe, and Asia--and regionally within the country, if necessary, with relatively few staff people per office. This model requires extremely good organizational skills and availability of experienced managers, but the strategy can be implemented slowly over time. Countries like Mexico, Venezuela, Colombia, Nigeria, India, and Brazil ("assertive upper tier countries") do not seriously lack educated people to staff such an endeavor. The goal is to promote the state's investment opportunities on the investor's turf, gain access to more global resources and expertise, and therefore, increase its flexibility and its potential disadvantage vis-a-vis the TNC.

The Industrial Development Authority would be established to:

- Promote and market the country's interests and resources around the world and develop rational incentive packages to enhance its attractiveness to potential investors.
- Research, gather, and share information about the needs and interests of business enterprises and develop methods and strategies to meet those needs in the context of its own national development priorities.
- Better understand its competitive position among countries and also develop strategies to improve its competitive advantage as well as induce and maintain a competitive environment among potential or existing investors.
- Streamline and coordinate decision-making, negotiating, and implementing in the government with respect to foreign investment so that a wide policy perspective is maintained and expertise about foreign investment grows.

Within this model, I recommend some specific strategies for states to keep in mind during foreign investment negotiations. No single strategy can stand on
its own, the state should work toward implementing all these strategies with sensitivity to the inevitable differences that will occur from one negotiation to the next.

(1) Plan for negotiation by clearly identifying those resources that the country has to offer, i.e., cheap labor, land, markets. Also identify the state's development objectives and industry and firm-specific needs and interests. From this, incentive packages can be developed that will promote investment to serve the interests of the state, the domestic and international industry, and the firm. Tax breaks, grant programs, or special investment assistance (such as site selection or administrative liaisons) are some components of an incentive package.

(2) Emphasize post-investment assistance in order to build a good relationship with the firm. This will also enable the state to maintain greater control over the investment since it has a hand in developing the enterprise over time.

(3) Lengthen the time horizon of the negotiation in order to create the anticipation of a future relationship. Emphasize during a negotiation that agreement may depend upon the future expansion or other plans of the firm. Many investors, particularly those engaged in a joint venture, have short-term profit horizons. The state need not take this as given, but should induce the investors to discuss their long-term plans to motivate the parties to consider a long-term relationship.
(4) Make use of diplomatic ties and establish networks with other developing countries that have negotiated agreements with the particular firm in question or that are also developing a particular industry. Information-sharing directly or through an agency like the United Nations Centre on Transnational Corporations can be a source of strength.

(5) Effectively taking advantage of the role of competition involves both offensive and defensive strategies. Making the country's investment environment more attractive with streamlined processes, incentive packages, and a reputation for good relationships over time is a way to maintain a competitive lead among countries.

Inducing competition among potential investors is more difficult, but if the state has identified its attractive resources it can establish a policy of competitive bidding for investment opportunities. Another possible method for maintaining a competitive environment may be to require a search for alternative investors or outside expert opinions on company proposals presented to the government authorities. This recommendation can apply for both potential investors and established firms. The state must not forget that established firms are a resource for inducing competition. Established investors can be played off potential investors and vice versa.

(6) The state may be able to play entrepreneur or venture capitalist itself by establishing state industries or providing grants to local industrialists in order to
create more alternatives to choose from.

(7) By organizing foreign investment policy, objectives, and practices in an Industrial Development Authority, the country can coordinate its efforts. The Board of Directors ought to represent the interests of the various ministries (i.e., along the lines of Mexico's Foreign Investment Commission) in order to allow for a wide policy perspective and avoid interministerial infighting.

(8) Plan for appropriate public exposure of the negotiations. Make sure that announcements and press releases are agreed upon by all the parties involved beforehand and that the information released is accurate.

(9) Plan for the appropriate decision-makers to be present during the negotiations. Match the level of negotiator sent to the negotiation to the level of negotiator that the foreign firm sends. For example, in the first round, exchanging information, defining the issues, and evaluating the technical components of the proposal can be achieved by sending lower tier officials or staff. These participants will be responsible for briefing the decision-makers of the agenda and technical issues. Later, when the agenda is set and decisions need to be made, those actually responsible for the decisions about the investment should join the negotiating table. It is important to keep those who will ultimately implement the decision or have technical expertise on the issues continually involved to ease implementation efforts later on. By having a consistent policy of how and by whom
decisions will be made, appropriate delegating—rather than circumventing—of authority is ensured.

Recent evidence suggests that developing countries are increasingly able to improve their bargaining power vis-a-vis TNCs. Where Mexico's record in bargaining encounters was poor, its recent efforts have been relatively more successful as the IBM in Mexico case suggests. Placing state-TNC bargaining in the context of negotiation principles and practice can add to the sophistication and wisdom of foreign investment interactions and agreements.
Notes to Conclusion:


[9] Ireland, a poor country with no existing or potential local market, has actively and successfully promoted industrial development through IDA Ireland, their Industrial Development Authority. (Ireland’s largest selling point is their 10 percent corporate tax rate and an English-speaking, educated work force.) IDA Ireland provides the basis for an industrial development organization model for developing countries.
APPENDIX:

Exhibits 1 and 2
Exhibit I: Mexico’s Foreign Investment Law: Chapter III

The National Commission on Foreign Investment

Article 11. The National Commission on Foreign Investment is hereby created and shall be composed of the Ministries of the Interior (Gobernacion), Foreign Affairs, Finance and Public Credit, National Resources (now Patrimonio y Fomento Industrial), Industry and Commerce, Labor and Social Welfare and the Presidency. [Mines and Programming and Budget is also included.] The Deputy Ministers appointed by each Minister shall act as alternate members. Meetings shall be chaired in rotating order, according to the precedence established in the above paragraph, by the Minister present. The commission shall meet at least once a month.

The Commission shall be assisted by an Executive Secretary appointed by the President of the Republic.

Article 12. The National Commission on Foreign Investment shall have the following powers:

1. To decide, in accordance with Article 5 of this law, the increase or reduction of the percentage of the foreign investment share in the country’s different geographical areas or economic activities, when there are no legal provisions or regulations that establish a given percentage or set the conditions under which such investment may be received;
2. To decide the percentages and conditions in which foreign investment shall be accepted in specific cases where, because of exceptional circumstances, special treatment is called for;
3. To decide on proposed foreign investment in business enterprises established, or to be established, in Mexico, or in new business enterprises;
4. To decide on the participation of foreign investment existing in Mexico in new fields of economic activity or in new production lines;
5. To act as an entity of mandatory consultation on foreign investment matters for agencies, enterprises with government participation, trust institutions for trusts set up by the Federal Government or state governments, and the National Securities Commission;
6. To establish the criteria and requirements for application of legal provisions and regulations regarding foreign investment;
7. To coordinate the action of Executive Branch agencies, decentralized agencies, and enterprises with government participation in exercising their powers with respect to foreign investment;
8. To submit, for the consideration of the Executive Branch, legislative and regulatory projects and administrative measures in the matter of foreign investment; and
9. Other powers granted by this law.

Article 13. In order to determine the advisability of authorizing foreign investment and to establish the percentages and conditions by which it shall be governed, the Commission shall take into account the following criteria and characteristics of the investment:

1. That it should be complementary to national investment;
2. That it should not displace national business enterprises that are operating satisfactorily, and that it should not enter fields that are adequately covered by such enterprises.
3. Its positive effects on the balance of payments and, especially, on the increase of Mexican exports;
4. Its effect on employment, taking into account job opportunities created and wages paid;
5. The employment and training of Mexican technical and management personnel;
6. The incorporation of domestic inputs and components in the manufacture of its products;
7. The extent to which it finances its operations with resources from abroad;
8. The diversification of sources of investment and the need to foster Latin American regional and subregional integration;
9. Its contribution to the development of the relatively less economically developed zones or regions;
10. That it should not enjoy monopolistic positions in the domestic market;
11. The capital structure of the branch of economic activity involved;
12. Its contribution of technology and its assistance in the country’s technological research and development;
13. Its effect on price levels and quality of production;
14. That it should respect the country’s social and cultural values;
15. The importance of the activity in question in the context of the country’s economy;
16. The extent to which the foreign investor is identified with the country’s interest and his connection with foreign centers of economic decision; and
17. In general, the extent to which it complies with, and contributes to, the achievement of national development policy objectives.
EXHIBIT 2: The Mexican Computer Plan
(Source: Data Services in Latin America and the Caribbean, UNCTC (September 26, 1985))

This is the Mexican Computer Plan as of early 1984 (after the government announced its intentions to take a more open view toward foreign investment).

STATED OBJECTIVES:
1. to develop a local manufacturing sector to supply both national and international markets;
2. to strengthen the Mexican economy by diminishing the negative impact of computer imports on the balance of payments;
3. to favour greater technological independence.

BASIC REQUIREMENTS AND INCENTIVES:
1. RESEARCH AND DEVELOPMENT:
   R & D centres of both government and private firms which are developing new products must be recorded in the National Registry of Scientific and Technological Institutions. Overall R&D expenditure will be monitored by the Secretariat of National Wealth and Industrial Development. Moreover, R&D expenditures must be invested in specifically defined activities.

2. TAX CREDITS ARE ALLOWED EQUIVALENT TO:
   - 20% of the amount of investment in the installation or expansion of production capacity;
   - 20% of the number of jobs generated directly by the investment or of additional jobs due to the installation of new shifts;
   - 15% of the value of purchased components manufactured in Mexico;
   - 15% of purchase price of computer equipment bought from firms registered in the National Computer Plan;
   - 15% of value of nationally manufactured components provided the supplier is registered under the Plan;
   - (negotiable percentage) for local R&D divisions developed to foster a national market.

3. EXPORT/IMPORT RATIO REQUIREMENTS:
   Microcomputers: 25% in the second year; 70% by fifth year. Firms not complying with these regulations face a possible cutback in import permits.

4. LOCAL CONTENT REQUIREMENTS:
   Microcomputers: at least 35% in first year; 45% by third year. The Secretariat is given the authority to establish annual import quotas of computer systems and equipment applicable to the manufacturers and distributors who are registered. It is expected that import quotas will decrease within five years and become a "minimal part of the national supply of computer systems and equipment."

5. DIFFERENTIATION BETWEEN EXISTING MANUFACTURERS AND NEW COMPANIES:
   - New companies must be "Mexicanized" with 51% national capital.
   - Existing companies with majority foreign ownership are grandfathered into the Plan and are not affected. These companies, when registered with the Plan, may only receive incentives if their manufacturing operations are exclusively in the areas of mini and macro computer systems.
   - New companies, in order to receive the incentives outlined in the Plan, may be required to locate their manufacturing facilities in specified geographic zones established in the Incentive Program. (Decentralization effort).
   - Companies must promise to manufacture in Mexico products which have the most advanced technology and invest in R&D as well as market their products through their own retail outlets.
   - Companies must promise to manufacture their products in accordance with Mexican quality standards. In the absence of particular Mexican standards, companies are required to abide by applicable international standards.
   - Companies are required to file a production schedule covering a minimum period of three years. Production levels must be maintained or increased.
   - Companies are required to present a schedule which outlines the creation of new jobs over a period of three (3) years. The company must also promise to generate the jobs necessary to meet its detailed production program.
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