
Ojo del Jaguar S.A.¹

GUATEMALA CITY, GUATEMALA

CASE A

List of Main Characters:

Guatemala:

Edgardo Vanberger	Co-founder, part owner, and day-to-day manager of Odj
Juan Carlos Toriello	Co-founder, part owner of Odj
Haroldo Gonzalez	Plant manager at Odj

Boston:

Craig Erickson	Investment analyst at Houghton Financial Group
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Monday, January 11, 1993

Guatemala City

After spending a week at the Kitchen and Bathroom Trade Show in Miami, Edgardo, Vanberger was eager to get back to Guatemala City and see how his factory—Ojo del Jaguar S.A. (Odj)—fared without him. As he arrived at work on Monday morning, he was greeted at the front door by his head secretary who informed him that the telephone cable down the road had been severed² over the weekend and the entire 30-square-mile area was going to be without phone service for the next three days. “Great,” thought Edgardo, “that’s just what I need on the day I’m supposed

to get a call from a potential U.S. investor responding to our business plan.”

When he rounded the corner to enter his office, Edgardo found his plant manager, Haroldo Gonzalez, sitting slumped in a chair. “Guess what,” said Haroldo, “the buses are on strike and we have about 70% attendance in the plant. We’ll never get that shipment of nightstands out by Wednesday.”

“*Puchica* (wow),” exclaimed Edgardo. “Look what happens when I leave for a week. The whole country goes up for grabs. What’s this bus strike all about anyway?”

“Well, it’s been high drama around here lately,” explained Haroldo. “Last week the transportation minister cut the fuel subsidy for public transport and the bus owners therefore threatened to raise fares by 20 centavos.³ On Friday, the Ministry vetoed the fare hike, and this morning the owners pulled their buses off the streets. Our real problem, though, is that we don’t have enough employees to get those nightstands out the door,” said Haroldo.

Edgardo sighed, looked out the window for a moment, then spun around and said, “You know, doing business in Guatemala sometimes reminds me of an Army recruitment commercial that used to be on TV all the

time when I was living in the States: ‘The Army:’—except in our case it would be ‘Guatemala:’—‘... it’s not a job; it’s an adventure.’”

“Well it’s going to be a lot more than an adventure if we don’t get paid this week for those nightstands. You know better than I do that we need the cash because of that crazy *Bono Catorce*⁴ last month,” says Haroldo.

“You’re right. I’ll have someone run the numbers to see if we need to take out a 30-day note to make payroll next week. Meanwhile, why don’t you get back to the plant and let’s see how many of those nightstands we can get out the door.”

EDGARDO VANBERGER: BACKGROUND OF A GUATEMALAN ENTREPRENEUR

Edgardo Vanberger was the Founder and President of Ojo del Jaguar S.A.,⁵ an export-oriented wood products company located an hour south of Guatemala City, Guatemala. Odj produced furniture and millwork products⁶ from traditional rainforest hardwoods such as mahogany and pine, but was also increasingly utilizing man-planted, “sustainably-harvested” rubberwood.

Edgardo had founded Odj three years before at the age of 34, after working for 10 years in the United States and Central America as a sales representative for a U.S.-based pharmaceutical firm. By 1989, Edgardo had worked himself up to chief Central America representative for the firm, but he was still not ready to commit his life to working for a multinational company. When a childhood friend of his, Juan Carlos Toriello, suggested the idea of forming Ojo del Jaguar, he jumped at the chance. The total initial capital invested in Odj was US\$1.9 million.⁷ Juan Carlos and a group of investors—two Guatemalans and one North American—put up 85% of the initial capital and retained 85% ownership, while Edgardo invested 15% and was placed in charge of day-to-day management of the firm.

Edgardo left his comfortable salary at the multinational company and the relatively secure world of pharmaceutical sales management because he was tired of moving his family around the United States and Central America, tired of simply executing someone else’s strategy and ready to strike out on his own. He realized Ojo del Jaguar was an excellent chance to create something he could call his own and also simultaneously to

contribute to the development of the country in which he had grown up.

Coming from a close-knit, business-oriented family, Edgardo always envisioned himself as the owner of his own company. Edgardo’s father, the grandson of a German immigrant, was born middle-class in Guatemala but made himself into a very successful and influential business executive and community leader. Not only did he manage the largest paper processing plant in Guatemala, he also sat on the board of several of the largest corporations of the country.⁸ He helped found the Guatemalan Chamber of Commerce as well as several educational and philanthropic organizations.

Edgardo’s father imbued in his sons and daughters a great appreciation for hard work, competition and innovation. Edgardo’s two sisters both received advanced degrees in the United States, very unusual for Guatemalan women, and were co-managing their own agricultural export firm. As for Edgardo, he spent half his life in the United States studying and working, and he absorbed many American ways of thinking and ways of conducting business. Unlike many of his childhood friends who were now professionals, Edgardo eschewed the formalities of the Guatemalan business world. Instead of sticking to polite conversational patterns among his colleagues and carefully guarding information about his company, Edgardo was often surprisingly frank when assessing the strengths and weaknesses of Odj, evaluating the competition, or discussing the future direction of his company. In the mold of the archetypical U.S. entrepreneur, he often came to work in a pair of blue jeans, drove a wobbly station wagon around town, and was accustomed to interacting with employees, clients and suppliers on a very informal, first-name basis.

Jaguar Today

While Edgardo was aware that one of his great strengths was his adventurous, innovative and charismatic nature, lately he had been wondering if he had taken too big a risk in starting up and investing most of his life savings (US\$285,000) in Odj, a company in its third year of operation and just barely breaking even. Although he and Juan Carlos still believed strongly in promoting rubberwood, this raw material was proving much more difficult to work with than they originally

anticipated. (See Exhibit I: “What is Rubberwood?”) The yield from converting raw log into sawn board foot, and sawn board foot into manufactured product, was much lower than they originally projected.⁹ In addition to problems with yield, it was unclear how Odj was going to be able to enter the U.S. market on a large scale. To date, Odj had sold a variety of furniture products to several U.S. clients but failed to establish its own distinct line of products. By not establishing a line and instead operating on a case-by-case “job shop” basis, Odj had not been able to routinize its production flows and thereby lower its production costs over time.

On the positive side, Edgardo believed that three years of frustration, long hours, and hard work were finally

beginning to pay off. Through extensive trial-and-error experimentation, Edgardo and his plant manager Haroldo Gonzalez were finally beginning to solve some of the most nagging production problems with rubberwood. In the company’s first year of operation, for example, it was discovered that rubberwood was highly susceptible to insect and fungal attack. After three years of experimentation, Edgardo finally found the right mix of preventative measures: careful timing of the kiln-drying process, and application of a specific combination of chemical protectants.¹⁰ In terms of marketing and sales, Edgardo believed he was finally beginning to establish a line of products—in the kitchen and bathroom vanity market—that would both be in steady demand and fit his production capabilities.

Exhibit I

WHAT IS RUBBERWOOD?

Rubberwood comes from the rubber or latex producing tree, *hevea brasiliensis*. Rubber trees are found in the wild in the Amazon Basin, but are also widely planted in Southeast Asia, West Africa, and Central America. These trees reach heights of 100 to 125 feet and possess large, cylindrical trunks.

Although most widely-known for its latex-producing capabilities, rubberwood has become increasingly important as a wood source. As deforestation advances and bans on logging natural forests come into effect, many traditional tropical hardwoods such as mahogany and pine are becoming increasingly scarce. Rubberwood, on the other hand, is a cultivated, renewable, and widely available alternative resource.

Rubberwood trees yield substantial quantities of latex for approximately 30 years. After 30 years of latex production, these trees are traditionally burned and new seedlings are planted. Increasingly, however, instead of burning before replanting, latex producers are selling the “timber rights” to this wood to furniture and wood products manufacturers. These wood products manufacturers then cut down the trees and use them as raw lumber.

Originally, rubberwood was only found in the wild in Brazil, Central America, and Africa. Attempts to cultivate the species in Brazil all ended in failure because the species is highly susceptible to disease when planted in rows in the Amazon region. Although Brazil had a government ban on the exportation of rubberwood seeds, in 1876 an adventurous Englishman, Henry Wickham, commanded an abandoned ship and smuggled 70,000 seeds out of the country to Kew Gardens in London.¹¹ These rubberwood seedlings were later transplanted and cultivated in British colonies in Asia. When synthetic Asian production entered the market a few decades later, it devastated the Amazon

rubber industry. In 1910 Brazil accounted for 57% of world latex production; in 1919 the country contributed less than 1%. Because of the geographic shift in production in the 1920s, over 95% of modern-day, world rubberwood production derives from Asia.

In Central America, rubberwood was introduced during World War II by multinational companies such as Firestone and Goodyear. After Japan captured Malaysia and controlled its rubber supply, U.S. multinational companies and the U.S. Army mounted a massive campaign to source natural rubber from Central and South America. In Guatemala, more than 25,000 hectares of rubber trees were planted. These trees are the source of raw materials for Odj.

Production and Pricing Issues

Compared to traditional tropical hardwoods, rubberwood is a small diameter, short-length yielding timber. This raw material therefore is not recommended for products such as doors which require long lengths. Instead, the ideal product line involves short lengths, narrow widths, and glued-up panels.

Another distinguishing characteristic of rubberwood is its extremely low yield. The lumber often arrives at the Odj plant partly diseased because of the incisions made through the trunk in order to tap latex. In addition, dried latex in the trunk makes the lumber difficult to saw and leads to problems with bow and twist of finished products.

Due to the lack of demand, prices for rubberwood in Guatemala are low and should remain low in the near future. Odj is the only business interested in purchasing this raw material in Guatemala and at present rates of production there is more than enough raw material to keep the plant in operation indefinitely, even if it were to triple or quadruple production.

Faced with break-even performance and limited cash availability, yet still showing promise as a company, Edgardo decided a few months ago to pursue outside investment, beginning his search in the United States. He concluded that in order for Ojo del Jaguar to turn a profit, the company needed to invest in the acquisition of more rubberwood timber rights, newer machinery, and a permanent professional marketing presence in the United States. Edgardo was willing to dilute his ownership share as long as it meant a healthier company in the long-run. With the goal of attracting new investors, Edgardo and the head accountant at OdJ had prepared a business plan over the last few months and sent it to several interested North American investors.

Boston, Massachusetts

After spending a relaxing weekend attending a Celtics game on Saturday night and strolling around Harvard Square the next day with his fiancée, Craig Erickson was eager to get back to work Monday and finish his report on an investment proposal in Guatemala. At 10:30 am Monday morning, sitting in his office at Houghton Investment Group, Craig dialed his secretary and asked: "Hey, what's happening with that call to Guatemala?"

"I'm sorry, Mr. Erickson, but we've been getting a busy signal for the past two hours. The operator doesn't even know what's wrong. I'll try again in the afternoon. I'm sorry."

"I wonder what the heck is going on in Guatemala," he thought. "I talked to Edgardo last Tuesday in Miami and he said to call him first thing Monday morning. I need to talk to him before I make this presentation on Wednesday."

Craig Erickson was an analyst at Houghton Investment Group, a private investment firm that recently had entered into several joint ventures in manufacturing operations in Asia, Latin America, and Eastern Europe. Because of Craig's three years of experience working with Citibank in Brazil, he was asked to review all the Latin American investment proposals that were sent to the firm.

Ojo del Jaguar S.A. came to Houghton's attention through a mutual friend of Edgardo and Craig. Although Edgardo did not have the time or the qualified personnel on staff to produce a business plan to meet U.S. corpo-

rate standards, Craig had asked him a month ago to prepare the best plan he could under the circumstances and deliver it to him at the Kitchen and Bathroom Trade Show in Miami. Even though the plan in its current form probably would not make it through a traditional U.S. venture capital screening, the partners were interested enough in the rubberwood concept to ask for a more detailed explanation of OdJ and its proposal.

Craig was due to give a presentation on the OdJ investment opportunity at Houghton's weekly partners' meeting on Wednesday. To prepare, he had several important questions for which he needed answers from Edgardo. (See Exhibit 2 for excerpts from OdJ's business plan including a brief history of the company and a statement of its strategic goals.)

Tuesday, January 12, 1993

Guatemala City

The head accountant at Ojo del Jaguar walked into Edgardo's office and laid a sheet of paper on his desk. "Here's that cash flow analysis you asked for. We're real tight this month and it looks like we'll need a 30-day note just to make payroll."

"OK," said Edgardo, "I'll stop by the Banco Guatemalteco tomorrow morning, although I can't call ahead for an appointment when all our phone lines are dead. Luckily my brother-in-law is a vice-president over there and he's obligated to make room for me in his schedule."

The accountant left the office and Edgardo returned to reading a description of a loan program from the *Banco Centroamericano de Integración Económico* (BCIE).¹² Edgardo picked up this information yesterday at a presentation given by a BCIE representative at the Guatemalan Chamber of Commerce. After talking with the representative, Edgardo was convinced that OdJ had a strong chance of receiving a loan of upwards of US\$1.0 million at low interest (11%) from BCIE under this program. The BCIE representative, an old high school classmate of Edgardo's sister, informed him that the Bank would look favorably on the environmental dimension of the company as well as the fact that OdJ provided employment and on-the-job training for over 400 workers.

Exhibit 2**FIVE YEAR BUSINESS PLAN FOR OJO DEL JAGUAR S.A.****1993–1997****I. Macroevironment: Guatemala****A. Geographic and Demographic Context**

- Guatemala encompasses 100,000 square kilometers and has a population of approximately 9.5 million people. Over 60% of the population is Mayan Indian.
- The national literacy rate is approximately 50%. (Illiteracy in Guatemala is most prevalent in rural areas. Partly due to its location near Guatemala City, the literacy rate at Odj is 90%.)
- Guatemala City is 2½ hours by plane from Miami. In addition, Guatemala is located 48 hours by ship from the port of New Orleans, borders on two oceans, and has a well-developed transportation network. Therefore, shipping time to the United States for Guatemalan products is significantly less than that required for Asian markets.

B. Political Context

As the Cold War recedes, support for extreme leftist and rightist groups in Central America has diminished, resulting in a much more stable and democratic region. In Nicaragua and El Salvador, the peace processes are progressing rapidly, and democratic institutions are believed to be taking hold.

Within this more peaceful regional context, Guatemala is also moving towards a more stable and democratic society.¹³ The Guatemalan Congress has been democratically elected three times since 1984, a new constitution was designed and ratified in 1986, and Guatemala has experienced two peaceful transitions of presidential power.

C. Economic Context

- Due to a combination of several political and economic factors—peace and political stability in the region, a strong economy and fiscally responsible leadership in Guatemala, and historically low interest rates in the United States—over US\$500 million in investment capital has returned to Guatemala over the last two years, largely from Guatemalans who had been holding their money in the United States. The return of this investment capital has created a “boom” in the construction industry in Guatemala City that has greatly benefitted Odj.
- Guatemala possesses the largest GDP in Central America, far larger than the runner-up, Costa Rica.
- Central American regional integration is moving along swiftly and as a result the trade barriers between Central American countries are minimal or nonexistent.
- Guatemala will become an even more important supplier or “feeder site” for Mexico after the North American Free Trade Agreement (NAFTA) comes into effect.

II. Introduction to Odj

Located an hour south of Guatemala City, Odj is a medium-sized wood-working company (473 employees) that aims to become Latin America’s premier supplier of man-planted, environmentally-sustainable wood products. Founded in December 1989 by Edgardo Vanberger and Juan Carlos Toriello, Ojo del Jaguar sold US\$2.7 million of product in 1992. Over the next five years Odj plans to achieve a sales volume of \$12 million annually. The company intends to achieve this dramatic growth largely by increasing its export of kitchen and bathroom cabinet doors produced from rubberwood. While these products currently account for approximately 10% of company sales, Odj hopes to increase this percentage to 65% over the next 5 years. It is important to note that Ojo del Jaguar controls every step of the extraction and production process: the logging of trees, the sawing into board form, the treatment of the boards, and the final manufacturing process. (See Exhibit 3 for Odj’s current and projected sales and profitability figures).

Although approximately 60% of Odj’s sales are still based on traditional tropical hardwoods such as mahogany and pine, in the future the company plans to work almost exclusively with rubberwood. To guarantee its source of raw material, over the next two years Ojo del Jaguar plans to purchase the timber rights to 2,000 hectares or 21 million board feet of rubberwood trees in Guatemala. (See Exhibit 4 for Odj balance sheet.)

III. Strategic Plan**A. Financial Goals**

- Acquire new lines of financing (approximately US\$800,000: \$350,000 for the acquisition of new timber rights and \$450,000 for investment in new extraction and manufacturing equipment) by selling 40% of company to a new partner.
- Work less on a cash-in-advance basis (50% of charges due up front) with customers and more with letters of credit.

Exhibit 2 (continued)**FIVE YEAR BUSINESS PLAN FOR OJO DEL JAGUAR S.A.****1993–1997***Financial Notes*

In order to expand the company, Ojo del Jaguar needs to find new sources of financing outside of Guatemala. At present the interest rates in Guatemala are a prohibitive 30% annually.

Under a Guatemalan statute, Odj is exempt from all income taxes on export sales until 1996. In addition, the company is also free from U.S. import duties under the Caribbean Basin Initiative (CBI). CBI exempts certain industries from import taxes and mandates preferential treatment for these goods. In this respect, Odj enjoys a comparative advantage over Asian rubberwood manufacturers.

B. Sourcing

- Over the next two years, invest US\$350,000 acquiring timber rights to 2,000 hectares of woodlands (approximately 5,000 acres), or 21 million sawn board feet of rubberwood trees.
- Increase cutting from 1.5 to 6 million sawn board feet per year.
- Continue to purchase traditional timbers on an as-needed basis.

Sourcing Notes

Traditional tropical hardwoods are increasingly difficult to purchase on the open market. Like most nations around the world, the Guatemalan government has imposed severe restrictions and some all-out bans on the extraction of many tree species. These regulations have dramatically reduced the legal sale of many species and this situation is not likely to change in the near- or long-term future.¹⁴

C. Processing/Manufacturing

- Improve layout and working conditions in order to increase plant productivity.
- Invest US\$450,000 in new equipment to increase production capacity and efficiency (kilns, edgers, portable saw equipment).
- Increase utilization of waste from processing/manufacturing by:
 1. Selling low quality timber as firewood and construction lumber;
 2. Manufacturing alternative products from the waste such as particle board, parquet flooring, and kitchen utensils;
 3. Producing standardized product line resulting in less waste.

Processing/Manufacturing Notes

Since rubberwood is a small diameter, short-length yielding timber, its production characteristics dovetail perfectly with Odj's proposed cabinet and bathroom vanity line. However, because of rubberwood's low yield, only 55% of the wood that arrives at the plant from the forest is converted into usable, sawn lumber. Out of this sawn lumber, only 50% leaves the plant as finished product. Therefore, an important factor in Odj's profitability is its utilization of "waste" from the sawing and manufacturing process. Currently, Ojo del Jaguar sells 35% of the waste to local residents for firewood. The other 65% is not salable and is used to generate power for the plant or is simply thrown away.

With regard to the utilization of plant capacity, Odj is using 75% of its sawing capacity, 100% of its kiln capacity, and 95% of its manufacturing capacity. If funds were available, Odj would invest first in extra kilns and then in additional manufacturing equipment.

In addition, if Ojo del Jaguar were to increase its sales of standardized product lines, then labor productivity, machine productivity, and manufacturing capacity would greatly increase, perhaps by as much as 50%. In other words, Ojo del Jaguar loses a great deal of manufacturing efficiency because it operates essentially as a "job shop," producing different products each month. As a "job shop," Odj is forced to constantly rearrange the product flow within the plant, re-work and tinker with product designs, and retrain workers on manufacturing processes.

Odj pays an average factory wage of US\$.70/hour and administrative and support staff earn an average of US\$.90/hour. These salaries include benefits. Management salaries are as follows: Edgardo Vanberger, general manager, \$45,000; Haroldo Gonzalez, plant manager, \$25,000; head accountant, \$25,000; and assistant accountant, \$10,000. In 1992 Odj hired outside consultants at a cost of \$30,000 to provide assistance in the following different areas: anti-fungicidal treatment of the wood, plant layout and production flow, and export marketing.

Exhibit 2 (continued)**FIVE YEAR BUSINESS PLAN FOR OJO DEL JAGUAR S.A.****1993–1997****D. Marketing/Sales**

- Establish rubberwood as a recognizable, quality wood product marketed as “castilla,” one of its scientific names.
- Develop brochures and marketing strategy to attract export clients for standardized product line.
- Establish relationships with several dependable, medium-sized export clients with similar product lines.
- Maintain presence in the domestic market with furniture while focusing on increasing export markets.
- Market the waste from the manufacturing process to related, secondary industries.
- Pursue “environmental seals” from appropriate certifying agencies and position product as “environmentally friendly.”

Marketing/Sales Notes

In terms of the domestic market, the recent construction boom in Guatemala City has greatly benefitted Ojo del Jaguar. Because of its excellent reputation for high-quality products, moderate prices, and on- or ahead-of-schedule delivery, Odj has captured a significant portion of the local business for furnishing luxury hotels, condominiums and apartment complexes. For these clients, Odj is constructing doors, moldings, and furniture out of traditional tropical hardwoods. As most of the new construction is being managed by only a handful of large developers, Odj has relied on word-of-mouth advertising and has not needed to invest in local marketing.

With regard to the export market, Odj has been selling a variety of furniture products made out of rubberwood that are often stained to look like traditional hardwoods. Over the past three years, two of Odj’s major export contracts have been artificial fireplace mantles for the Sears, Spiegel and American Express catalogs, and toy wagons for Crate & Barrel. The export market for rubberwood furniture appears stable, but profit margins are low due to the high cost of designing and manufacturing these products.

In terms of the kitchen/bathroom export market and the acceptability of rubberwood or “castilla” cabinet doors, Odj has been test marketing its product line and the results are very encouraging. In 1992 the company shipped US\$300,000 of cabinet doors to a distributor in Texas and the product was very well received. The quality and price points were competitive and the customer has reordered asking for an even larger volume.

IV. The Offer to Houghton Financial Group

Although Ojo del Jaguar’s book value is approximately US\$1.5 million, its true value is US\$2.0 million. The US\$500,000 premium can be explained by the following intangible assets:

1. Three years of experience with the production of furniture and millwork from rubberwood as a raw material, in other words, intangible manufacturing knowledge;
2. An excellent reputation for producing high-quality wood products, meeting delivery schedules, and providing follow-up service to clients after the sale;
3. Enormous future profit potential when the export line of kitchen and bathroom vanity products catches on.

Thus, the Odj management is seeking a 40% partnership investment and our offer is US\$800,000 based on a valuation of the company at US\$2.0 million.

When Edgardo outlined his proposed uses for the bank loan, the BCIE representative advised him of several restrictions on these funds. First, BCIE capital could not be utilized to purchase rubberwood timber rights because of the difficulty in securing insurance for this type of property (i.e., insuring against “natural catastrophes”—forest fires, disease, etc.). Second, any imported machinery or equipment had to be purchased new and from donor countries that financially supported the bank. Third, loan requests needed the approval of two separate financial institutions, BCIE and a private partner bank. (BCIE put up 60% of the

capital and a private partner bank supplied the remaining 40%.)

On a notepad, Edgardo scratched the following Pros and Cons of the BCIE proposal:

PROs

- Long-term loan, to be paid off over a 10-year period.
- Four-year grace period for capital investments during which no interest needs to be paid.
- Low-interest (11%) compared to other available loans.

Exhibit 3**Odj SALES AND PROFIT SUMMARY**

(in US\$ 000s)

Sales Breakdown by Customer and Product	Historical (1990–1992)						Projections (1993 and 1997)			
	1990	%	1991	%	1992	%	1993	%	1997	%
Export (Kitchen and Bathroom)	\$0	0	\$0	0	\$300	11	\$1,000	24	\$8,100	68
Export (Furniture)	600	33	800	37	900	33	1,200	29	1,800	15
Total Export Sales	600	33	800	37	1,200	44	2,200	54	9,900	83
Domestic (Furniture)	900	50	1,000	47	1,100	41	1,200	29	1,600	13
Domestic (Millwork)	300	17	350	16	400	15	700	17	500	4
Total Domestic Sales	1,200	67	1,350	63	1,500	56	1,900	46	2,100	18
Total Sales	\$1,800	100	\$2,150	100	\$2,700	100	\$4,100	100	\$12,000	100
Profit after Taxes	–\$300		–\$100		–\$1		\$100		\$1,300	
Profit Margin	–16.7%		–4.7%		–0.0%		2.4%		10.8%	
Sales Breakdown by Raw Material	Historical (1990–1992)						Projections (1993 and 1997)			
	1990	%	1991	%	1992	%	1993	%	1997	%
Rubberwood	\$600	33	\$850	40	\$1,100	41	\$2,300	56	\$7,800	65
Traditional Hardwoods	1,200	67	1,300	60	1,600	59	1,800	44	4,200	35
Total Profit										
Total Sales	\$1,800	100	\$2,150	100	\$2,700	100	\$4,100	100	\$12,000	100

- Compared to Houghton investment option, no need to dilute ownership share and no need to share management decisions.

CONs

- Cannot use capital to purchase timber rights.
- Cannot purchase second-hand equipment that would be considerably cheaper and perhaps more appropriate for Odj plant.
- Highly bureaucratic, inflexible process: reams of documentation and paperwork required, and a possible 8–12 month delay before funds are disbursed.
- Opportunity cost of diverted manpower required at Odj to prepare the extensive proposal and documentation necessary for a government loan.
- Loan needs to be approved by two separate institutions, which may lead to longer delays and significant alteration of our plans.
- Loan made in hard currency (US\$) and, therefore, risky if quetzal devalues significantly.

As Edgardo finished reading the BCIE program description, Haroldo came rushing into his office holding a three-foot long piece of rubberwood.

“Guess what? Our old friend the sticker stain is back. Not only did many of those nightstands not make it to the loading dock yesterday, but about half of the ones that did have this daggone stain on them,” said Haroldo as he handed the board to Edgardo.

“I thought we solved this problem by taking the wood directly from the sawmill to the kiln,” said Edgardo.

“So did I,” said Haroldo. “But then I took a spin by the loading dock this morning and I find this. The thing that galls me is that none of the supervisors mentioned the stain as the nightstands went through the factory. Now, instead of correcting this problem when it was in the glue stock stage, we’re going to have to repair a finished product. It’ll take twice as long to correct and cost twice as much.”

“I think it must be those new chemicals we’re applying to the wood to protect against fungal and insect attack. You’d better stop the chemical treatment immediately and see if the stain disappears,” said Edgardo.

Exhibit 4**OJO del JAGUAR S.A.
BALANCE SHEET**

Year Ended December 1992 (US\$ dollars)

ASSETS**Current Assets**

Cash	\$150,000
Accounts Receivable	105,000
Inventory	
Raw Materials	312,000
Finished Goods	198,000

Fixed Assets

Land & Building	\$650,000
Machinery and Equipment	1,673,000

TOTAL ASSETS \$3,088,000

LIABILITIES

Accounts Payable Local	\$203,000
Accounts Payable U.S.	74,000
Severance Pay (1)	80,000
Bond on Warehouse (2)	150,000
Banco Agro (30 days) (3)	50,000
Banco Guatemalteco (4)	535,000
Banco Internacional (5)	497,000
TOTAL LIABILITIES	\$1,589,000

OWNERS' EQUITY \$1,499,000**NOTES**

- Under Guatemalan law, when an employee leaves a firm, he is entitled to one month's pay for each year he has worked at the company.
- Loan taken with inventory as collateral. Odj was able to borrow 75% of the value of its inventory. In order to avoid paying principal on this loan, Odj must maintain the same level of inventory. A representative of the bank visits Odj and checks inventory levels each month. Variable rate, quetzal-denominated.
- 30-day note taken last month in order to meet payroll needs, the "aguinaldo" and the "bono catorze." Variable rate, quetzal-denominated debt.
- Start-up loan taken in 1989, 17% rate. Variable rate, quetzal-denominated debt.
- Loan taken in 1991, 18% rate. Variable rate, quetzal-denominated debt.

"Just another adventure with rubberwood, I guess," said Haroldo. "You know, around here, we have one manufacturing crisis after another and yet we still have to push the product out the door so we can meet payroll. Sometimes it reminds me of driving a car down the highway and simultaneously leaning out the window and fixing the motor. It's quite a trick we're pulling off here."

"Yeah, it's a nice trick until the car runs out of gas and sputters to a halt," said Edgardo. "We keep thinking we're going to turn this project into a Formula 1 racing car and this rubberwood keeps telling us it's more comfortable being an old Chevy station wagon. I guess we'll find out pretty soon how somebody else values what we've been working on. Craig Erickson from Houghton Financial is supposed to get a hold of us tomorrow. Because of the problem with our phones, though, he's going to call Juan Carlos (Odj co-founder) at his downtown office."

Wednesday, January 13, 1993*Boston, Massachusetts*

As Craig Erickson walked into the Houghton Financial Group partners' meeting, he was slightly uneasy because he had not been able to contact Edgardo Vanberger in Guatemala to clear up the numerous doubts he had about Odj and its business plan. However, even without talking to Edgardo, he was confident he could present a fairly clear picture of the proposal at the meeting. If the partners felt Odj had enough potential, Craig was ready to catch a plane to Guatemala City later in the week. Craig had distributed a copy of the business plan to each of the four partners and it was his duty today to summarize the plan and assess the offer.

Craig began his presentation by explaining that Ojo del Jaguar S.A. was a very innovative business experiment that could have excellent profit potential. Based on the increasing scarcity of traditional tropical hardwoods, the international wood products industry was going to have to locate new sources of raw material.

According to Craig, the question at hand for Houghton Financial was whether the answer to these scarcity problems was going to be rubberwood, whether rubberwood should be sourced out of Guatemala, whether Odj was the proper joint-venture partner in this endeavor, and whether \$800,000 in exchange for 40% ownership of the company was an acceptable offer.

Craig explained that Odj had the following strengths:

- A very charismatic, astute, and well-connected general manager in Edgardo Vanberger;
- A three-year jump on the competition in dealing with the various production problems associated with rubberwood;

3. A strong, although somewhat untested, marketing potential in the kitchen and bathroom vanity market.

After analyzing Odj's strengths, Craig then focused on the company's weaknesses.

1. Despite plant improvements, Odj was still having several production problems, and rubberwood's yield was still very low;
2. Partly because of the low yields, production and labor costs at Odj were high compared to similar factories in Central and South America;
3. The marketing plan for the export market, although promising, was not at all a sure thing.

With regard to the offer of \$800,000, Craig explained that it was difficult to estimate the real value of Odj's assets without visiting the plant. Edgardo had mentioned that much of the machinery was especially suited to the manufacture of rubberwood, and Craig wondered about its scrap value if for some reason the project had to be discontinued. Finally, Craig mentioned that he was awaiting a profit and loss statement for Odj for 1992 but had not received it yet by fax because the phone lines had been down all week outside of Guatemala City.

No sooner did Craig finish his presentation than the four partners began with a barrage of questions. Following is a summary of some of their queries and Craig's responses.

Question: When we looked at a mahogany operation in Brazil last year, I believe the extraction and sawing costs were around \$.44 cents per board foot. Odj says it can produce rubberwood for \$.40. That's not much of a cost difference and rubberwood can't compete with mahogany for customer acceptance and reputation as a hardwood. Isn't that a problem?

Response: First, I believe that Odj's production costs will drop sharply over time. If in the near future Odj can produce a single line of items—such as kitchen and bathroom vanities—the dollar value of the company's output will jump tremendously while its costs will remain essentially the same. Second, \$.44 is the extraction cost of mahogany right now. As mahogany becomes less available in the near future and governments begin enforcing even tighter logging bans on natural forests, I believe this cost will rise dramatically.

Question: What's the inflation rate and the devaluation rate in Guatemala?

Response: First, it's important to realize that Guatemala has traditionally had one of the most stable currencies in Central and Latin America.

With regard to inflation, the official rate is about 8% annually. In talking to Edgardo, though, he explained that this 8% figure is slightly misleading as it is based on a "canasta basica" or a typical consumer basket, i.e., beans, tortillas and basic foodstuffs. On the other hand, the price of the "industrial basket," which includes electricity rates, labor costs, etc., is increasing at about 18% per year.

In terms of devaluation, the quetzal is losing about 6% annually against the dollar and this trend appears likely to continue into the near future. For a long time the quetzal traded on a 1 to 1 basis with the dollar and then during the early- and mid-1980s it devalued to around 5 to 1. For the last several years, though, the currency has stayed more stable and the quetzal currently exchanges at about 5.30 to 1. To sum things up, with regard to inflation and devaluation rates, Guatemala is not Western Europe, but it's no Brazil either.

Question: We've invested in a bottling operation in El Salvador and if I recall correctly the average manufacturing wage is about 20–30% lower than the salary Odj is paying. What accounts for Odj's comparatively higher labor costs?

Response: Guatemala's labor costs are higher than some neighboring countries such as El Salvador but lower than others such as Costa Rica. Edgardo Vanberger explained to me in Miami that he is paying his workers a "semi-skilled" wage even though their current productivity level merits a lower, or "unskilled" wage. He believes that although his present production levels don't justify the wages he is paying, in the near future the plant's efficiency will improve significantly and his workers' wages will make more economic sense.

Question: How about unionism at the plant?

Response: The Odj management appears to have very good relations with its work force. Odj participates in the 'Solidarity Labor Movement' in Guatemala. Under the Solidarity system, the workers eventually own a small portion of the firm and labor and management work in a cooperative fashion. At Odj, for example,

there is a free health clinic for employees that is staffed by a doctor and a dentist.

Question: How much rubberwood is there in Guatemala and what percentage is this of the world total?

Response: There is approximately 25,000 hectares or approximately 60,000 acres of rubberwood planted in Guatemala. This is less than 1% of the total world rubberwood supply.

Question: I think their export marketing strategy looks a little shaky. What kind of marketing structure do they have in place?

Response: This was one of the major questions I wanted to ask Edgardo, but I wasn't able to get in touch with him this week. I know OdJ does not have a permanent U.S. marketing representative, and this is one of the areas in which they were expecting the new partner to provide assistance. It looks like so far they have relied on a U.S. partner who sells part-time, a distributor who also sells on a part-time basis, word of mouth, and several of Edgardo's personal contacts. I think they believe they have a product with strong potential, but don't have the marketing expertise or financial resources to sell it themselves at this point. This is one of the principal reasons OdJ is looking for help, in my opinion.

Question: It looks like OdJ has over US\$1 million in outstanding bank loans at about 18% interest. Even though these debts are quetzal-denominated, that's still quite a liability to be carrying around. No wonder they are having problems with cash flow.

Response: I agree this is a problem. If Houghton gets involved, maybe we can help secure another line of credit in the United States and wipe these unpredictable, high-interest loans off the books. Or, if the quetzal starts on a rapid devaluation, we can just sit tight and we won't have much of a problem. In any case, I agree that Houghton could help OdJ with their foreign currency management.

Question: If I understand this correctly, these guys are claiming that they have about \$1.5 million in book value in the company, but I'm not convinced it is worth this much by the numbers they are presenting for their fixed assets—land, building, machinery, etc. In cases like this involving unknown, risky ventures without a long history of retained earnings, I prefer to base our valuation on a future earnings projection. I would sug-

gest we ask OdJ for a future earnings projection and demand an internal rate of return of at least 14% above inflation, or 22%.

Response: With regard to OdJ's fixed assets, Edgardo has provided me with a certified, independent valuation of the company, but I would agree that it's risky to put too much stock in these figures. The next time I speak to Edgardo, I'll ask for the future earnings information.

The partners concluded the meeting by deciding that the project was interesting enough that Craig should fly down to Guatemala on Friday morning and collect more information. Craig believed the partners were skeptical about several aspects of the operation, but were intrigued enough by its innovative, environmental dimension that it merited a closer look. In addition, Craig was aware that Houghton managed investments for several "Green Pension Funds" that had "socially responsible" restrictions, and he imagined that OdJ might fit nicely into this investment strategy. If nothing else, Craig believed, maybe the partners would be willing to invest in a "socially responsible" company that not only turned a nice, small profit, but also enhanced the overall image of the investment group.

Guatemala City

Edgardo Vanberger sat at his desk reading an informational packet he received in the afternoon mail from Green Cross Scientific Certification Systems in the United States. Green Cross was a nonprofit organization that administered environmental certification programs for commercial products. In this packet, Green Cross described the advantages of participating in its sustainable wood certification program and the burgeoning market opportunities for environmentally-sound wood products.

According to the information in the packet, Home Depot, one of the United States' largest home products retailers, had recently implemented a strict, company-wide environmental program in all of its 184 warehouse stores. As part of this program, the company was requiring suppliers to provide certification of their environmental claims and was distributing in all of its stores a circular entitled *Environmental Greenprint*, a list of more than 70 "nature friendly" products available from Home Depot.

Edgardo was in the midst of reading the packet when Juan Carlos Toriello, his partner, entered his office and

informed him of the latest news from Guatemala City. First, Juan Carlos explained that he had received a phone call an hour ago from Craig Erickson, and that Craig was going to be at OdJ on Friday and Saturday. Craig had requested that by Friday OdJ prepare projected earnings for the company over the next five years. Juan Carlos also reported that Craig didn't sound overly optimistic on the phone, but just the fact that he was visiting Guatemala was a sign of some interest on the part of the Houghton Financial Group.

Second, Juan Carlos said he had just come from a meeting with a local hotel owner who was ordering 500 more nightstands and planned to construct a luxury hotel in El Salvador in October or November. The hotel owner was very satisfied with OdJ's product and service and wanted to start talking about the El Salvador deal. In addition, Juan Carlos commented that he had had a meeting with the United States Agency for International Development (USAID) the day before, and they might be interested in ordering over 20,000 tables and chairs for a rural medical project beginning that June.

After Juan Carlos finished, Edgardo described the potential US\$1.0 million loan from the BCIE. As they were discussing these latest developments, the head accountant entered the room and handed Edgardo the 1992 profit and loss statement (Exhibit 5) to be discussed with Craig Erickson later that week.

After glancing at the statement, Juan Carlos said, "We need to do some serious talking around here. We've got a potential investor visiting us just when it's starting to look like we might be able to turn a consistent profit without diluting our ownership share. Also, our local sales are picking up, so we don't need as much marketing assistance as we originally thought. Maybe we should refocus our goals and just concentrate on being a high-quality producer for the domestic and Central American market. With the loan from the BCIE we could make the necessary investments in equipment and content ourselves with the local hotel, apartment and condominium market, while just dabbling in the export market as a safety valve. Also, maybe we shouldn't be so enthusiastic about rubberwood, and we should stay with a 50–50 or 40–60 mix of rubberwood and traditional hardwoods."

Exhibit 5

OJO del JAGUAR S.A. PROFIT AND LOSS STATEMENT

Year Ended December 1992 (US\$ dollars)

	Amount	% of Sales
SALES		
Domestic	\$1,500,000	56%
Export	1,200,000	44%
TOTAL SALES	\$2,700,000	100%
COST OF GOODS SOLD		
Wood	\$945,000	35%
Material	135,000	5
Labor	810,000	30
Overhead	243,000	9
	\$2,133,000	79
GROSS PROFIT	\$567,000	21
SALES & ADMIN EXPENSE		
Advertisement	\$22,000	1
Salaries (I)	145,000	5
Telephone	22,000	1
Rent	51,000	2
Insurance	22,000	1
Depreciation	90,000	3
Health Clinic	35,000	1
TOTAL SALES AND ADMIN COSTS	\$387,000	14
INTEREST EXPENSE	\$181,000	7
PROFIT BEFORE TAXES	(1,000)	
TAXES	0	
PROFIT AFTER TAXES	(\$1,000)	
RETAINED EARNINGS	(\$1,000)	

NOTES

- I. Includes administration and support staff, management and consultant salaries.

"Well, according to what I've just been reading, 'environmentally sound' wood products are getting real hot in the United States and Europe," replied Edgardo. "I'm always happy to hear about potential local sales, but you know as well as I do that although we get a 30% higher profit margin on domestic sales, the Guatemalan and Central American market will never have the volume we could obtain in the United States and Europe. Besides, what about all our talk about improving flow through the factory, reducing production costs, and ceasing to be a glorified 'job shop'?"

"As you can see, Juan Carlos," continued Edgardo, "I'm still in favor of proceeding with our business plan and

trying to sell outside investors on the idea, but on the other hand I realize you are raising some very good points. I'll put together the projected earnings statement this afternoon and let's you and I and Haroldo

meet to talk this thing over tomorrow. Before Craig Erickson gets here on Friday, we've got to decide where this company is going."

CASE B

Thursday, January 14, 1993

Guatemala City

Juan Carlos Toriello, Haroldo Gonzalez and Edgardo Vanberger sat down in Edgardo's office to discuss the future direction of Ojo del Jaguar S.A. Each had received a copy of Exhibit 6 showing Odj's projected earnings for the next five years. The following is a summary of each manager's comments.

JUAN CARLOS TORIELLO (Partner Based in Guatemala City)

"I'm looking at these projected earnings numbers, and I'm very skeptical. Odj is a company that after three years is just now breaking even, and yet five years from today we're projecting more than a million dollars annually in profit after taxes. If I'm not convinced by these projections, imagine what Houghton is going to think. I'm willing to see what they say, but I am not too optimistic that they'll buy these numbers and accept our offer.

"Instead of placing our hopes in fresh funds from Houghton, I think we should concentrate on expanding by ourselves, making use of the BCIE loan. In my opinion, the factors that favor us going it alone are the following:

1. The Guatemalan construction market is booming and shows no signs of letting up.
2. Central American economic integration is moving along rapidly. In the near future it will be even easier to move product between countries and import duties will be reduced to almost nothing.
3. Odj has a substantial potential order with the USAID health project. Moreover, Odj has an excellent reputation among development organizations in Central America and this could lead to more government contracts in the future.

4. We're making a 30% margin on our local sales, as opposed to about 15% with our export clients, if we're lucky. Moreover, if we put a mahogany stain on the rubberwood and sell our product for just slightly less than true mahogany, we can make an even wider margin on local sales.

"Instead of embarking on a partnership with Houghton, let's pursue the BCIE loan. The most pressing need at Odj is new extraction and manufacturing equipment, and we can use the BCIE money for this purpose. As for the restrictions on the loan, I don't think it's a problem that we can't use these funds to purchase rubberwood timber rights. In fact, at this point in the company's development, I think a large investment in rubberwood timber rights would be premature, given that the market is still untested.

"By not putting all our eggs in one basket—i.e., purchasing timber rights and committing ourselves exclusively to this raw material—I think we would be incurring much less risk. If Odj doesn't invest too heavily in rubberwood timber rights, this leaves the company with the flexibility to experiment with other raw materials and other export markets. What about the idea we discussed a few months ago of purchasing oak from the States and acting as a *maquila*, simply sawing and manufacturing the wood according to specifications and then reshipping the final product back to the United States?¹⁵ Although the margins might be smaller with *maquila* and oak than with rubberwood, at least Odj wouldn't run the risk of losing money."

HAROLDO GONZALEZ (Plant Manager)

"Before I discuss the big picture, I want to bring you up-to-date on the sticker stain issue. It appears this problem has been solved by taking the sawn boards directly from the rip saw to the kiln, without applying

anti-fungicidal chemicals. The chemicals are now being administered after the wood is kiln-dried and the stain has not reappeared.”

“Bueno,” the others responded in unison.

“Regarding the direction of the company,” Haroldo continued, “from a plant manager’s perspective, I must admit first of all that I’d rather work with almost any other raw material than rubberwood. I’ve been managing furniture plants and carpentry shops for 15 years now, and I would say without a doubt that rubberwood has given me more headaches than anything else I’ve encountered. I would summarize the major production difficulties as follows:

1. Because of the pock marks from the latex extraction, we can’t get long board lengths; to produce even a medium board length, we have to cut very carefully, and this is time consuming.
2. Rubberwood has an extremely high torsion so that, even after it’s cut into board form or made into a furniture piece, warp, twist, and cup are common.
3. Rubberwood is very susceptible to insect and fungal attack, and it appears that as soon as we solve one contamination problem, another disease appears.
4. Being a relatively new raw material for the industry, rubberwood has not been researched extensively and, therefore, we’re obligated to operate in the dark using trial and error. Even when we call the U.S. wood research institutions for assistance, they often don’t know what to recommend. I suggest that when OdJ makes it past these cash flow problems, we should take a trip to Malaysia and talk to some production people over there. The real knowledge about this wood is in Asia, and most of it has not been documented in written form.

“Having said all that and outlined the production headaches, I’d still hate to throw away three full years of hard work and experimentation just because we’re seeing a steady demand for our traditional hardwood product in Central America and a reasonable bank loan is now a possibility. At this point I would recommend a production test with rubberwood kitchen and bathroom cabinet doors. You know, even with all that fancy talk in the business plan about future production goals and cost savings, we’ve never tried to set up the plant to run just kitchen and cabinet doors.

“If I’m not mistaken, the longest production run we’ve ever had for rubberwood cabinet doors is about 10 days. We always start on a production run and then some developer in Guatemala City screams that he needs his nightstands or his baseboards, and we stop everything to finish the local order. How about if we just run kitchen and cabinet doors for a whole month and see if we can produce 1,000 a day? By running this experiment, we’ll find out once and for all whether our low productivity is the result of inefficient manufacturing processes or whether it’s a consequence of the raw material we’re working with.”

EDGARDO VANBERGER (Partner and Day-To-Day Manager)

“I think we need to separate two issues that we’ve been confusing in our discussion: (1) Should OdJ focus on the Guatemalan and Central American market, or should it concentrate on expanding its exports in the United States and Europe? and (2) Should OdJ aim to work exclusively with rubberwood, or should it continue sourcing traditional timbers? Up until now, OdJ has generally sold rubberwood to the export market and traditional hardwoods to Guatemalan and Central American clients, but this doesn’t mean that these two issues are inextricably linked.

“As for the first issue, our market focus, I disagree with Juan Carlos that we should concentrate on Guatemala and Central America. Juan Carlos, perhaps because you haven’t been out there talking to developers and selling our product, I think you don’t quite understand how unusual and transitory this construction “boom” is in Guatemala. The local developers are so flush with cash right now they can’t believe it. A local developer doesn’t even begin digging a foundation until he’s sold every unit in the building and has the money in hand—in cash. In other words, these guys are locking in a 40–50% profit before they even start to build. In my opinion, the situation the Guatemalan construction industry is experiencing right now is so extraordinary that there’s no way it can last more than another year or two. For this reason, I believe it’s imperative we continue to expand aggressively our U.S. and European sales.

“On the second issue, concerning our raw material, I am more amenable to changing our plans. To put it bluntly, from a production standpoint, rubberwood has

been a pain in the neck for the last three years and maybe we should rethink the extent to which we tie our fate to this raw material. On the other hand, I agree with Haroldo that we can't just throw away everything we've been working on for three years. If Houghton is able to guarantee us significant help in the financial and marketing realms, I can devote more of my time to solving manufacturing problems, and we still might be able to turn a nice profit with rubberwood.

"I like the idea of (1) seeing what Craig Ericksen says over the next two days; and (2) running a production test for a month to see how many doors we can produce per day and at what cost. Meanwhile, on the marketing end, let's push our U.S. distributors to sell hard in the next few months so that we can determine as soon as possible rubberwood's market potential. If the results of these tests indicate that rubberwood is more headache than it's worth, then I agree we should start working with other hardwoods and thinking more seriously about the *maquila* concept with oak."

The three managers adjourned the meeting agreeing to follow Edgardo's final recommendations.

Friday, January 14, 1993

Guatemala City

Craig Ericksen arrived in Guatemala City on Friday mid-day and in the afternoon met with Edgardo at the Odj plant.

Craig entered Edgardo's office, shook his hand, and said, "*Um prazer. Como vai? Tudo bem?*"

"*Todo bien. Si, estoy bien,*" replied Edgardo. "I see you must have been in Brazil. You speak a little Portuguese."

"Yeah," said Craig, "I lived in Brazil for three years, working for Citibank in São Paulo. It seems to me that the wood products industry here in Guatemala shares a number of concerns with their counterparts down in Brazil: environmental destruction and international outcry, but much less ecological concern on the domestic level. Is that right?"

"That's a pretty accurate comparison," said Edgardo. "The people here in the capital think about the rainforest up in Northern Guatemala as if it were the Wild West and aren't really too surprised or concerned

when they hear about illegal environmental destruction up there. I must say, however, that there is much more environmental awareness now in Guatemala than there was a few years ago, even though we don't see the effects yet in the domestic demand for 'environmental' wood products.

After a few rounds of pleasantries about wood and local concerns, Edgardo continued: "As you can see from the business plan, Odj is still seeing a strong demand for traditional hardwoods within Guatemala and Central America. While traditional hardwoods are also in demand internationally, the company plans to concentrate on promoting 'castilla' or rubberwood in the U.S. and European markets, partly to take advantage of the growing 'Green Consumer' trend in these countries."

Craig and Edgardo toured the factory, talked with various production supervisors, and then sat down to discuss the business. The following is a summary of their conversation:

Craig: "You provided us with two separate valuations of Odj, a shareholders' equity statement and a future earnings model. With regard to your equity statement, I am very wary of basing my assessment of Odj on these figures. I'm not an expert in machinery, but it looks like a considerable portion of your equipment is second-hand and has negligible salvage value. Because of the lack of reliability of these numbers, I have instructions from the Houghton partners to focus our discussion on the projected earnings statement.

"Turning to the projected earnings model, I also have a few doubts. When participating in a risky venture like Odj, Houghton usually demands a minimum IRR of 14–15% above inflation, which in this case would be an IRR of 22 or 23%. If we take your numbers as believable, then your profit projections would probably fall above our minimum criteria. However, I'm not too sure what your numbers are based on. Essentially, the management of Ojo del Jaguar is taking a company that is just now breaking even and asking Houghton to pour in \$800,000 for a 40% share. What are you basing this confidence on?"

Edgardo: "Our optimistic outlook is based on the argument we present in the business plan; namely, that as sales rise substantially over the next five years, our

Exhibit 6**Odj SUMMARIZED PROJECTED EARNINGS**

(in US\$ 000s)

	1993	Percent of Sales	1994	Percent of Sales	1995	Percent of Sales	1996	Percent of Sales	1997	Percent of Sales
Sales	\$4100		\$5500		\$7200		\$9500		\$12000	
Cost of Goods Sold:										
Wood	1400	34%	1750	32%	2200	31%	2750	29%	3400	28%
Materials	170	4	220	4	300	4	400	4	500	4
Labor	1200	29	1500	27	1900	26	2400	25	3000	25
Overhead	<u>350</u>	<u>9</u>	<u>510</u>	<u>9</u>	<u>600</u>	<u>8</u>	<u>650</u>	<u>7</u>	<u>700</u>	<u>6</u>
	3120	76	3980	72	5000	69	6200	65	7600	63
Gross Profit	980	24	1520	28	2200	31	3300	35	4400	37
Selling and Advertising Expense	700	17	1000	18	1400	19	2150	23	2600	22
Interest Expense	<u>180</u>	<u>4</u>	<u>220</u>	<u>4</u>	<u>300</u>	<u>4</u>	<u>400</u>	<u>4</u>	<u>500</u>	<u>4</u>
Profit before Taxes	100	2	300	5	500	7	750	8	1300	11
Taxes	<u>30</u>	<u>1</u>	<u>90</u>	<u>2</u>	<u>150</u>	<u>2</u>	<u>225</u>	<u>2</u>	<u>390</u>	<u>3</u>
Profit after Taxes/Increase to Retained Earnings	\$70	2	\$210	4	\$350	5	\$525	6	\$910	8
Cumulative Retained Earnings	\$1569	38	\$1779	32	\$2129	30	\$2654	28	\$3564	30

average production and administrative costs will diminish. If you look at our projected earnings model, you can see that we expect sales to rise approximately 33% each year while our costs will only increase approximately 25% annually. Part of these cost savings will be due to 'leveraging our costs'; our overhead (rent, administrative salaries, etc.) will not grow nearly as fast as our sales. More importantly, we expect significant cost savings as we move higher on the learning curve in our production of a standardized product line."

Craig: "The partners want more information about your current export marketing structure and your export marketing plan for the future. What can you tell me?"

Edgardo: "Our current export marketing structure is the following. One of the original investors in Odj, our U.S. partner, lives in California and has numerous contacts in the home furnishings industry. While he does not work exclusively for Odj, over the past three years he has helped us cultivate several important furniture clients. In addition to this partner, we have been working closely with a distributor in Texas, a Nicaraguan who has been living in the States since the early '80s. While he also doesn't work full-time for Odj, this Texas distributor has taken the lead for us in selling the kitchen and bathroom line; in 1992 we sold him US\$300,000 of this product. Finally, my father has numerous U.S.

contacts who have helped us in the past and I have made several trips a year to the States for trade shows or to follow up with important clients.

"As for the future, I must emphasize that one of the main reasons we are seeking an outside partner is to strengthen our marketing efforts. Maybe through one of Houghton's contacts we could tap into an already established home furnishings sales and distribution system and simply pay a percentage commission on sales. If we get more serious about negotiating a partnership with Houghton, perhaps we can discuss this idea in further detail."

Craig: "Do you have more detailed production cost information available, particularly in reference to your export products? For example, do you have a cost breakdown for each final product that leaves the plant? If you don't have this information, how will you know in the future if you are improving your production efficiency?"

Edgardo: "We don't currently have the cost information you are requesting but we recognize that this is another area for improvement. There are two concrete steps we are taking to improve our cost controls: (1) In the next month we will be hiring another accountant and one of the main duties of this new hire will be to

improve and monitor our production cost controls. (2) Yesterday I held a meeting with the other principal partner and Odj's plant manager in which we decided to run a production test for a full month on the kitchen and bathroom cabinet line. Simultaneously, we are going to press ahead with aggressive marketing of this product line in the United States. Thus, in another month and a half we should have more accurate cost information as well as a better sense of export market demand."

On Saturday morning Craig took another walk around the plant and confirmed his hunch that while the machinery was working well for Odj, it would be difficult to assess its scrap value. Before leaving to catch the plane back to Miami, he informed Edgardo that although Houghton was interested in Odj, the rubber-wood project was just too risky a venture to merit investment at the present time. Craig advised Edgardo that he would like to review the cost and marketing data in two months or so and he would keep in touch.

Monday, March 15, 1993

Guatemala City

Ojo del Jaguar decided in January to pursue simultaneously the BCIE loan and outside private investment. As for the loan, Odj was deeply involved in the time-consuming loan approval process. Even though final approval and disbursement of the loan was still a minimum of six months away, Edgardo already had a five-inch thick binder filled with BCIE loan documents.

Still interested in pursuing the Houghton investment, Edgardo sent Craig Erickson the following fax:

March 15, 1993

Dear Craig:

I'm writing to inform you of the results of our six-week production and marketing tests and I have some good and bad news to report.

Production Positive Results: The quality of the finished doors was excellent and our yield within the factory, normally around 50%, improved to nearly 60% in this production run.

Production Negative Results: Instead of reaching our target of 1,000 doors per day, we produced an average of 600. With experience, however, we still expect this production figure to increase significantly. Another problem we encountered was that

we ran out of wood finisher halfway through the production run. As this finisher is only available in the United States and Europe, we had to shift production to another furniture piece, while we waited a week for the new finisher to arrive.

Marketing Positive Results: It looks like we have significant interest in Texas among developers building new apartment and condominium complexes.

Marketing Negative Results: The process to win over these construction contracts is very time consuming and adversely affects our cash flow situation. It takes 30 days for our distributor to prepare and submit a bid, 30 days for the developers to decide on a supplier, and 30 more days to deliver the product and be paid. Thus, we must wait 90 days for payment, which is difficult as we are short of cash at the moment. Partly because of cash flow concerns and partly to improve efficiency, we laid off 40 production personnel last week.

That's all the news I have for now. Please stay in touch and I hope to speak to you soon.

May 1993

Guatemala

In a very surprising move, the democratically elected president of Guatemala, Jorge Serrano Elias, implemented an *autogolpe*, disbanding the Congress and the Supreme Court and suspending most civil liberties for the general population. The state of emergency lasted eight days before Serrano was forced to resign and flee the country. Although Serrano officially justified the coup as an attempt to stem corruption and narcotrafficking, a series of factors and events had created a very unstable political environment in the months leading up to the coup: a steep increase in electricity rates, student protest against the Education Minister, the death of a student at the hands of government bodyguards and escalating national strikes.

The *autogolpe's* effect on Ojo del Jaguar was as follows:

- I. Guatemala was removed from the U.S. Generalized System of Tariff Preferences, thus increasing substantially the import duties charged for Odj products.

MAP OF GUATEMALA



2. The United States cut off all aid to Guatemala, thereby jeopardizing the contract for the USAID health program and the BCIE loan.
3. The black market exchange rate rose from Q5.4 per US\$1 to Q5.8 per US\$1 in a period of eight days, a devaluation of 7.5%.
4. The general investment climate in Guatemala soured dramatically.

Odj management was extremely upset by the news of the coup and worried about a direct, negative effect on its business. Without the protection afforded by the Generalized System of Tariff Preferences, Odj products were not nearly as competitive in the U.S. market. In addition, U.S. importers adopted a “wait and see approach,” putting on hold several large orders for Odj until the outcome of the crisis became clear.

Fortunately for Odj and Guatemalan exporters, the president was deposed and the constitution restored in less than two months. The Guatemalan Congress elected a new president who had strong international support, and foreign assistance and trade preference programs were fully restored. Odj continued its pursuit of both the Houghton investment and the BCIE loan.

Notes

¹This case was written by Neal Brady of Columbia Business School. The case is intended as a basis for class discussion

rather than to illustrate either effective or ineffective handling of an administrative situation.

²The sabotaging of the telephone line could have been performed by guerrilla groups in the area, but more likely was simply a petty crime, i.e., someone stole the cable in order to resell it. Guerrilla groups were active near Odj in the mid- to late-1980s, but had not been very visible in the area in the last few years.

³In 1993, 20 centavos was equivalent to approximately US\$.05. Increases in the bus fare traditionally sparked widespread public protests in Guatemala. In August 1985, for example, a government attempt to raise bus, milk, and bread prices lead to widespread riots, bus burnings, 12 deaths, over 1,000 arrests, and army occupation of the national university. See Susanne Jonas, *The Battle for Guatemala* (Boulder: Westview Press, 1991), p.181.

⁴In Guatemala, workers receive a government-mandated “13th Salary” at the end of the year, called the *aguinaldo*. In other words, in addition to the normal 12 months of salary, employees receive an extra month’s paycheck in the middle of December. In 1992 the government mandated that private companies must also pay employees a “14th month salary,” hence the *Bono Catorce* (the 14th Bonus).

The *Bono Catorce* arose out of a highly politicized debate over workers’ rights in the 1990 Guatemalan presidential elections. Even though the winner of the presidential elections, Jorge Serrano Elias, did not campaign for widespread labor reform, this issue remained prominent on the national political agenda. In order to avoid even more costly alternative programs, private sector representatives acquiesced to the *Bono Catorce* proposal.

⁵Ojo del Jaguar S.A. means “Eye of the Jaguar.” The jaguar symbol was very prominent in Mayan mythology and was considered a sacred animal by the ancient Maya. S.A. stands for *sociedad anonima* and is the Spanish equivalent of Inc., or corporation.

⁶Millwork products were defined as doors, windows, baseboards and casework of all types for the residential construction industry.

⁷The Guatemalan currency, the quetzal (= 100 centavos), was valued at approximately 5.3 quetzals = US\$1. This figure and those that follow are stated in U.S. dollar equivalents rather than quetzal to simplify the presentation.

⁸Edgardo’s father sat on the board of two of the largest banks in Guatemala, as well as multinational companies in the cement, insurance, and tobacco industries. In Guatemala, it was common practice for top executives to sit on the boards of as many as five separate major corporations. Top Guatemalan executives generally did not receive high salaries by U.S. standards so they sat on numerous boards to gain extra income.

Edgardo's father was a great admirer of the U.S. entrepreneurial spirit and the United States in general. In fact, he was such a staunch defender of U.S. values that in 1942 he took a train from Guatemala City to Washington, D.C. and enlisted to fight for the Allied cause in WWII.

⁹There were two different, equally important lumber yields calculated at Odj: (1) *The raw log to sawn board foot yield*: The yield at the sawmill, calculated by dividing the sawn board feet that came out of the sawmill by the raw log board feet that went into the sawmill; and (2) *The sawn board foot to manufactured product yield*: The yield within the factory, calculated by dividing the board feet that came out of the factory in finished product by the sawn board feet that went into the plant.

¹⁰It is important to realize that in addressing production problems, Edgardo and Haroldo worked almost completely on their own, without any significant technical assistance. The vast majority of rubberwood producers—over 95%—were located in Asia, and there was no other rubberwood operation in Central America.

¹¹In 1920, Henry Wickham was knighted by George V. See “Seed Snatch” in Howard and Ralph Wolf, *Rubber: A Story of Glory and Greed* (New York: Covici, Friede Publishers, 1936), pp. 151-168. See also Barbara Weinstein, *The Amazon Rubber Boom: 1850-1920* (Stanford, CA: Stanford University Press, 1983), p. 218.

¹²The *Banco Centramericano de Integración Económico* (BCIE) was a multilateral development bank whose mission was to support industrial development in Central America with an emphasis on medium to large export-oriented companies. The members of the BCIE were the five Central American countries; additional funding came from the United States and several Western European nations.

¹³Ojo del Jaguar purchased the land for its plant from a prominent family which owned the most widely read newspaper in Guatemala. In the early 1980s, the patriarch of this clan was assassinated by guerrillas while sitting by his swimming pool at a house 200 meters from the present day factory.

In its first year of operation, 1989, Odj was visited by a guerrilla group which left a letter demanding that the company raise the wages of its workers. Confident that he was paying a reasonable, slightly above-market wage, Edgardo ignored the letter and has not had any further encounters with guerrilla groups.

¹⁴While legal purchase of these timbers was increasingly difficult, there was a strong black market trade in Guatemala. In late 1991, a Guatemalan reporter launched an investigation into illegal logging in the Maya Biosphere Reserve, a government-designated wilderness area. While pursuing this investigation, the reporter was violently assaulted, repeatedly threatened with his life, and ultimately forced to leave the country with his family. “Periodista Omar Cano partió hoy al exilio.” *Siglo Veinte Uno*, February 10, 1992, p.2.

¹⁵*Maquila* refers to the process whereby foreign companies send raw materials to Guatemala to have final products assembled and then reshipped backed to the home country. The term “maquila” is most commonly used in reference to the textile industry in Guatemala and Mexico but the concept can be applied to other areas of production. In the Guatemalan textile industry, *maquila* producers are not taxed on the value of their imported raw material; duties are only paid on the value-added portion of the final product upon reshipment to the United States. In the last seven years, the *maquila* textile industry in Guatemala has been the fastest growing export sector in the Guatemalan economy, averaging 68% annual growth.