

## Case 7

### FRANK DAVIS COMES TO MADAGASCAR<sup>A</sup>

#### Antananarivo, Madagascar

*Valerie VinCola*

Frank Davis entered the cocktail lounge at the Madagascar Hilton Hotel, located in the nation's capital city of Antananarivo, and quickly scanned the room. Behind a cloud of cigarette smoke in the corner there was a table of boisterous French businessmen. A few other tables of two or three people were scattered throughout the lounge. Frank chose a seat at the bar next to a well-dressed white man who looked like he might be American. This was Frank's first visit to Madagascar and he wanted to get the impressions of other Americans doing business there.

"What would you like?" asked the bartender in slightly accented English.

"A beer, please. What kind do you have?" Frank asked.

"Actually the THB isn't bad. It's the local beer," offered the well-dressed gentleman next to Frank.

"Thanks. I'll try a THB," Frank told the bartender.

"Is this your first time in Madagascar?" asked the man after introducing himself as Jean-Paul, an American of French descent.

"Yes. I'm here evaluating the local business climate. I work for a U.S. food

processing company, Summit Foods, that is interested in the local spice market. How about you?"

"I head up the operations of a textile company in Madagascar's free trade zone, Zone Franche. I've been here since right after the presidential election in 1993."

Frank was somewhat familiar with the recent political history based on background material he had received from the U.S. State Department. Madagascar was a former French colony that had gained independence in 1960. Since independence, there have been four presidents: Tsiranana, from 1960 to 1972, and Ratsimandrava, assassinated in 1975, were both in power during the First Republic. Then came Ratsiraka, who introduced the country to the Second Republic and socialism, but he was forced to yield to a transitional government in 1991 after a 6-month strike. In February 1993 the current president, Zafy, was elected after a popular referendum which adopted a new constitution establishing a mixed presidential-parliamentary regime. Since the late 1980s and particularly under Zafy's Third Republic, the country was

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attempting to shift to a free-market economy from a centrally planned one.

“A textile company?” said Frank. “Then you must be pretty familiar with the general investment climate here. My boss is convinced there’s a lot happening in this country because he has a distant relative who made a fortune here. But I haven’t had a chance to look around yet, except for the ride from the airport to the hotel, and that was pretty depressing. The poverty seems to be so pervasive, and yet we passed several Mercedes and sport utility vehicles that didn’t seem to be driven by foreigners. I don’t get it.”

Jean-Paul laughed and shrugged his shoulders. Although he was smiling, his eyes seemed to be sad. “Investment climate? Investment climate . . . Well, I guess it depends on how you define it, and how badly you want to invest. It also depends on who you know and who you are willing to pay to get things done.”

Frank’s eyebrows shot up. “Pay to ‘get things done’? Like what things?” he thought to himself. He let Jean-Paul continue.

“The Third Republic is about 2 years old. The present administration was elected after a general strike that brought the government and the economy to a standstill. Conditions were bad, wages were low, and people got sick of socialism because it seemed to be benefiting only those in power, not the country. The new administration claims to support free-market capitalism, but according to many of my Malagasy business associates, this crew is almost as bad as the crew they voted out.”

“But your company is still here. Obviously you are making money if you’re still here, right?”

“Believe it or not, we’re making money despite the local business climate and the Malagasy government, not because of it. Thanks to the Zone Franche, we pay no

taxes on our export receipts and we can hold our profits in U.S. or French currency. Otherwise all the foreign exchange we earn would have to be directly deposited into local banks and then would be automatically converted and held in Malagasy currency. If we were not in the Zone Franche, each time we needed foreign exchange to do business outside the country, we would have to apply for it and, of course, pay a fee! Our firm is doing okay here due to the low barriers to entry in the textile industry, low labor costs, and the ability of the Malagasy work force to master new skills quickly. But you would not believe all we’ve gone through to get where we are now.” Jean-Paul fell silent and took a long drink of his beer.

Frank was thoughtful. “This guy doesn’t seem too optimistic, but he himself said he’s making money. I wonder what kinds of problems he ran into.”

“Don’t get me wrong. This is a beautiful country and the people work incredibly hard. When I first came here after President Zafy took office, I was full of optimism and could see lots of possibilities. I’ve been in operations management for 20 years. I’ve dealt with unions, weathered the effects of the energy crisis and foreign competition on the textile industry, as well as the relocation of our company to the southeastern United States from Massachusetts, my home state. I’ve even helped my company locate a facility in Taiwan. But it hasn’t prepared me for some of the things I’ve dealt with here.” He smiled ruefully and pushed back his chair. “Oh, and one more thing,” Jean-Paul added.

“What’s that?” Frank asked, eager for more information

“Do you have an umbrella?”

“An umbrella? No. Why?” Frank asked, puzzled by the amused expression on Jean-Paul’s face.

“Buy one, you’ll need it. We’re getting into the rainy season here, complete with cyclones. You’ll see what I mean soon enough. I wish you luck.”

“Cyclones!” Frank thought to himself. “Thanks,” he said to Jean-Paul’s back as he headed toward the door.

Frank wasn’t sure whether Jean-Paul was wishing him luck with his assignment or in weathering the rainy season in Madagascar. He felt a bit discouraged, but at the same time his interest was piqued. He smelled a challenge and envisioned himself as an investment pioneer in rugged territory.

### FRANK’S ASSIGNMENT

Frank Davis had been sent to Madagascar on an exploratory mission by his supervisor, Martin Herlihy, a regional vice president of a multinational food processing company, Summit Foods, based in the United States. Frank had been asked to identify potential opportunities for the company to either import agricultural products or set up a food processing operation in Madagascar. He was also asked to assess the country’s general investment climate. Even if opportunities could be found, Frank’s boss knew there could be several nonquantifiable costs of doing business in a developing country that could render an otherwise profitable project infeasible. Frank’s foresight and good judgment had saved the company money in past expansion projects, and Martin knew Frank would be thorough in considering the many factors that could influence a potential investment. Martin was eagerly awaiting Frank’s assessment of the situation.

Martin Herlihy was interested in expanding Summit Foods’ product offerings to include spices. Due to the heightened health consciousness of U.S. and European

consumers, spices were quickly replacing oils and heavy sauces as a natural flavor enhancer in both commercially processed and prepared-at-home foods. Given the increased numbers of dual-income families, consumers cooked at home less often than they did 20 years ago. However, they were using more volume and a greater variety of spices when they did cook at home. Ethnic cooking and ethnic restaurants were extremely popular, and that preparation required many nontraditional spices.

Madagascar was known for its spices, particularly vanilla and cloves. (See Exhibit 1.) Martin asked Frank to find out about other types of spices grown in Madagascar and their current production levels. He felt strongly that the Malagasy government would encourage export of spices because he knew that cloves and vanilla were historically the main sources of foreign currency earnings in the country (Exhibit 2).

The restaurant at the Hilton did not serve dinner for another hour and a half. Frank decided to take a walk around the neighborhood of the hotel. Although he had researched Madagascar as thoroughly as possible before he left the States, he had not found much information beyond the official reports put out by government agencies such as the State Department and the Commerce Department. He had learned that Madagascar was the world’s fourth largest island with a population of 12.5 million, 1 million of whom lived in the capital, Antananarivo, where he was staying. The annual population growth rate was estimated to be 3.19%, with a fertility rate of 6.68 children per woman. In economic terms, this could mean a largely untapped consumer market if the people had disposable income to spend. But Frank was not sure how to assess that yet. The annual per capita income was about \$230 but he did not know what the

**EXHIBIT 1** Spices of Madagascar

English Name	French Name	Malagasy Name	Latin Name
<b>Spices currently exported</b>			
Cinnamon	Cannelle	Kanela	<i>Cinnamomum zeylanicum</i>
Turmeric	Curcuma	Tamotamo	<i>Cucuma longa</i>
Ginger	Gingembre	Sakamal	<i>Zingiber officinale</i> <i>Roscoe</i>
Clove	Girofle	Jirofo	<i>Syzygium aromaticum</i>
Hot or chili pepper	Piment capsicum	Sakay	<i>Capsicum frutescens</i>
Black peppercorn	Poivre noir	Kipoavatra mainty	<i>Piper nigrum</i>
Green peppercorn	Poivre vert	Dioavatra maitso	<i>Piper nigrum</i>
Vanilla	Vanille	Lavanila	<i>Vanilla fragrans</i>
<b>Spices That Have Export Potential</b>			
Pink peppercorn	Baie rose	Voatsiperifery	<i>Schirus terebenthifolius</i>
Mace	Macis		<i>Myristica fragrans</i>
Nutmeg	Noix de muscade		<i>Myristica fragrans</i>

SOURCE: May 1994 Study of Madagascar Exports for Horticultural Products, ATW Consultants for USAID.

NOTES: Black peppercorn and green peppercorn share the same botanical name, probably because green peppercorn is a fairly new recognized plant. Mace & Nutmeg are part of the same plant, so they have the same botanical name. Apparently there are no Malagasy words for these spices. They are grown in the wild, not commercially, so perhaps they are not used in Malagasy cooking and are not known as spices there.

**EXHIBIT 2** Exports of Nontraditional Spices From Madagascar (1993)

Customs Code	Spices	Quantity (kg)	Value FOB (1,000 FMG) <sup>a</sup>	Price/kg FOB <sup>a</sup> (1,000 FMG) <sup>a</sup>
090411100	Green peppercorns in brine	371,559	1,616,136	4,350
090411900	Other peppercorns, not ground	1,470,148	2,506,289	1,705
090412000	Peppercorns, ground or crushed	4,824	37,064	7,683
090420000	Chili peppers, dried or ground	20,022	96,635	4,826
090610000	Cinnamon, whole	1,169,319	1,704,081	1,457
090620000	Cinnamon, ground or crushed	46,724	86,310	1,847
090810000	Nutmeg	143	1,725	12,063
090930000	Cumin seeds	150	99	660
090950000	Fennel seeds	245	36	147
091010000	Ginger	17,461	8,682	497
091020000	Saffron	146	194	1,329
091030000	Turmeric	2,256	15,402	6,827
091040000	Thyme	48	81	1,688
091050000	Curry	232	1,518	6,543
091099000	Other spices	476	6,619	13,905
	Total	3,103,753	6,080,871	

SOURCE: State Data Bank (BDE) Antananarivo.

NOTE: Average rate of exchange in 1993: 1 U.S.\$ = 1,900 FMG; 1 FF = 330 FMG. FOB, freight on board.

median income was, or what the cost of living was.

He knew Madagascar was approximately the size of Texas and rich in natural resources such as graphite, chromite, coal, bauxite, titanium, salt, quartz, and tar sands, as well as semiprecious stones. His environmentally conscious friends in the States knew that the country was home to many species and even genres of flora and fauna that were indigenous nowhere else in the world. He also knew that there was widespread soil erosion caused by deforestation and overgrazing, and that this was contributing to desertification of the island. Several species of plant and animal life were endangered.

Frank also knew a little about the Malagasy people. Their ethnic origin was a combination of Malay-Indonesian, African, Arab, French, Indian, and Creole. The religious composition of the population was 7% Muslim, 41% Christian, and 52% indigenous beliefs. A strong emphasis on ancestor veneration characterized most spiritual belief in the country. Over 90% of the Malagasy workforce was employed in the agricultural sector, including fishing and forestry, and the major exports included coffee, vanilla, cloves, shellfish, sugar, and petroleum products. The chief industries were largely agricultural product processing (such as meat canneries, soap factories, breweries, tanneries, and sugar-refining plants) and textile factories, like the company Jean-Paul represented.

The first thing that struck Frank after leaving the grounds of the Hilton Hotel was the poor condition of the infrastructure—streets, sidewalks, and the storm drainage or sewer system (he was not quite sure what the purpose was of the little streams that ran alongside the streets)—and the absence of traffic signals. Come to think of it, he did not remember stopping at a single red light on the way from the

airport. An extensive and well-maintained transportation network certainly would contribute to the success of any agriculturally based economy where the producers were geographically dispersed throughout the country.

Frank also recalled that the Madagascar airport was served almost exclusively by Air Madagascar, a state-owned enterprise. The lack of competition would likely keep the cost of freight and passenger travel high, with little incentive to improve service efficiency. Despite the poor roads and lack of traffic signals, there was certainly no shortage of cars in the capital, and almost every third car seemed to be a taxi. The air was hot and hazy, thick with car exhaust. Frank noticed several buses so full of people that the backdoors remained open and two or three people clung to the outside. Exhibit 3 captures a few of the sights that caught his eye along the way.

As he continued down the street, Frank was approached by several people selling a variety of items which they pushed at him: handicrafts, Ray Ban sunglasses, brooms, tire irons, a basketball, and some fruits or vegetables he did not recognize. “*Non, merci,*” he said over and over again, but they continued to walk alongside him displaying their wares.

“*Bon marché! Combien, Monsieur?*” They were ready to bargain but Frank had no money and no need for a tire iron in Madagascar. He began to feel annoyed and a bit overwhelmed by the entourage of vendors. He decided to turn back after another several minutes of sales pitches in French and another language which he assumed was Malagasy. It occurred to him that he needed to change his money at the hotel before dinner anyway. As he came closer to the hotel, he was approached by a barefooted little boy in dirty rags carrying a baby on his back. “That boy can’t be any more than 5 years old,” Frank thought, shocked by the sight. “And the

EXHIBIT 3 Scenes of Madagascar



Buildings fill the hillsides around downtown Antananarivo



A street vendor displays local produce in the market

baby isn't even old enough to walk. Where are the parents?"

"*Monsieur, donnez-moi la monnaie? Donnez-moi la monnaie?*" the boy begged,

thrusting his little hand forward. His big brown eyes implored Frank to give him some spare change. His face was dirty and his nose runny. Frank was torn inside but



looked away and walked quickly back to the hotel, just as the sky was turning dark and threatening rain. Frank reminded himself to buy an umbrella as he took refuge in the air-conditioned lobby from both the rain and the pitiful scene he had confronted outside. He headed for the cashier to change his money.

## THE FLOTTEMENT

The exchange rate was just under 4,000 Malagasy francs (FMG) to a dollar. Frank recalled that when he left the United States 2 days before, the rate was about 3,600 FMGs. "Could the rate have changed that much in 3 days?" Frank asked himself. Then he recalled what he had read about the monetary system. In May 1994, the FMG moved from a fixed exchange rate system to a floating exchange rate. The FMG was untied from the French franc (FF) to fluctuate on its own against hard currencies, but the FF remained the main currency of reference. This step to liberalize the Malagasy currency was referred to as the flottement, and was required by the International Monetary Fund (IMF) in fulfillment of a planned structural adjustment program. As a result of the flottement, the FMG lost about half of its value almost overnight, setting off wide-scale price increases. Because of the weak economy, Madagascar's currency was weak. It had consistently lost value relative to hard currencies since the flottement was instituted.

"Do you need to stamp this?" Frank pushed a small currency declaration form across the counter to the cashier. He had been given the form by the stewardess on his flight into Madagascar and told to declare all his currency, traveler's checks, credit card account numbers, and personal checks. The paper was barely large enough to contain all the information requested, but Frank

complied. He did not want to be unnecessarily detained for not following procedures when he left the country. His tour book had warned him that airport officials would ask him how much he spent in the country and whether he was taking any Malagasy money outside the country with him.

"I'm sorry sir, we don't have a stamp. Only the banks stamp the form if you change money there," the cashier informed him.

"But aren't I required by law to have a stamp? How can the hotel exchange money for me but not stamp my form? I'm not sure I understand." Frank was genuinely puzzled.

"If you want your form stamped, you must go to a bank. But the banks are closed until Monday. If you want to exchange your money here, I'll give you a receipt, but I don't have a stamp. Do you want to change it here?"

Frank hesitated. He wanted to follow the rules but he did not quite understand them, and the cashier did not really clarify it for him. He needed the money now and the banks were closed. Was he expected to wait two days to exchange his money, or would he have to explain his predicament to the airport officials and risk being detained at the airport? He finally decided to exchange only as much money as he thought he would need for the weekend, and hope it would not be an issue later. He did not see any other option.

"For a country that is badly in need of foreign exchange, they certainly make it difficult to convert your money," he thought to himself as he left the counter.

## GOVERNMENT APPROVALS

Frank entered the dining room and was seated promptly at a corner table set for one. A short time later Jean-Paul poked his

head inside the restaurant and, seeing Frank, waved and approached his table.

“Mind if I join you?” he asked.

“Not at all.” Frank gestured towards a chair, “Please, have a seat.”

“How are you doing? I barely missed getting caught in the torrential downpour. It’s coming down pretty hard out there.”

Both men stared out the window at the pouring rain. The sky was dark and ominous. It was hard to believe that just 45 min ago the sun had been shining brightly with barely a cloud in the sky.

After giving their dinner orders to the waiter, Frank decided to broach the topic of Madagascar’s investment climate again with Jean-Paul. He felt that although Jean-Paul seemed a bit cynical, there was probably a lot he could learn from his experiences. He planned to try to schedule appointments at the Ministry of Commerce, Ministry of Industry, Energy and Mining, and Ministry of Transport, Meteorology and Tourism during his 1-month visit. He felt that an initial discussion with Jean-Paul would help him put things into a context and develop some meaningful questions for his interviews with the various Ministers.

“So Jean-Paul, I’m interested in hearing more about your experiences in Madagascar, if you don’t mind sharing them with me. Tell me about some of the obstacles or problems your company encountered when trying to set up a facility,” Frank asked.

“Well, the first thing any company interested in setting up business in Madagascar needs is an *agrément*, or official approval of the government. The hard part is deciding who to approach to obtain this approval, and how to present your business proposal. You need some type of approval from every ministry which has jurisdiction over any part of your business. For example, in our case, we needed the okay of seven ministries, and each ministry has a set of questions that must be answered and documents

that must be filed. Some ministries asked for the same information, others asked for information which seemed irrelevant or outside their jurisdiction. One ministry lost our dossier, but didn’t bother to inform us—and maybe they didn’t realize themselves—until we called to inquire about the status of the approval 2 months after submitting everything. The amount of red tape here is mind-boggling.”

“Is there some sort of checklist or description of the type of documentation required? I mean, do they want a full-blown business plan? A letter from your financial institution? What do they base approval on?” Frank asked, trying to get a clearer picture of what the Malagasy government would request.

“That’s just the problem. No one seems to know. It changes from ministry to ministry, day to day. To the first ministry we approached we gave every piece of documentation we thought they could possibly use. I figured that if I was forthcoming with information and demonstrated a serious willingness to do business in Madagascar, the review process would be shorter because they didn’t have to keep asking for additional information. I even gave them the names and resumes of the managers we intended to bring in to manage the new facility,” explained Jean-Paul.

“That seems like a reasonable approach. Did it help expedite things?” Frank asked.

“Expedite? That’s not quite the word I would use. Try *mora mora*,” responded Jean-Paul. “It means slowly, slowly in Malagasy—and is often used to describe the ‘Malagasy way,’” he grinned. “That first ministry was the ministry that lost it all. Or at least that’s what they told us after 2 months.”

Jean-Paul went on to explain that there seemed to be a great deal of overlap between the ministries, and even conflicting information about what types of



business activities are encouraged. The laws of one ministry were often superseded by proclamations, decrees, and statutes of that ministry or a different one. There was also a lack of communication between ministries, and Jean-Paul got the feeling there were little rivalries and power plays among the ministries.

“Reasons for denial or disapproval are not given, so it’s difficult to address their concerns and try again. I heard from a friend that he knew someone who was denied an *agrément* because they wouldn’t offer an interest in their project to people high up in the ministry.”

“It sounds like there’s a problem with administrative efficiency and consistency. But you could probably find that sort of problem in any large organization in any country, really,” Frank remarked.

“That may be true. But if you want to do business in this country and save yourself a lot of time and trouble, I’d suggest you find yourself an influential partner who is highly placed in the government.”

The waiter arrived with their dinner. As he laid the plate down in front of Frank, the lights went out and the music stopped. The waiter immediately lit the candle on the table as other waiters circulated around the dining room to light those at other tables.

“*Bon appetit!*” the waiter said to the two men, as he walked back toward the dark kitchen. Dumbstruck, Frank watched the hotel employees for a few minutes waiting to see if someone would take control of the situation and explain to the customers what was going on. Jean-Paul and many of the other diners began eating as if nothing was awry.

“If you’re waiting until the lights come back on to eat your dinner, it’ll probably be cold. You might as well eat. The power will come back on eventually. It goes out just about every time there’s a big rain.

During the rainy season, that could mean at least once a day.”

Frank was surprised. Frequent power outages could obviously cause problems with production schedules and delivery dates. And what about information management? Companies which were highly dependent on data must have to take special precautions to safeguard it. Frank made a mental note to find out what provisions were made for back-up power sources, if any.

“What other types of problems have you dealt with?” Frank asked.

“The property rights laws,” Jean-Paul answered. “It’s been the policy of our company to purchase land and do the construction ourselves, to very exacting specifications. We have built two factories in other countries in the recent past and have found the best layout and configuration for our machinery and assembly lines. So we prefer to build from scratch rather than lease. But, as you may know, foreigners cannot own land in Madagascar. This posed a problem for us, and frankly our CEO took this to be a signal of distrust by the government.”

Frank was not aware of this prohibition against foreign ownership of land. Jean-Paul went on to explain that the Malagasy culture considered the land to be sacred. He had even heard a man once say that to the Malagasy, the land is like their body. It was passed down through the generations from the ancestors, and the fact that Madagascar was an island nation probably contributed to their beliefs. Jean-Paul explained that many people get around this law by using Malagasy partners, but that this arrangement can be extremely costly and risky because the foreigner is beholden to the Malagasy. If there is ever a dispute or the relationship deteriorates, the foreigner has questionable legal recourse.

Jean-Paul’s company solved the problem by leasing the land under a 99-year

lease and constructing a building that would revert to the property owner at the end of the lease term. The rent was paid in foreign currency because of the high inflation rate. This eliminated the need to have the rents adjusted monthly as the value of the Malagasy franc declined.

“Is that legal? It seems like the government keeps very close tabs on the exchange of foreign currency,” Frank remarked. Jean-Paul shrugged.

### VISITS TO ASSESS THE POTENTIAL FOR EXPORTING SPICES

Over the next several days, Frank tried to make appointments to speak with government officials, agricultural membership organizations, food processors, exporters, and anyone else who he thought would have valuable information about the export potential for nontraditional spices. At the Ministry of Agriculture he hoped to obtain national production statistics but soon learned that the information available was inaccurate, outdated, and incomplete. He also found out that the centralized or geographically concentrated cultivation of spices was declining in Madagascar, as the plantations once run by the French were either abandoned or extremely rundown. Some spices were grown wild and harvested by independent peasants, so yields varied from year to year. Many plants from the large plantations had succumbed to disease, and those that grew wild often were damaged by severe weather and by the rampant deforestation taking place on the island, because they were not grown in a self-contained and protected area. The wide dispersion of spices also could pose a problem for processors, as the roads and communication infrastructure were almost nonexistent in many rural areas.

On the positive side, Frank was heartened to find out that spices were not restricted export products. Initially, he feared that they might be classified as protected flora, and therefore could not be exported except by special permit due to environmental regulations. Frank did have some concerns about the quality grade of the spices and whether it was comparable to those on the world market. He found out that there were government standards, set by the Ministry of Commerce, for most types of spices. However, these standards pertained to physical characteristics, such as the length and width of the vanilla bean, rather than the quality, growing and harvesting conditions. The majority of spices grown in Madagascar were exported, with 80% going to Europe. (See Exhibit 4.) Frank hoped that boded well for the U.S. market, and that the Malagasy spices would meet U.S. standards, which are typically the highest on the world market. He thought the products of the island would stand up well against those produced in other countries (Exhibit 5).

### MEETING A MALAGASY BUSINESSMAN

Frank set up a meeting with the proprietor of a Malagasy spice-processing company to learn more about the organization of spice production in Madagascar, and to gauge preliminary receptivity to the idea of forming a partnership with Summit Foods. He hoped to gain a better understanding of how the agricultural sector functioned, and what types of concerns Malagasy operators may have about working with an American importer.

Frank was early for his 2:00 p.m. appointment despite the traffic jam caused by market day in Antananarivo. He was

**EXHIBIT 4** Countries of Destination for Exports of Nontraditional Spices From Madagascar

Country	Quantity (kg)	Percentage	Value FOB (1,000 FMG)	Percentage
France	1,096,803	35	1,971,797	32
Germany	469,833	15	1,088,027	18
Great Britain	471,346	15	721,459	12
Belgium	149,473	5	583,252	10
The Netherlands	367,213	12	568,748	9
Soviet Reunion	68,557	2	171,382	3
Spain	87,221	3	162,850	3
South Africa	73,036	2	146,562	2
Poland	83,515	3	130,993	2
Italy	32,268	1	114,219	2
Soviet Union	12,500	0	97,170	2
Singapore	53,850	2	79,017	1
Tunisia	36,050	1	53,921	1
Nigeria	25,000	1	51,447	1
Niger	24,000	1	33,557	1
Denmark	3,730	0	28,963	0
Egypt	18,000	1	25,366	0
Comoros	22,627	1	17,536	0
Ghana	6,462	0	15,386	0
Sweden	1,259	0	7,804	0
Switzerland	300	0	4,899	0
United States	297	0	3,448	0
Austria	360	0	3,047	0
Mauritius	50	0	16	0
Malta	2	0	4	0
Monaco	1	0	1	0
Total	3,103,753	100	6,080,871	100

SOURCE: State Data Bank (BDE) Antananarivo.

NOTE: Ranked by value of freight on board (FOB), 1993. Average rates of exchange in 1993: 1 FF = 330 FMG; 1 U.S.\$ = 1,900 FMG; 1 ECU = 2,200 FMG.

offered a seat in a crowded office where five employees appeared to share one telephone and one typewriter. He noticed the office workers used and reused sheets of carbon paper to make copies of their work. At 2:15 p.m., Frank asked if Mr. Rakotomanana knew he was here. The workers exchanged glances and one of them told him he should be back shortly. Frank figured he may be tied up in traffic

somewhere. All of the meetings he had attended so far had begun at least 20 min late. The Malagasy took lunch from noon until 2:00 p.m., and many returned home for the noon meal with their family.

At 2:55 p.m., Mr. Rakotomanana arrived. Frank was slightly annoyed because he realized he would probably miss his next meeting, scheduled for 3:30 p.m. He asked if he could use the phone

**EXHIBIT 5** Alternative Sources of Supply for Spices

Spices	Origin	Unit	Price	
Cinnamon	Sticks	Madagascar	kg	
	Pieces	Madagascar	kg	
	Ground	Madagascar	kg	
Mace	Indonesia	ton	U.S.\$2,375	
Chili pepper	Nouvelle Guinée			
	Togo	kg	18–25 FF	
	Central Africa			
	Republic of China			
	Madagascar	kg	35–60 FF	
Peppercorn	Martinique	kg	35–100 FF	
	Morocco	kg	8–10 FF	
	I. White	Sarawak	ton	U.S.\$1,525–3,750
		Sarawak DW	ton	U.S.\$1,525–3,750
		Muntok	ton	U.S.\$1,525–3,750
	II. Black	Brazil	ton	U.S.\$1,900–3,300
		Lamong	ton	U.S.\$1,050–1,895
		Sarawak	ton	U.S.\$1,000–1,835
		Brazil	ton	U.S.\$1,000–1,700
	Ginger	Madagascar	ton	U.S.\$1,050–1,700
Brazil		kg	9–22 FF	
Thailand		kg	12–19 FF	
Chili pepper, green	Morocco	kg	6–10 FF	
	Madagascar	kg	30–60 FF	
	Martinique	kg	30–100 FF	

SOURCE: Marchés Tropicaux et Méditerranéens, 1993.

NOTE: Sales prices include cost, insurance, and freight.

briefly to call his next appointment. On his first few tries, there was no dial tone. One of the office workers volunteered to try calling for him so the meeting could begin.

After explaining who he was and Summit Foods' interest in spices, Frank spoke about his stay so far in Madagascar and asked for some recommendations about what tourist destinations he should visit. They discussed the weather, the local street market, and the traffic, and Frank complimented Mr. Rakotomanana on his

efficient staff. Frank was interested in touring Mr. Rakotomanana's processing plant but he did not yet feel comfortable asking to do so. Mr. Rakotomanana's manner was friendly, but still quite formal. Frank finally described in detail the techniques and processes used by Summit Foods, and asked Mr. Rakotomanana some basic questions about his operations. It was about 4:00 p.m. when Mr. Rakotomanana offered to take Frank on a tour.

The tour was brief, but Frank was impressed by how much they were able to

produce in such a small space with the unsophisticated equipment they used. He almost felt as though he were in a time warp. Many of the processes they used had been used in the United States in the 1940s and 1950s. Frank then asked some questions about the company's current customers and processing capacity: "You mentioned that your customers are all domestic. What is your current production capacity?"

"Yes. We like to produce for the Malagasy market. I cannot say for certain because our capacity depends on our customers. During harvest season, we hire temporary workers and they work longer hours until the work is finished," Mr. Rakotomanana explained.

"Are you interested in possibly producing for export as well?"

"Yes."

"Do you have the capacity to produce large quantities over a sustained period of time, for a large export customer such as Summit Foods, for example?"

"Yes. Of course." Mr. Rakotomanana seemed very definitive about that.

"Or would it be necessary to expand your operations, perhaps with the assistance of a partner like my company, through some sort of partnership agreement, to ensure you could meet demand?" Frank offered.

"Yes. I think that would be interesting," Mr. Rakotomanana eagerly replied.

"And your company would be willing to share in the capital expenses of such an expansion, if it were needed?"

Mr. Rakotomanana hesitated, and did not look back up at Frank. "I cannot say. This must be discussed with my family."

"Of course. I understand. I am only exploring the possibilities at this point. Do you think you might be interested in discussing this further at a later date?" Frank asked hopefully. He did not want to push too hard, but wanted to get a clearer

indication of what this processor could do for Summit Foods, and on what terms.

"Yes. I think it would be interesting."

"I am leaving in about 3 weeks. Would you like to set up a meeting next week, after you have a chance to discuss things with your family?"

"Oh, yes."

"When would be convenient for us to get together again?" Frank inquired. He was beginning to feel his approach may be too aggressive.

"I must talk with my family."

"Can you call me at the hotel, or should I phone you later to set up a meeting?" Frank at least wanted a definitive next step, since setting up the meeting had been so difficult to begin with.

"Yes."

Frank wasn't sure which question Mr. Rakotomanana was responding to.

"You can call me at the Madagascar Hilton?"

"Oh, yes."

"Or would you prefer that I call you?" Frank felt he might have a better chance of solidifying plans if he called Mr. Rakotomanana because he had already scheduled several meetings outside the hotel the next week.

"Oh, yes. I think that would be very interesting." The men shook hands and Frank departed.

As he left the building Frank thought to himself, "He certainly was an amiable guy, but a bit hard to read. Was he being realistic about his company's capabilities? He almost seemed too accommodating." Frank was not sure how well the meeting had gone.

## ASSESSING THE CREDIT MARKET

Frank ran into Jean-Paul at the Hilton on his way into the dining room, so they decided

to have a drink together before dinner. Frank wanted to know about the commercial loans market in Madagascar. If he were able to set up a partnership agreement or close a long-term deal with a Malagasy processor, the processor would most certainly need to expand in order to handle Summit Foods' business. Frank preferred to deal with one or two large suppliers rather than dozens of smaller ones, and he was fairly certain there were few, if any, with enough production capacity to take on a customer such as Summit Foods while continuing to serve their current customer base.

"What can you tell me about the credit situation here?" Frank asked. "I know the national government is far outspending its receipts and I'm sure that affects the availability of credit here. Did your company finance anything locally?"

"The banks here are extremely risk averse. Even so, they still have many non-performing loans in their portfolio. We didn't need to use any local banks for financing but we use a Mauritian-owned bank for our accounts payable and our payroll because we don't have a lot of faith in the local banking institutions. Two of the five banks are still partially owned by the Malagasy government, although they're in the process of privatizing. Until that happens, we'll stick with Union Commercial Bank."

Jean-Paul went on to explain that the prime rate was set by the Banque Centrale, which serves much the same purpose as the Federal Reserve Bank in the United States. The five commercial banks then set their rates accordingly.

"Just out of curiosity, what is the current rate to commercial borrowers?" Frank asked.

"Twenty-three percent," Jean-Paul answered, grinning. "No, really." Frank laughed.

"I'm dead serious, Frank. And they require a 50% guarantee."

"A guarantee? What do you mean? How does that work?"

Jean-Paul explained that a borrower must deposit 50% of the total amount of the loan in the bank, or commit some other type of collateral that is acceptable to the bank.

Frank was incredulous. "That's crazy. If you had the money to begin with, you obviously wouldn't need the loan."

Jean-Paul shrugged. He went on to explain that banks and other funding institutions depended a great deal on a borrower's reputation through word of mouth. There are no formal credit bureaus in Madagascar. Knowing the "right" people was essential.

Frank now understood the capital constraints firms like Mr. Rakotomanana's were facing. After Frank described his earlier conversation with Mr. Rakotomanana, Jean-Paul explained the concept of *fihavanana*, or family harmony, which was central to Malagasy culture. "It is a critical decision-making factor in all family decisions. Preserving the *fihavanana* is of great importance in this culture, and it often leads to 'uneconomic' business decisions. You are not dealing with what economic theory traditionally refers to as 'rational actors.' What makes perfect business sense to you may not even be a consideration to your Malagasy colleague."

Jean-Paul had another appointment, so Frank ate alone that night. Over dinner he considered what he had learned about doing business in Madagascar during his first week, and what additional information he would need before he left the country in 3 weeks. He was scheduled to receive a call from Martin Herlihy tomorrow morning to give him a progress report.

Madagascar was 8 hr ahead of the United States, so Martin would likely be



calling around 6:00 a.m. local time. Frank wanted to think through the pros and cons tonight so he would be clear headed tomorrow morning when the call came through. He knew Martin would be interested in “the numbers,” but there were so many other nonquantifiable factors that warranted as much if not more consideration than the numbers. He was not even at the stage where he could discuss production volume, profit margins, and freight costs. Frank was not sure how to present what he learned thus far because, since Martin had not visited the country, he

would not easily grasp the business environment nor see both the potential opportunities and obstacles to doing business in a developing country such as Madagascar.

### NOTE

a. This case was written by Valerie VinCola of Emory University under the supervision of Professor Richard Linowes of American University in Washington, DC. It is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.