

# **MS thesis**

## **Marketing and International Business**

### **Cuba: The Sleeping Caiman of the Caribbean**

**Tamila Gámez Garcell**



**HÁSKÓLI ÍSLANDS**

**University of Iceland School of Business**

**Advisor: Thorhallur Gudlaugsson Associate professor**

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# Abstract

Cuban society has for decades been characterized by its egalitarian policies. In recent years, Cuba has initiated a process of privatization which has enabled capitalist initiatives in the country. This master thesis has the objective to analyze the general business environment prevalent in Cuba and find opportunities for possible investors in the Cuban market and ways of entry which are available at the moment.

Qualitative research, (specifically a desk research) is the primary method used in order to develop a PEST analysis and a TASK analysis, which have been adapted to the Cuban tourism industry.

The thesis is divided into four parts. The first part focuses on the international theories and entry modes to international markets which have been discussed in numerous studies. The second part makes an analysis of Cuba's market environment assisted by the use of the PEST model. The third part of the thesis concentrates on analyzing the micro environment of the Cuban Tourism Industry market through the development of a TASK environment analysis of an analysis, here the Five Forces Industry analysis was approached in order to define those industry factors that could have direct impact on investments in the Cuban tourism industry. In the last and fourth part of this thesis, the author arrives at conclusions and the most relevant issues concerned with the Cuban market.

The main conclusion from this master thesis is that the main entry mode for investors in the Cuban market is a joint venture. The country offers numerous business opportunities and an attractive business environment for companies to invest in the Cuban market.

The theories of internationalization used in this master thesis and applied to Cuban market analysis could have broader application to the Caribbean region as a whole.

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# 1 Introduction

Cuba is a mystery for many people over the world, especially for those interested in business in the island. For decades the country has been under the USA embargo, which has made it difficult for foreign companies to seek business opportunities on the island and also affects the Cuban government and the island's population on a regular basis. The country's government has been adopting economic reforms that have allowed the island to become one of the best performers in the region. Recently, Cuba has begun a series of economic liberalization reforms that reinforce the belief that the Cuban market is opening in incremental steps which in turn presents a gap for capitalist initiatives.

This master thesis has as an objective to analyze the general business environment prevalent in the island to discover opportunities for possible investors in the Cuban markets, and modes of market entry available at the moment. There is not a very much published about the Cuban market's current situation and the lack of official available information is challenging and interesting. The existing information can not all be catalogued as reliable. Most of the journal articles, researching papers and news in the Internet have a political flavor by the different authors who also are divided in two groups: the negative or opposed to the Cuban political system and the positive or followers of Cuban policy. The Cuban origin of the author of this master thesis has helped a great deal by providing a real life context to the economical and political issues. However, the author struggled with a great challenge to keep the data neutral and to translate it without bias. The value of this research lies in the challenge to find reliable and valid data and to remain neutral in a highly political situation.

## 2 Methodology

In the thesis two methods are used in order to analyze the Cuban market: PEST analysis and the TASK environment analysis. The later one is used in order to analyze the Cuban tourism industry in order to identify factors of the TASK environment that could influence business decisions.

The goal of this thesis is to determine the attractiveness of the Cuban market and understand its evolving opportunities and threats as they relate to the strengths and weakness of the Cuban market.

Qualitative research methods were used primarily to define the Cuban market (desk research). This method involved the search for secondary data such as government publications on the Internet, and the government's expenditure and population census and social trends. Secondary data research - usually- outlines changes in economical and social patterns in a country.

### 2.1 PEST Analysis

According to theories on strategic management and competitive advantage (Barney and Hesterly, 2010) when a firm plans to go out of the home market, it must implement an effective strategic management process, which requires that a firm engage in an analysis of threats and opportunities in its competitive environment before a strategic choice can be made.

The PEST analysis divides the general environment mainly into four categories: political, economic, social, and technological. Each of these categories is concerned with issues that could affect the strategic development of a business and that are found on firm's macro environment (Barney and Hesterly, 2010).

Many factors in the macro-environment could affect decisions for entering international markets. For analyzing these factors with the use of the PEST model it must be considered the following:

- Political factors referred to government policy, such as the degree of intervention in the economy.

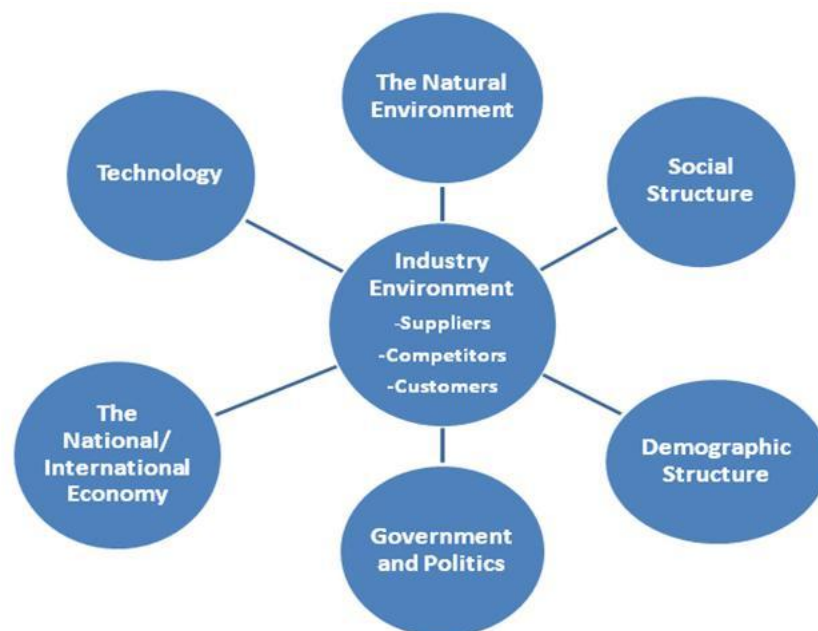
- Economic factors include interest rates, taxation changes, economic growth, inflation and exchange rates (Kotler, Wong, Saunders and Armstrong, 2005).
- Social factors referred and linked to changes in social trends that might impact on the demand for a firm's products and the availability and willingness of individuals to work (Kotler and Keller, 2006).
- Technological factors are related to new technologies create new products and new processes. Technology can reduce costs, improve quality and lead to innovation (Kotler and Keller, 2006; Porter, 1990) which consequently can benefit consumers as well as the organizations providing the products. Technology can be a threat to firms entering the Cuban market that have not a well developed computer system and information technologies because in Cuba technology development is under absolute control of the government, and information technologies is also regulated by the government.
- Environmental factors (weather and climate change) were also analyzed because of these represents significant external factors. Legal factors also are considerable important, and a brief analysis will be executed. Over the past years, Cuba has gone through many significant legal changes that have affected firms' activities

In Cuba, any firm entering the market must consider the presence of pressure groups and the restrictions that are imposed to these groups or individuals by the Cuba government. Kotler and Keller (2006) state that in the political- legal environment, marketers must work within the many laws regulating business practices and with various special interest groups since marketing decisions are strongly affected by developments in the political and legal environment. Kotler and Keller (2006, p. 93) look at those laws as possible opportunities for business. For many years, Cuba has been undergoing coercion from the USA government due to restrictive trade policies. The embargo imposed unilaterally to Cuba has as objective to change the Cuban government. All the sanctions on Cuba by the United States government have been only translated to the Cuban economy as a loss of business opportunities and has reflected on the inability of Cuban entities to fulfill business contracts, which has lead to image problems.



## 2.2 Task environment

The task environment is the internal environment of the organization and the elements that compose it have a direct influence on the organization. Grant (1999) assumes that elements such as consumers, competitors, suppliers, labor market, industry, and financial resources affect a firm's decisions and performance. According to his view, environmental influences can be classified by source (PEST analysis) or by proximity (the microenvironment or task environment). Grant (1999) assumes that the TASK environment helps to identify critical determinants of threats and opportunities a company will face when entering overseas markets (figure 2.1).



**Figure 2-1: From environmental analysis to industry analysis. Adapted from Grant (1999).**

Grant (1999), also considers as a key factor how these more general environmental factors affect the firm's industry environment (Figure 2-1). By identifying those environmental factors and taking advantage of them, the firm is ensuring future success on the market. However, Chun Wei Choo (2003) has argued that factors in the task environment usually create greater perceived uncertainty to organizations than factors in the general environment because his belief on that the task environment is more volatile than the general environment and it is connected with the short-run while the general environment is connected with the long-run.

### 3 Internationalization theories

Under the marketing concept, the customer who becomes the center of business attention. Firms no longer perceive production or sales as the key to prosperity, growth and survival. Firm's main focus is on the identification and satisfaction of customers' needs and wants.

In order to keep up with the changing tastes and changing people's value systems, the activities of the competition and important changes in the external business environment, the marketing orientated firm needs information. Firm's information is what has been called "the life-blood of the marketing orientated firm." Without the right kind of information, effective marketing is almost impossible. Marketing research provides the organization with a wide range of useful information (Kotler, Wong, Saunders, and Armstrong, 2005).

Marketing analysis has been considered a necessary part of the marketing planning process. Rothe, Harvey, and Jackson (1997) suggested that the scope and nature of the marketing audit need to be broadened to include a global perspective. Other respected writers on the subject (Kotler, Gregor Rodgers, 1977) look at the marketing analysis as an instrument to judge an organization's overall commitment to a marketing orientation.

According to Taghian and Shaw (1998), in order to manage and to exploit the opportunities created by the rapid changes in the marketing environment, organizations require a substantial amount of accurate, comprehensive, and action-oriented information

#### 3.1 The international business imperative

According to Axinn and Matthyssens (2002), most theories of internationalization have their roots in industrial organization and economics (from Coase in the 1930s through Bain in the 1950s to Williamson in the 1970s) and have been developed in the 1970s and 1980s when American multinationals started to invest in Europe and when European SMEs began exporting, mostly to neighboring countries.

Michael Czinkota (2002) and partners affirm that the failure to become part of the global market assures a nation a declining economic influence and a deteriorating standard of living for its citizens and ineffective participation in international business.

International business offers companies and countries new markets (Czinkota, Ronkainen, and Moffett, 2002) since the combination of domestic and international business offers more expansion opportunities. Internationalization facilitates the mobility of production factors and consequently opens markets to competition.

An understanding of how to make globalization work for firms or countries is actually a challenge and an opportunity as well. According to different theories of internationalization, an understanding of national differences, e.g. culture, values, customs and language, is required in order to take complete advantage of internationalization.

### 3.2 Internationalization theories

Several key theories have been applied to the internationalization process, e.g. industrial organization theory (Axinn, 2002), internalization theory (Axinn, 2002; Penrose, 1959; Rugman, 1981), and transaction cost theory (Axinn, 2002). In addition Dunning's eclectic theory where he expands its scope to incorporate consideration of trade as an alternative to investment in reaching foreign markets (Dunning, 1979; Dunning, 1988; 2000) cannot be forgotten in this discussion. A common point in these theories is that the environment is taken for granted, but in the Nordic theories developed later, the environment is seen as an important determinant factor of performance.

The internationalization process model (Johanson 1977, 1990) rests on the resource-based view that is rooted in the classical theory of the firm (Penrose, 1959). The model, which considers entry mode decisions as a time-dependent process, considers a state (i.e. entry mode) as a consequence of a firm's prior experience and knowledge. The theory has been challenged for being too deterministic and too limited by focusing only on one explanatory variable (Andersen, 1997; Johanson, 1990). On the other hand, Network theory considers investments in relationships as assets that determine future strategic development. This approach blurs the "market-versus-firm" distinction, which is central to transaction cost-based theories (Weisfelder, 2001).

Table 3-1 resumes the main aspects of the three main approaches to international marketing, discussed previously.

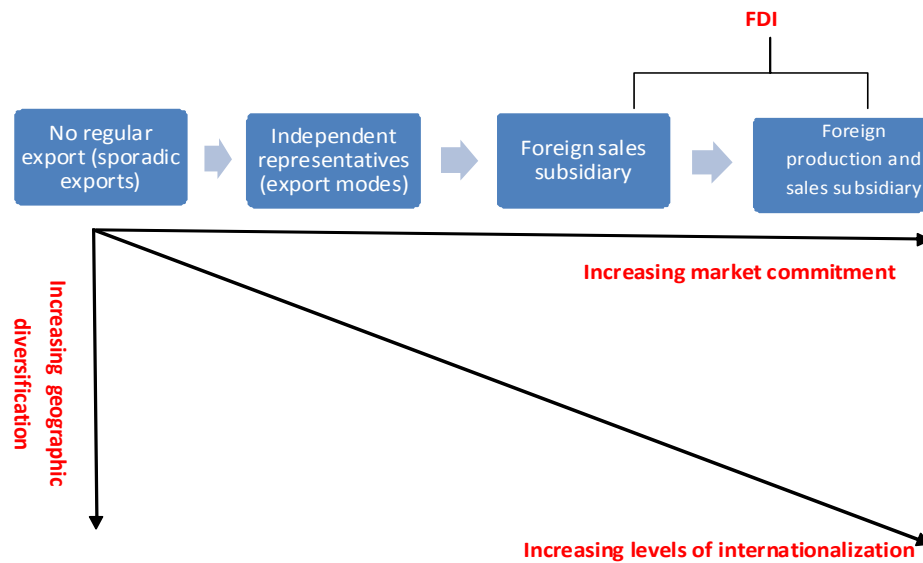
**Table 3-1 Different theoretical approaches to international marketing. Adapted from Nykänen, Aaltonen, Helander, and Myllärniemi (2008).**

	Uppsala model	Network model	Born Global
View point of internationalization	Incremental	Through networks	Opportunity seeking
Density of the internationalization	Low	Medium	High
Role in the process	Active/ learner	Active/passive	Active
Time for the process	Long	Varies	Fast
Risk	Low	Medium/Can be shared	High
Market selection	Markets physically close to home market	Depends on the availability of networks	New emerging and large markets with purchasing power
Success factors	Interactive learning	Strong relationships and access to resources	Experience of international operations

The intention of this section is to present three different theoretical approaches to international marketing: The Uppsala theory, the Network approach and Born Globals.

### 3.2.1 Uppsala theory

The Nordic School provided the Uppsala Model of Internationalization (Johanson, 1977; Johanson, 1975), which was built on observations of Nordic multinationals, but has been widely applied to explain the behavior of SMEs in many other regions as well. Johanson and Wiedersheim-Paul (1975) distinguish four different modes of entering an international market (Figure 3-1). Each of these stages, is successive and suggests different levels of international involvement and market commitment.



**Figure 3-1 Four levels of international involvement/market commitment. Adapted from Hollensen (2004)**

Johanson and Wiedersheim (1975) notice two important facts about firm's internationalization process. First, companies which appear to begin their operations abroad in fairly nearby markets and only gradually penetrate more distant markets. Second, companies enter new markets through exports. According to this model, the concept of market commitment is assumed to contain two factors - the amount of resource commitment and the degree of commitment. International activities also require both general knowledge and market-specific knowledge.

The Uppsala theory/stages model implies that additional market commitments, as a rule, will be made in small incremental steps. But Hollensen (2004, p. 54) points to three exceptions: (1) *firms that have large resources*, (2) *when market conditions are stable and homogeneous* and 3) *when the firm has considerable experience from markets with similar conditions*. From what is possible to infer that the geographical dimension of the theory assumes that firms will enter new markets with successively greater psychic distance, such as differences in language, culture and political systems (which could be cause for concern on the flow of information between the firm and the market) by taking incremental steps based on a firm's experience or the presence of competitive resources.

### **Critical views of the original Uppsala model**

The stages model has made significant contributions to internationalization research. Several empirical studies (Bilkey, 1977; Kedia, 1986) have confirmed that managements' perceptions of international markets, such as market size, costs, risks and benefits, influence the extent to which their firms internationalize. The stages model has been widely used in internationalization literature because "it does represent a clearly overt manifestation of the overall process" (Welch, 1988).

Prasad (1997) proposes that the stages model provides valuable insight on internationalization when combined with the notion of Kimberly and Miles (1980) organizational life-cycle. The organizational life-cycle perspective means that there is a cyclical nature to an organization's life, and thus it is fluid and dynamic. He argues that this view is similar to the stages model which conceptualizes the process of change in organizations in four sequential stages.

The stages model, however, has its weaknesses.

According to Hollensen (2004), the model is too deterministic and neither valid for service industries nor situations of highly internationalized firms and industries. Johanson and Mattson (1987) consider that the model does not take into account interdependencies between different markets. In addition, with the changing world's homogeneity (Nordström, 1990), psychic distance has decreased and consequently the firms are willing to enter into large markets. Nordström (1990) also claims that the actual uncertainty is actually a minor factor since buying knowledge about legal and financial standards from international consulting firm is not an obstacle anymore. Firms today have easier access to knowledge through information technologies, which make it easy and not costly to obtain market knowledge needed to start operations abroad.

#### **3.2.2 Network Theory**

According to Hollensen (2004), the basic assumption in the network model is that an individual firm is dependent on resources controlled by other firms. The companies are also supposed to get access to these external resources through their network positions. Access to a network outside requires that other participants be motivated to engage in the interaction, something that Hollensen (2004) considers resource

demanding, which might require several firms to adapt their performing business. Thus the networks in a country may be extended far beyond borders and can be used as bridges to other networks.

According to Hollensen (2004, pp. 62-63), the network model also has consequences for the meaning of internationalization of the market and assumes that a production net can be more or less internationalized. He distinguishes between four different situations:

1. The early starter. This situation implies a low degree of internationalization of the firm and of the market. Non-important international relationships are present.
2. The lonely international. In this situation the firm has a high degree of internationalization but a low degree of internationalization of the market. The firm is supposed to have experience on international relationships which enable knowledge capabilities and its ability to manage issues, such as culture differences and enable the organization to use international relationships as a bridge to those nets attained for its suppliers and customers.
3. The later starter. The degree of internationalization of the firm is low, but the degree of internationalization of the market is high. According to Hollensen (2004), this implies the risk of being “pulled out” of the domestic markets by customers or suppliers and often is translated on difficulties for establishing new positions in a tightly structured net, which explain the considerable importance of the factor of time.
4. The international among others. With these companies is observed a high degree of internationalization of the market and of the firm as well. In this situation the firm has the possibility of using positions on one net to bridge over to other nets that might lead to increase in intra-firm trade across borders.

A common assumption is that a high degree of internationalization implies many and strong relationships between the different national sections of the global production net. With a low degree of internationalization the national nets have few relationships with each other.

In sum, many networks exist within and between companies in global, national and local scales. Researchers in the theme (Johanson and Matson, 1987; Sasi, 2008; Hollensen, 2004), consider two reasons to make a network formation appealing. One is the wish to increase revenue, and the second, the wish to work together in order to beat competition or to reduce costs. Additional reasons for networks are clusters of specialized resources and knowledge in regional or industrial areas.

### **Critical views of the Network model**

The Network model has its advantages because. it allows for close and concise co-ordination of investments and overcoming technological problems. However, according to Johanson and Matson (1987), the network model is not hierarchical and was developed to analyze the dynamic aspects of industrial systems and firms. Thus the model does not explain governance structures and only stresses the firm's action possibilities. In addition, it is considered by Sassi and Aveniur (2008) that the theory fails to address the importance of the decision-maker. In other words, the network theory of internationalization neglects the entrepreneur and his/her social networks (Sasi, 2008). Sassi and Aveniur (2008) are specially concerned with the fact that once the entrepreneur has created a partnership, which enables rapid foreign market entry, the entrepreneur may become disconnected from the end-users and market dynamics. Consequently, future product development initiatives and creation of new partnerships can become limited.

Research on networks and internationalization has been dominated by the network theory of internationalization. The network theory of internationalization focuses on non-hierarchical systems, where firms invest in strengthening and monitoring their positions in international formal business networks (Johanson and Matson, 1987).

### **3.2.3 Born Global**

The term Born Global is one of the most fashionable terms on the marketing arena of today's business world. What does the term Born Global entail?

Hollensen (2004) uses the following definition of the term Born Global



*“A firm that from its inception derives competitive advantage from the use of resources and the sale of outputs in multiple countries”* (Hollensen, 2004, pp. 67).

S. Rasmussen and Tage Koed Madsen (2002) assume that *“there is absolutely no clear definition – neither theoretically nor empirically – of a Born Global or similar concepts.”* The authors analyzed and resumed the concepts used, their definitions, and the empirical background of Born Global and similar concepts in order to demonstrate their assumption. Rasmussen and Madsen’s study, encourage us to assume that internationalization processes of firms will be much more individual and situation specific in internationalized markets

Hollensen (2004, p. 69) mentions some factors giving rise to the emergence of Born Globals:

- Increasing role of niche markets (existence of growing demand among customers in mature economies for specialized or customized products).
- Advances in process/technology of production (increasing specialization in many industries due to development of technology that facilitates the production of diverse products on a small scale).
- Flexibility of SMEs/Born Globals (flexibility and/or adaptability which facilitates response to international standards).
- Global networks (successful international commerce due to increased international partnerships).
- Advances and speed in information technology (everything is smaller and faster and reaches more people and places).

According to Sasi and Arenius (2008), a number of researchers such as Coviello and Munro, Chetty, Holm, Madsen and Servais, have argued that networks contribute to the success of born global firms by identifying new market opportunities and building market knowledge. An important trend in the subject is the globalization of the technology, which facilitates new and better approaches to manufacturing and general operations are readily available to smaller firms.

According to Hollensen (2004), becoming global is a decision, not always the result of the firm's choice, rather a firm's response to changing market conditions. Thus, these firms are pushed into globalization by global customers and too small national/regional market segments.

### **Critical views of the Born Global**

The fact that Born Global is a newly researched field is something almost every research on the area refers to its newness in the field of marketing. Many unexplored aspects of the approach exist for further study. Research in this area is limited, and in a recent review of a decade of born global firm internationalization, Rialp and colleagues (2005), observe that the literature remains fragmented and is still today lacking of a comprehensive theoretical explanation and causal models of the phenomenon.

Gilian and Jay (2006) assume that Born Globals tend to be vulnerable because they are frequently dependent upon a single product which they commercialize in lead markets first, regardless of where their markets are situated geographically. These firms often seek partners who complement their own competencies in these lead markets in order to develop effective networks.

## 4 Internationalization vs. Globalization

Michael Czinkota's (2002) definition of International business focuses on transactions which are carried out across borders, also called, international transactions, which recall an understanding of international market research. For Michael Czinkota (2002), transactions are devised and carried out across borders to satisfy the objectives of individuals, companies, and organizations. Primary types of transactions are export-import trade and direct foreign investments. Direct foreign investments takes various forms, like joint ventures. Others types of international business are: franchising, licensing, and management contracts.

Over the last years, the importance of international business has grown and it has adapted to the environment through economic linkages transforming the world into a global marketplace. As a result, nations are more affected by international economic trends than decades ago. Economic linkages, represent not only opportunities but threats as well.

Globalization is frequently confused with internationalization (Daly, 1999). Globalization, according to Daly (1999), is the global economic integration of many formerly national economies into one global economy, mainly by free trade and free capital mobility, but also by easy or uncontrolled migration. Thus, globalization can be considered as an effective removal of national boundaries for economic purposes. Globalization is related to the belief in, or in some cases the hope of new opportunities and threats for governments and firms to become able to compete successfully in the global marketplace, which represents a big challenge.

On the other hand, internationalization implies expansion and the existence of national borders. Internationalization increases the interdependence of nations which are impermeable to national policies (Daly, 1999).

Globalization can be directly related to technological development, trade liberation, and deregulation. Globalization can be translate for nations as more business flexibility because of the use of business networks and alliances enable the firms/countries to integrate its various functions (production, marketing, research, financing) and carry them out in a part of the world, which is best suited for it without

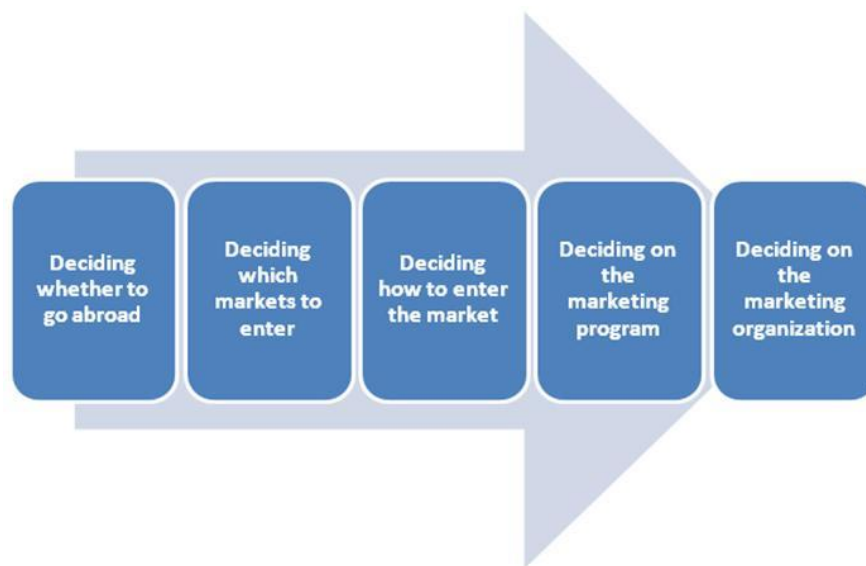
any regard to political borders (Daly, 1999). In summary, globalization could represent a complete negation of political borders and the merging of economic areas.

However, globalization offers a number of challenges besides the technological revolution it entails. This combination provides opportunities as well (Daly, 1999). This could be particularly true for companies in smaller countries where the lacking domestic market is evident and entering foreign markets is definitely necessary for growth, and for companies in developing countries with weak infrastructures and limited supporting industries.

## 4.1 Entry modes

In the International business literature, entry modes appear to be directly associated with varying levels of resource commitment, risk exposure, control, and profit return.

Gilligan and Willson (2003, p. 9) suggest that any company of any size when going global must consider or examine a number of decisions (figure 4-1).

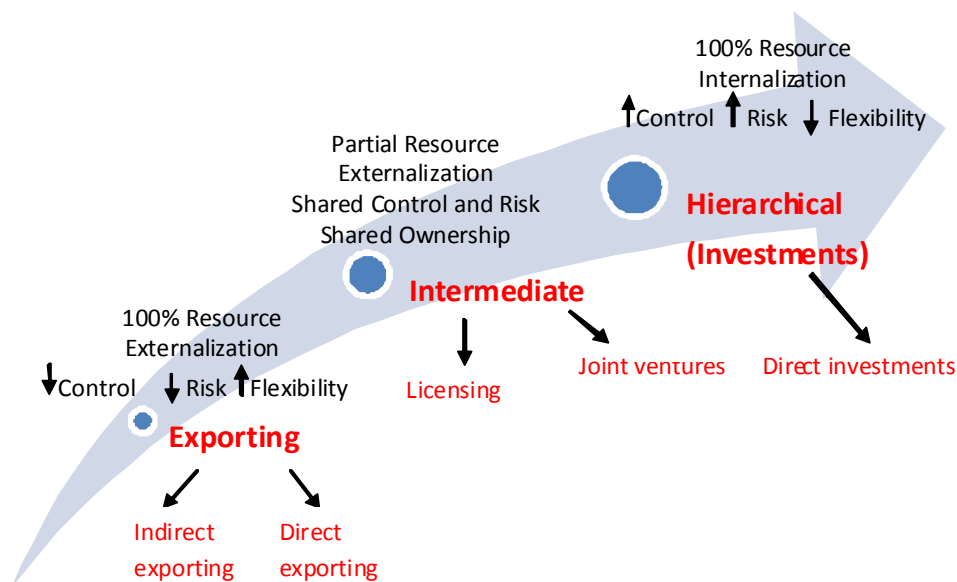


**Figure 4-1 Major decisions in International Marketing. Adapted from Gilligan and Willson (2003).**

Market selection is a decision process that narrows down and selects markets, which the decision-maker believes the firm has the ability to enter. Once the firm has decided to enter a particular market, it has to determine the best mode of entry. There is a variety of ways in which organizations can enter foreign markets. Various market strategies exist, from which the organization can choose. Each of them involves

different degrees of commitment, risk control, and profit potential. The question which an organization must consider at this point is what kind of strategy should be used for the entry mode selection.

This section will concentrate on the following modes of entry: exporting mode, intermediate mode, and hierarchical mode (see figure 4-2).



**Figure 4-2 Modes of entry into Foreign Markets Adapted from Kotler and Keller (2006).**

Figure 4-2 demonstrates that when a company chooses to make higher market commitments, it will be facing higher risk and control, and at the same time, will guarantee a higher profit potential. New market opportunities may be made available by expanding firm's activities, but the risks may, in some cases, outweigh the advantages. With investment and control, the question really is how much control the organization wishes to keep. The degree of risk involved, attitudes, and the ability to attain objectives in the target markets are important factors in the decision on whether to license or to enter a joint venture or to just get involved in direct investment.

Four groups of factors are believed to influence the entry mode decision (Kotler and Keller, 2006):

1. Internal factors, such as firm size, firm's international experience and firm's products.

- a. Firm size: bigger firms are more likely to use internalization modes when entering a market.
  - b. International experience: reduces the cost and uncertainty of serving a market and increases the probability of hierarchical modes.
  - c. Product: Products with high value/weight, complex and differentiated products will increase internalization.
2. External factors include the perceived distance between home country and host country, which determine resource commitments. For example, when the perceived distance is great, firms favorably enter a joint venture, which implies low resource commitment and high flexibility. Another factor to consider is the country risk/ demand uncertainty. Both economic and political risks are involved when a firm enter a new foreign market. Firms typically enter high risk markets in externalized modes. Market size and growth is another factor that determines firm's resources commitments. Firms invest more resources in large markets with growth potential. Direct and indirect trade barriers, such as tariffs and quotas, and the existence of a small number of intermediaries will certainly, favor firms choice of hierarchical modes (local production). Competition also have a great influence on firms's internationalization decisions.
3. Desired entry mode characteristics. If the firm is risk averse, it will prefer export modes or licensing. Joint venture might be another choice since it involves shared risk and shared costs. Risk adverse firms may lose profits and opportunities as well. Control is often associated to the level of resource commitment, while modes that involve a low resource commitment, like indirect export, may result in low control. Wholly owned subsidiaries provide most control but also require a substantial commitment of resources. In addition, flexibility influences the decision on whether to choose an hierarchical mode of entry or an intermediate mode of entry. Hierarchical modes are most costly but least flexible and most difficult to change in the short run. Intermediate modes limit the firm's ability to adapt or change strategy when market conditions are changed rapidly.

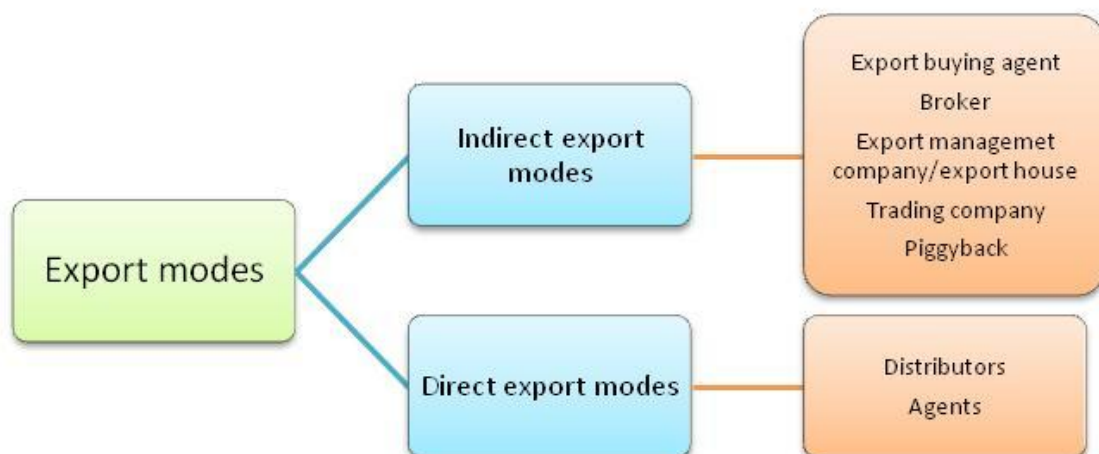
4. Transaction-specific factors. The greater the tacit component of firm-specific know-how, the more a firm will favor hierarchical modes.

The choice of entry mode (export mode, intermediate mode, or hierarchical mode) involves consideration of all the aspects summarized here. None of the modes can be described as the “best” or as the “worst” in specific circumstances.

#### 4.1.1 Exporting: Direct and indirect exporting

Export is the most common mode for initial entry into international markets and is typically used as an initial entry, which gradually evolves towards foreign based operations. Exporting methods include direct or indirect export (Figure 4-3). In direct exporting the organization may use an agent, distributor, overseas subsidiary, or act via a government agency.

In direct exporting, a common identified problem is market information. The exporter's task is to choose a market, to find a representative or agent, to set up the physical distribution, and documentation, to promote, and price the product. Control, or the lack of it, is also a problem that often results in marketing decisions activities in the hands of others. Direct exporting modes include export through foreign-based agents and distributors (independent intermediaries).



**Figure 4-3 Export modes. Adapted from Hollensen (2004).**

Indirect exporting is considered to be more appropriate for firms with limited international expansion objectives or with minimal resources to devote to international

expansion, which wants to enter international markets in a gradual form. By using this export mode, the firm is supposed to establish little or no contact with the overseas market. Consequently, it has limited information about the foreign market potential and gets little participation in the developing of a plan for international expansion. This limits the firm's ability to identify potential sales agents or distributors for its products. In addition, the indirect export activities allows the firm little control over how, when, where and by whom the products are sold (Hollensen, 2004).

Export mode poses advantages and disadvantages. By exporting, the organization takes less risks than those based abroad. By remaining in the home country while doing business with foreign markets, the firm gets an opportunity to "learn" or "study" the market before making resource commitments while reducing potential risk related to operating in international markets. The disadvantage is mainly that the firm is dependent of foreign agents and so the lack of control has to be weighed against the advantages.

#### 4.1.2 Intermediate entry mode

Intermediate entry modes include a variety of arrangements such as licensing, franchising, management contracts, joint ventures and technical know-how (Young, 1982). Usually this entry mode is distinguished from export modes because of the main way of transferring knowledge. In addition, intermediate entry mode differs from hierarchical entry modes because of the absence of a full ownership involvement and the presence of risk and control sharing.

In this section licensing, joint ventures/strategic alliances will be presented for a better understanding of intermediate entry modes.

##### **Licensing**

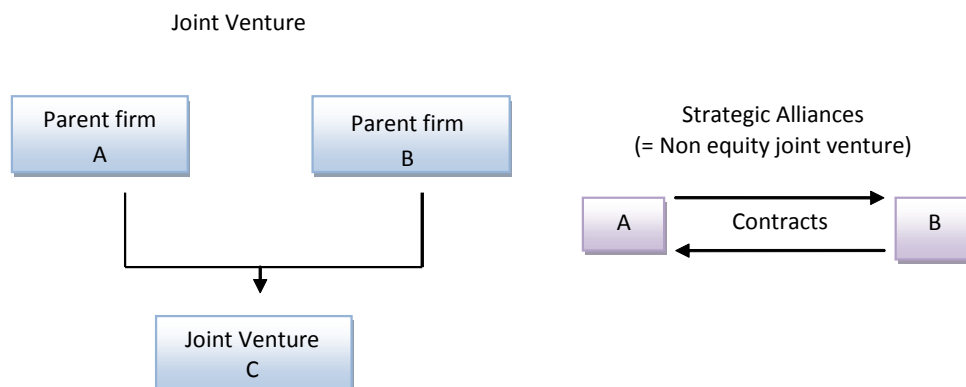
When licensing, the firm establish local production in foreign markets without capital investment (Bradley, 1995). A licensing agreement or contract is always formalized in a written document. The details of the contract are usually the subject of a detailed negotiation and hard bargaining between the parties. Under a licensing agreement, one firm permits another to use its intellectual property for compensation designated as royalty (Czinkota, Ronkainen, and Moffett, 2002).



Licensing has advantages and disadvantages to consider. Licensing permits the entry into markets that are otherwise closed on account of high rates of duty, import quotas and other factors. Licensing is a viable option when the manufacturer is near the customer's base as it requires little capital investment and should provide higher rates of return on employed capital. With licensing, firms don't have the risk of losing assets, and due to the little capital requirement, new products can be rapidly exploited on a worldwide basis before competition develops. The licensor can get immediate advantage of the licensee's local marketing and distribution organization and of existing customer's contacts (Bradley, 1995). Besides, licensing may prove less competent than expected in marketing and other management activities. Costs can even grow faster than income, and even if the licensee reaches a good turnover, he/she may not fully exploit the market. Control issues are also something to be concerned since this mode of entry implies a lack of control over licensee operations (Young, 1989). In addition, licensing implies little or no control over product quality and the product will often be sold under the licensor's brand name (Hollensen, 2004).

### Joint ventures/strategic alliances

A joint venture or a strategic alliance is a partnership between two or more parties. In international joint ventures these parties will be based in different countries, which obviously complicates the management of such an arrangement (Nanda and Williamson, 1995). Strategic alliances and non-equity joint ventures are more or less the same (Hollensen, 2004). Figure 4-4 illustrates formal differences between a joint venture and a strategic alliance.



**Figure 4-4 Joint ventures and Strategic Alliances. Adapted from Hollensen (2004).**

The formal difference between a joint venture and a strategic alliance is that the strategic alliance is typically a non-equity cooperation so the partners do not commit equity into the cooperation or invest in the alliance while an equity joint venture involves the creation of a new company in which foreign and local investors share ownership and control (Hollensen, 2004). The decision to choose equity or a non-equity joint venture is a question of how the cooperation is formalized.

According to different experts on the theme (Nanda and Williamson, 1995; Hollensen, 2004; and Young, 1989), a number of reasons for setting up joint ventures are the following:

- Complementary technology or management skills provided by the partners can lead to new opportunities in existing sectors.
- Many firms find that partners in the host country can increase the speed of market entry.
- Many less developed countries try to restrict foreign ownership.
- Global operations in research, development and production are prohibitively expensive but are necessary to achieve competitive advantage.

Joint ventures offers advantages and disadvantages. A joint venture gives access to expertise and contacts in local markets (Hollensen, 2004), since each partner gets access to the other partner's skills and resources. In addition, joint ventures reduces market and political risks and helps to overcome host government restrictions. Anyhow, a joint venture is less costly than an acquisition, for example, since it implies shared failure risks and offers an opportunity to build better relationships with national governments through a local partner. In a joint venture, partners may become locked into long term investments from which it is difficult to withdraw, and the relevance of the venture to each partner might change over time. Also, cultural differences may result in differences in the management culture among participant firms (Hollensen, 2004). Moreover, the respective partners may be incompatible, which may result in conflicts and disproportionate contributions to the venture.

Strategic alliances help increase the rate of new product development which enhances a company's chances for survival and success (Deeds, 1996). Firms may get certain advantages in terms of resource growth and firm survival if they can identify and

exploit value-creating opportunities with alliance partners that possess harmonizing resources. In addition, strategic alliances provide participants with credibility or legitimacy (Human and Provan, 2000). Credibility and legitimacy allow entrepreneurial firms to access financial resources (Stuart, Hoang, and Hybels, 1999). Furthermore, strategic alliances help gain market power and the ability to move more quickly into new markets and technologies (Hagedoorn, 1993). Firms can utilize their partners established key linkages with customers, distributors, and suppliers.

#### 4.1.3 Hierarchical (Investments): Direct investments

Hierarchical is the final entry mode to be analyzed in this dissertation. Entry mode in which the firm completely owns and controls the foreign entry mode. Organizations that are not one hundred percent owned are catalogued as an export mode or intermediate mode (Hollensen, 2004).

Direct investments represent influence and control over local marketing but involve high resource commitment and the transfer of responsibilities of performing the value chain functions to the local management in the different countries (Hollensen, 2004). Direct foreign investment takes different forms and each form has advantages and disadvantages as all other entry modes discussed in this thesis (see figure 4-5).

Domestic-based sales representatives	Region centres/transnational organization	Acquisition	Greenfield investments
<ul style="list-style-type: none"> <li>• Control of sales activities</li> <li>• Close contact with customers</li> <li>• Costly, can be expensive</li> </ul>	<ul style="list-style-type: none"> <li>• Achieves potential synergies on a regional/global scale</li> <li>• Regional/global efficiencies</li> <li>• Political threats</li> <li>• Communication problems</li> </ul>	<ul style="list-style-type: none"> <li>• Rapid entry to markets and distribution channels</li> <li>• Local knowledge and contact with local market and government <ul style="list-style-type: none"> <li>• Reputation</li> <li>• Very expensive</li> <li>• High risk</li> </ul> </li> <li>• Threat of integration with existing operation</li> <li>• Communication and coordination problems</li> </ul>	<ul style="list-style-type: none"> <li>• Increase of operational efficiency <ul style="list-style-type: none"> <li>• Integration of production with home base production</li> </ul> </li> <li>• High investment cost</li> <li>• Slow entry to markets (time consuming process)</li> </ul>

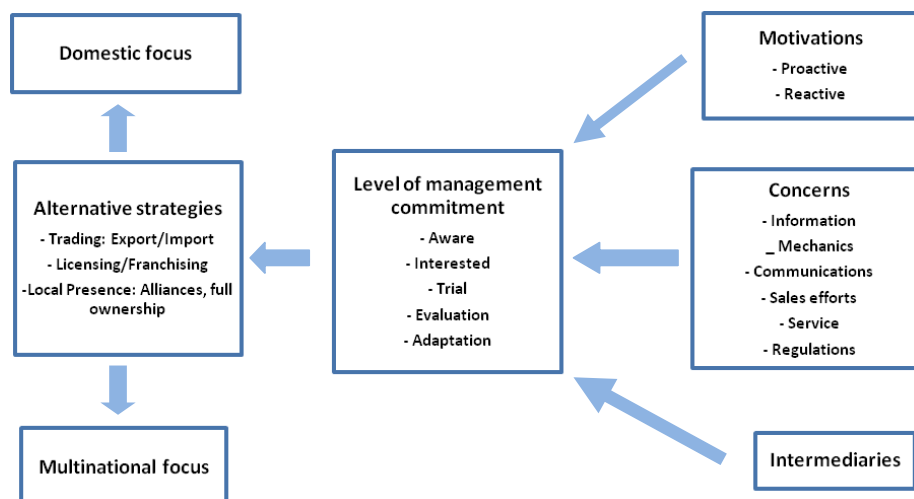
**Figure 4-5 Advantages and disadvantages of different hierarchical modes. Adapted from Hollensen (2004).**

The choice of a direct foreign investments mode over another depends on firm's commitment decisions and the level of international experience the firm poses. In addition, the transition from a hierarchical stage to another depends on the firm's interest in becoming more decentralized and transferring the responsibilities of the

performance of the value chain functions to the local management in the different countries. In addition, the firm's capabilities and experience plus the attractiveness of an industrial sector in a country are important factors in the decision of further steps in the internationalization process.

## 4.2 A concluding note about market entry options

Firms are not born experienced in international business. They rather progress gradually through an internationalization process, which is triggered by different motivations to go overseas. After analyzing the different entry modes a firm may use to implement an internationalization strategy, the researcher concludes that the main drive for internationalization is the level of managerial commitment. This commitment will grow from awareness of international potential to the adaptation of international business as a strategic business direction (figure 4-6).



**Figure 4-6 A comprehensive model of International market entry. Adapted from International Business (Czinkota, Ronkainen, and Moffett, 2002, p. 299).**

Figure 4-6 illustrates that all developments, processes, and factors involved in the overall process of going abroad are linked to each other. But when a firm chooses an entry mode over another, economic characteristics of the market deserves special attention.

## 5 Developing country or emerging market: characteristics and problems

Nations that are performing a shift from central planning to market orientation are called transition economies (Czinkota, Ronkainen, and Moffett, 2002). Large markets experiencing economic changes, such as China and Latin-America, where privatization is in the national agenda; are called emerging markets since they are only gradually becoming integrated into the global economy. The revision of major economic and structural dimensions of the emerging democracies could help identify major shortcomings and opportunities for international business intending to operate in those markets.

Transition economies have the following common characteristics: infrastructure shortages; the nonexistence or inadequate transportation systems; the lack of adequate housing; poor condition of the communication systems (Czinkota, Ronkainen, and Moffett, 2002, p 229). To improve these conditions many years will be needed to make any progress. It will take many years to improve. Also the absence of market intermediaries, inadequate payments and funds transfer systems are challenges to a successful business venture; infrastructure shortcoming inhibits economic growth, etc.

Capital shortages are also considered a major constrain for emerging economies. In light of existing inefficiencies in the Cuban economy, corruption, and domestic uncertainties, the Cuban government must ensure that the capital remains in the country rather than capital flight to safe havens abroad.

Firms operating in emerging democracies encounter interesting market demand conditions. Buyer's preferences are often vague and undefined. Available market information is often inaccurate or very difficult to capture, but to the surprise of many investors, emerging economies have important and valuable knowledge resources to offer (Czinkota, Ronkainen, and Moffett, 2002). On the other hand, staff commitment is difficult to find, and the new environment can complicate decision making. Thus, the key to international business success of firms doing business in emerging economies is the understanding of the need for adaptation of business skills to those economies. Also, the time to complete the transformation of those societies and an

early adaptation to the changes those economies are experiencing, can offer new opportunities to the international firm.

Emerging markets is another term that it is possible to link to the actual situation in Cuba. According to Chua Li (2010), emerging markets are countries which are restructuring their economies along market-oriented lines. They offer a wealth of opportunities in trade, technology transfers, and foreign direct investment. Chua Li (2010) suggests four major characteristics for emerging markets:

1. *These markets are regional economic powerhouses with large populations, large resource bases, and large markets. Their economic success will spur development in the countries around them but if they experience an economic crisis, they can bring their neighbors down with them.*
2. *These economies are transitional societies that are undertaking domestic economic and political reforms. They adopt open door policies to replace their traditional state of interfering policies that failed to produce sustainable economic growth.*
3. *They are the world's fastest growing economies, contributing to a great deal of the world's explosive growth of trade... They will also become more significant buyers of goods and services than industrialized countries.*  
*They are critical participants in the world's major political, economic, and social affairs. They are seeking a larger voice in international politics and a bigger slice of the global economic pie.*

In the late 80's Cuba experienced an economic downturn due to the collapse of communism in the Soviet Union. The country's economy was forced to take steps through legislative measures to reform the Cuban trading system. Moving away from centralized economic agendas to the initiation of reforms, the country moved closer to international markets. Cuba, which has a communist political direction, began to invite foreign investors to form joint ventures in order to satisfy domestic and international demand. With these economic reforms, the government obtained the hard currency necessary to ensure the survival of the nation. The Cuban nation began to move toward a market economy.

Czinkota and colleagues (2002) study about transition economies, expose the fact that the Cuban economy is experiencing a transition. Also, the underlying existence of the possibility of political changes will lead to new economic transformations. Clearly privatization is taking place in the country, so the Cuban market has the characteristics of an emerging market as well.

An analysis of the characteristics of emerging economies, place Cuban economy into the category of an emerging market. Failure of state-led economic development and the need for capital investment for the economic survival of the nation, leads researcher's assumption. Cuban policy decision makers allowed non-state owned parties to participate in developing market oriented lines that contribute to economic growth. Cuba is unable to access major sources of international credit and have limited access to other sources of credit, such as commercial banks, suppliers or official lending agencies. Still Cuba has also borrowed short-term high-interest loans to finance export activities, such as sugar and to purchase imports (Ritter, 2002). Cuba, to a great extent, needs capital to finance economic development, which force the Cuban economy to rely on equity investment as a means of financing economic growth. Cuban government seek to attract equity investment, from private investors who will become their allies in economic development, by establishing the preconditions of a market economy and the creation of a business climate that meets the expectations of foreign investors. This change in financing sources has become another factor leading to the rise of emerging markets (Li, 2010). Emerging markets, face big challenges associated with their traditional economic and political systems. Cuba's market economy require a redefinition of the government's role in the national development process and a reduction of the government's unnecessary intervention. Another serious issue must confront is controlling corruption, which contributes to a misrepresentation of the business environment and impedes the development process. In the case of Cuba, this problem is worsen by the U.S. sanctions imposed to the island.

A challenging task for Cuba and countries with an emerging market condition, is the need to undertake structural reforms within their financial, legal, and political systems, in order to guarantee a closely controlled and stable economy fairly free of political disturbances and interference.

## 6 Cuba: PEST analysis

Cuba is now open to investment and trade with market economies. But businesses interested in entering the Cuban market should avoid the assumption that Cuba is in deep need and in a desperate state. The country keeps normal trading relationships with almost every nation in the world, except the United States.

A PEST analysis of the Cuban market will describe the macro environmental factors that could affect firms that intend to enter the Cuban market.

### *Geographic location*

Cuba is the largest island of the Caribbean Sea, strategically located at the entrance of the Mexican Gulf and in the middle of the American continent. This strategic geographical location with its proximity to the North, South and Central Americas make Cuba a valuable source. The capital city is La Havana, with a population of about 13 million people according to official statistics (ONE, 2009), which have been considered inaccurate. Other major cities in Cuba, are Santiago de Cuba, Santa Clara, Holguín, Camagüey, Matanzas, and Cienfuegos.

Cuba is the least commercialized island on the region. The island have remained partially isolated in part due to the United States's policy towards the country and partly due to the political government of the country. This relative political isolation has prevented the island from being overrun by tourists, and locals remains friendly to those who do visit the island.

Three mountain ranges make up about one-quarter of Cuba's land area. The highest peak is Real del Turquino in the eastern Sierra Maestra range, which reaches 1974 meters above sea level. The rest of the country is mostly plains and basins (ONE, 2009).

The average temperature in January, mid-way through the dry season, is 23 degrees Celsius. The August average is 28 degrees with very high humidity (Library of Congress – Federal Research Division, 2006). The period from September to November is considered to be hurricane season.



## 6.1 Political Environment

In 2006, for the first time in the history of Cuba since 1959, Fidel Castro released his position as president due to health conditions. His brother Raúl assumed the role as the head of the Communist Party, the only party in the state. The world considers Cuba to be a country without political freedom (Worldpress.org, 2006).

No political changes are to be expected while Fidel Castro is alive and maintains any kind of influence on the Cuban government policy. Thus, the rules for doing business in Cuba are expected to continue down the same path (Export Development Canada, 2010), and complications related to United States policies are not expected to change in the short term. So, the question of what happens when the Castro brothers disappear from the scene remains unclear.

Raúl Castro, elected by the national assembly as president of the ruling council of state on 2008, has shown a practical attitude towards foreign firms. He has turned to foreign governments and businesses to try to help the country recover from Hurricanes Gustav and Ike. These hurricanes left the country devastated in the second half of 2008 (BBC News, 2008).

Raúl Castro has been introducing a series of improvements to the country's economy with the intention of liberalizing the economy and social life. However, this liberalization process has not moved forward since the devastation of the two hurricanes has obligated the government to focus in the reconstruction of affected areas. This has led the economy and social life of the country to reach the lowest levels since the economic recuperation started.

Opposition movements have been active in the country despite strong restrictions (according to the author of this thesis who is a Cuban citizen). The European Union and the United States have been active in the past years on pronouncing their condemn to the limited political freedom of the country (Cuba Source, 2003). U.S. have opposed alleviating any sanctions imposed on the country until the Cuban government implements economical and political reforms. This sanction was expected to be removed by the actual United States president, Obama, but things remain the same at the second half of 2010. However, small business transaction (pre-paid food and medicines) have been allowed by United States government and Americans are

showing remarkable interest in allowing more travel and trade which could lead to a certain flexibility on American government restrictions.

In 2006, Cuba signed a “People Trade Agreement” with Venezuela and Bolivia<sup>1</sup> (Wilson, 2006), which allowed access to Cuba of Venezuelan’s Oil, a considerably critical factor to Cuba’s economy. Other countries like China had relationships with Cuba but the country and its people do not expected heavy dependency on any one relationship after the experienced with the former Soviet Union (according to the author of this thesis who is a Cuban citizen).

A total absence of political violence on a daily basis is possible to find in Cuba, but the preconditions for the future manifestation of civil violence are latent on the society (Export Development Canada, 2010), due to the governmental limitations, the people’s inability for making their own decisions, and the incapacity of the government for satisfying peoples needs for individual freedom, goods and services

The greater fear of Cuba and the Cuban people, is the possibility of a U.S. intervention that could end in the country’s total dependency on the US (according to thesis’s author based on her life experience). The Cuban population beliefs that if U.S. government sanctions are lifted, Cuban residents in Miami could return to the island, intending to recover their former properties and face resistance from the population, and as a result those Cuban-American citizens in the end will ask for help to the U.S. government to “keep the peace in the area.” Cubans want their own government and rules. Cuban Army and the Cuban people are especially trained in case of a military American Intervention (according to the author of this master thesis who is a Cuban citizen).

### 6.1.1 The Embargo

In 1963 the United States instituted an embargo to Cuba, (Becker, 2003), and was further increased by the Cuba Democracy Act of 1992 where United States. Businesses were banned from carrying on economic trade with Cuba or permitted to invest foreign capital in Cuba. The embargo has also included prohibitions on trade in medicine and food shipments to the island. Limited access to pharmaceuticals products over all these years has created high potential health risks to Cuban

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<sup>1</sup> To see contents of the „People Trade Agreement“ visit: <http://quest.quixote.org/node/305>

population, but on the other hand, this has pushed the government to develop a pharmaceutical industry and medical sector, which has become one of the most recognized in the world. In addition, cargo ships visiting Cuban ports would not be provided access to collect or deliver cargo to United States ports for a period of 180 days following the delivery of cargo to Cuba (American Association for World Health Report, 1997).

Over the last 10 years, normalization of relations between Cuba and the U.S. has existed in the areas of foods and pharmaceuticals (Becker, 2003). Still, the amounts Cuba can get is limited. The United States government will not allow credits to be used for payment of goods by Cuba and the Cuban government does not have enough hard currency.

Over the last years there has not been very much flexibility in the blockade but rather reinforcement. Expectations of the possibility of changes on the actual situation have begun to vanish in the actual world economic downturn along with the limitation of power of the actual United States president. Historically, the U.S. government prohibited spending money in Cuba; but also, for a long period of time it was prohibited that American citizens travel to Cuba as tourists, an action that have been proclaimed to be against the constitutional rights of the American citizen, but changes have been considered. The U.S. Republican leadership and the representatives of the right wing of the Cuban-American community in Congress, considered these actions in favor of Cuba as a threat to their interest. Cuba calls this group “the mafia” of Miami (Morales, 2000).

The conflicts between Cuba and the United States government. have existed for more than 200 years (Nusa Peñalver), but this confrontation has never been between the people of the United States and the people of Cuba. Today many businessmen and regular citizens of the United States disagree with the U.S. government policy of the blockade against Cuba.

### 6.1.2 Threats and opportunities on the political environment

The recent changes implemented by Cuba’s government (i.e., domestic appliances, cars, cell phones, and hotels are now accessible to the Cuban population) although

positive, do not address the root of economic, social, and political problems facing the country.

Repression of political opposition creates preconditions for political violence. However, serious episodes are only expected if the regime cannot, in the long term, respond to the population's desire to access a larger variety of goods and services (Grinfeld, 2010).

The Cuban government has shown signs of awareness in keeping its country's autonomy while recognizing that deeper relations with the global economy are an imperative.

Reuter's (Fletcher, 2009) reports that one finding from the Greater Miami Chamber of Commerce report has considered the scenario that if President Barack Obama's administration ease or even end the embargo without major changes inside Cuba, this could result in Miami's business district to grow if the United States unilaterally lifts its trade embargo on Cuba, but the city could face "unfair" competition from state-subsidized Cuban cigar, citrus, and rum exports, its main body of trade (Fletcher, 2009).

## 6.2 Economical environment

While the Cuban government continues to balance the need for a liberalization of the economy against the aspiration of a firm political control, Cubans make great effort to survive in a dual economy, one in pesos and another in dollars. Cubans can use their pesos to obtain a few subsistence items in government peso stores, called "bodegas", or exchange their pesos for dollars to spend in the dollar-only stores. All Cubans are paid wages in pesos. Salary for an average Cuban is the equivalent of \$5 to \$20 per month (according to the author's experience). A doctor, dentist, or professor earns, at the most, \$20 a month. Although housing, transportation, health care, and education are subsidized, survival on wages alone is very difficult.

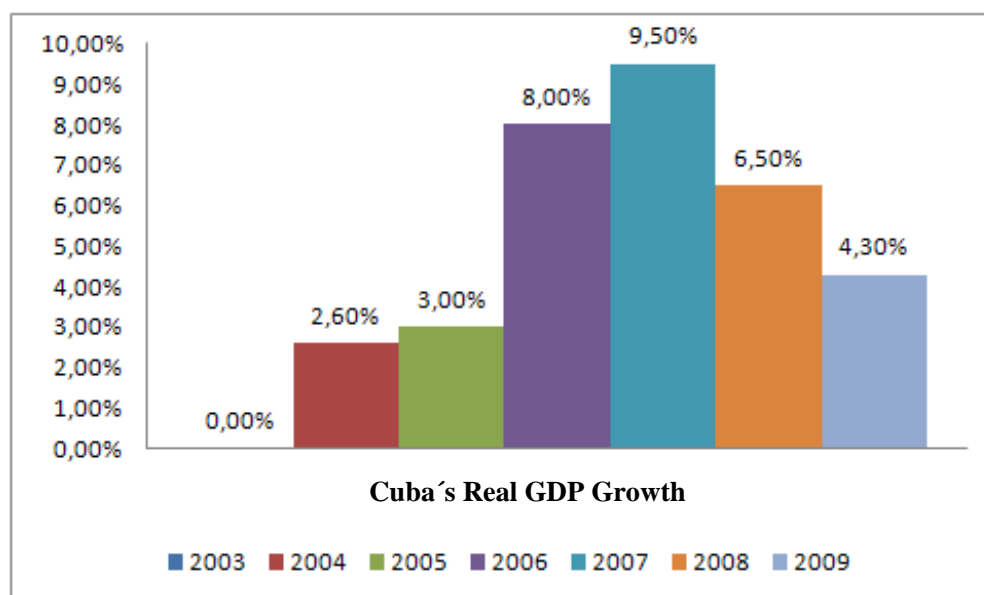
Recently, the government has drawn back limited reforms undertaken in the 1990s to increase venture efficiency and lighten shortages of food, consumer goods, and services (Central Intelligence Agency, 2008).

The year 2008 has been described by the inhabitants as one of the most difficult for Cuba since the special period in the early 1990's (MTI, 2009).

The major factors accounting for this performance according to the Ministry of Trade and Industry of Trinidad and Tobago (2009) were:

1. The severe spike in the international price of oil
2. Significant increase in food prices
3. Decline in the price of nickel
4. Three high-intensity hurricanes

Figure 6-1 illustrate that the economy in Cuba until 2007, had signs of recovery. Cuba's GDP has been growing steadily since 2004. Its highest growth rate in 2007 was 9.5 percent. The downturn of 2008 could be explained by the two natural disasters that affected the island in the second half of the year 2008, leaving behind great destruction and the population in need of human aids as the island did not experienced similar situation in more than 50 years.



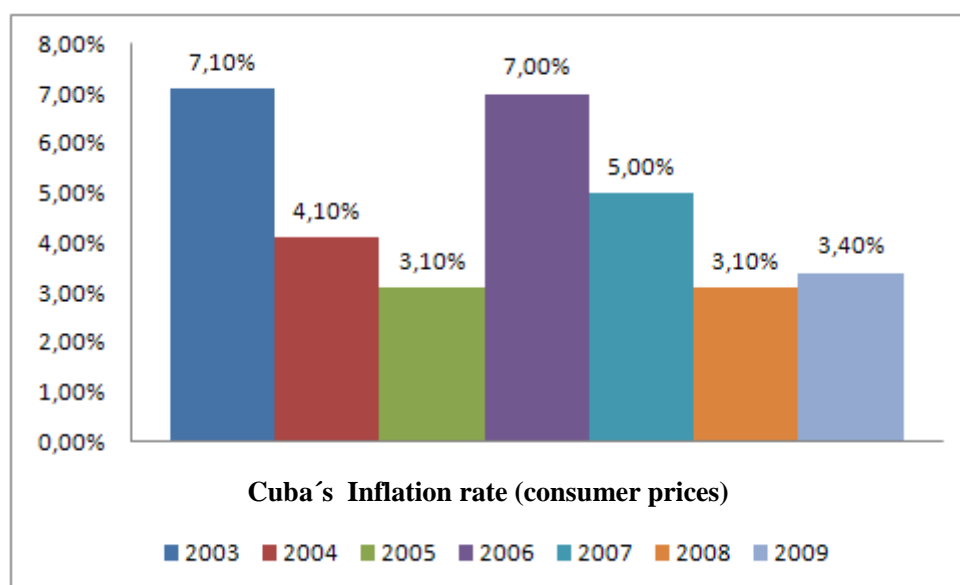
**Figure 6-1 Cuba- Real GDP Growth. Source: Index Mundi 2009**

GDP growth was showing signs of robustness in 2007, but in the second half of 2008 two natural disasters turned down the economical recovery of the island. In 2009 the country was still recovering from these natural disasters.

The decline of the terms of exchange in the world economic panorama is a threat not only to the country's GDP, but also to its monetary stability. Increase in price of

imports needed by the island has immediately lead to an increase of domestic prices (MTI, 2009).

Prices have been rising since the second half of 2008 mainly due to the natural hazards and the increase of prices of imported goods do not show signs of getting lower during an economic world crisis. Product and services that were relatively stabilized between 2004 and 2008 are showing serious signs of the drawback as a consequence of the two factors previously mentioned. The country faced a cutback on food production capacity, caused by the hurricanes. This lead to a considerable increase in domestic prices of agricultural products since they are rare and hard to find by the population. Inflation which has been under control since 1995 goes up as a result of supply-side shortfalls (figure 6-2).



**Figure 6-2 Cuba- Inflation rate (consumer prices). Adapted from Index Mundi (2009).**

In the Central America and Caribbean area, Cuba is situated in the 3rd position with only Panama (Real GDP 9%) and Dominican Republic (Real GDP 5%) (Index Mundi, 2009) showing higher levels of real GDP growth in that area.

The GDP real growth for Cuba has been stable since 2003 as well as in other countries in the area (Index Miundi, 2009). If considered all the limitations of the economy on the island, due to U.S. government's policies and the absence of aid, the country deserves a gold prize.

The average Cuban's standard of living, is at the same level as it was before the downturn of the 1990s, which was caused by the loss of Soviet assistance and domestic inefficiencies (according to the Cuban author of this master's thesis). Venezuela has been providing oil to the islands on preferential terms like the USSR in the past. Cuba has been giving the services of Cuban personnel in Venezuela in exchange for oil; including medical professionals, educators and health care assistance at Cuban hospitals to Venezuelan citizens.

The government has been investing in the country's energy sector to mitigate electrical blackouts that have plagued the country since 2004 (CIA, 2008). After the two natural disasters that affected the island in the second half of the year 2008, this situation was reversed and the population suffered prolonged blackouts. But in the second half of 2010, this situation seems to have stabilized.

Monetary stability in Cuba is considered a difficult arena to predict because of unstable currency exchange rates and the presence of two currencies circulating in the Cuban market (the Cuban peso and the convertible peso). Cuba is not as much exposed to the United States slowdown as Europe (Viswanathan, 2008).

### 6.2.1 Main sectors of industry

The main sector of activity in Cuba is the service sector (table 6-1). It represented more than 70 percent of GDP in 2008 and employed 60 percent of the active population (Emporiki Bank, 2010). The importance of the service sector is mainly related to the development of tourism in the last decades.

**Table 6-1 Cuba's economic activity by sector. Adapted from Alibaba.com, 2008.**

Breakdown of economic activity by sector	Agriculture	Industry	Services
Employment by sector (in % of total employment)	21.2	19.4	59.4

Industry represents about a fourth of GDP and employs 20 percent of the population (Emporiki Bank, 2010). Cuba's Industry is mainly concerned with agricultural products and the production of cement and agricultural machinery. Cuba also has significant mineral resources. The export of nickel represents the main source of income of the country. Cuba also has other minerals, such as gold and copper.

Agriculture represents about 5 percent of GDP and employs 20 percent of the population. Its main products are sugar and sugar cane (12.5 billion tons of sugar cane is produced every year), and represents one third of the cultivated land (Emporiki Bank, 2010).

### 6.2.2 Changes on Foreign Investment and Trade Laws

The liberalization of Cuba's economy has created opportunities for many foreign firms to invest in many economic sectors of the island. In order to cope with changing economic demands and a need to revitalize Cuban industries, the government has implemented a series of reforms, which have led to incredible economic recovering, to the development of economic capitalist activities in the island, space to national entrepreneurial activities for Cuban citizens, and incremented FDI on the island.

This section provides a brief overview of changes in Cuban laws governing foreign investment and trade and intends to give an overview of Cuba's trade situation.

#### **Changes in Cuban Laws Governing towards FDI**

According to Kaplowitz (1995) the most important Cuban law about foreign investment is the so called "Law 50: The Cuban Joint Venture Law" of 1982. Though few joint ventures were undertaken until the disruption of Cuba's trade patterns with the former Soviet Union in 1989. Kaplowitz (1995) also suggests that as Cuban officials began to search for new partners and new trade options, Cuban government began creatively, pragmatically, and realistically interpreting and applying the 1982 joint venture law. Kaplowitz (1995) resume the most important aspects of the "Law 50" as we can read onward:

- Foreign partners may hold a majority share of a Cuban resource;
- Foreign partners are permitted to fill senior management positions with foreign workers;
- Foreign managers are allowed to determine employment needs and may hire and fire Cuban workers at their own discretion;
- Foreign managers and technicians are permitted to remit up to two-thirds of their salary in convertible currency;
- Joint enterprises are completely independent of state control;



- No taxes are paid on an enterprise's gross income, its shareholders' dividends or its executives' personal income. Though joint ventures are subject to 30 percent tax on net profits, the Cuban government often grants tax exemptions running for periods up to and beyond recovery of the original capital investment;
- There are no restrictions on repatriation of profits by foreign partners;
- Joint ventures are permitted to establish production pricing, sales, and marketing plans;
- Joint ventures may import and export directly free from tariffs and duties (Kaplowitz and Kaplowitz, 1992). In return, the foreign partner receives a portion of the revenue or a portion of the product generated by the project. Several dozen such projects are in operation.'

Later, in 1991, the Cubans announced the possibility of establishing import-exports businesses in the free trade zones. Legalization of these trading zones allowed for the introduction of other types of foreign investments, such as suppliers of food and furniture for hotels. Consignment shops were also permitted, in so foreign companies provide goods for sale in Cuban hard currency stores and receive a profit on the items sold (Kaplowitz D. R., 1995). Subsequently, marketing and management agreements were allowed, so foreign partners could provide marketing or management expertise in specific joint ventures.

By 1994, according to Kaplowitz (2002), Cuba had established 146 joint ventures with foreign companies from 28 countries, covering 25 economic sectors. It is known that the highest percent of Cuban joint ventures is in tourism, followed by mineral extraction, oil exploration, industrial production, citrus, and tobacco in descending order. Spain has the most joint enterprises, mainly in tourism. Mexico and Canada hold the Cuban investments with the largest value (Kaplowitz D. R., 1995). Canada has extensive investments in the mining sector, and México has investments in telecommunications and oil refining. Also, France, Italy and the Netherlands are significantly involved in joint ventures.

A considerable number of domestic finance reforms were also initiated between 1993 and 1994 in order to respond to new economic demands. reforms that contributed to enhancing the attractiveness of the Cuban market for foreign investors. Because the

domestic reforms were helpful in increasing Cuba's attractiveness as an investment arena, the most important domestic reforms were described by Donna Rich Kaplowitz (2002):

- Legalization of the Dollar. In August 1993, Decree Law No. 140 was passed allowing Cuban citizens to hold and trade U.S. dollars. At the time, this new policy was an important step in Cuba's efforts to reintegrate into the world economy. The measure effectively eliminated the Cuban state as the sole employer or instigator of economic activity. The measure was aimed at increasing production incentives for workers in key sectors, like oil and nickel, and was also aimed at weakening the thriving black market in dollars. The legalization of the dollar anticipated the increase of the amount of remittances sent to Cubans from family members abroad. In response to this new opening of the Cuban economy the President Clinton prohibited Cuban-Americans from sending money to Cuba.
- Independent Workers. In September 1993, Decree Law No. 141 was passed allowing Cuban citizens to work for themselves in a variety of professions, including carpentry, painting, plumbing, taxi drivers, mechanics, hair dressers, cooks, and domestic help.
- Agriculture Privatized. In September 1993, Decree Law No. 142 partially privatized agriculture by allowing private citizens to farm unused state land and granting more autonomy to farm cooperatives.

The Cuban government also announced that state farms would not be subsidized after 1996 and that 1995's subsidies would be cut by 60 percent compared to 1994 levels (Kaplowitz and Kaplowitz, 1992). These measures effectively ended state farms.

Farmers' markets were established in October, 1994 (Perez-Lopez, 1994). Farmers' markets essentially represented the end of state monopoly on farm products and introduced prices based on supply and demand. Decree Law No. 192 which took effect in December 1994, allowed markets to sell crafts and light industrial goods setting prices by supply and demand.

Other Reforms: Other reforms followed, including Decree Law No. 147, which restructured state organizations in an effort to down-size government. Decree Law 149 authorized confiscation without compensation of illicitly-acquired goods. The law principally targeted black-marketers (Kaplowitz D. R., 1995).

In June 1994, price increases on cigarettes, alcohol, private fuel, inter-city bus fares, and domestic airfares were initiated. Prices for postal services, water, and electricity were increased in September 1994. All these efforts were directed to reduce inflation levels.

A tax system was established in July 1994. Cuban citizens had to pay for school meals, vacation sports, language classes, sporting and cultural events, museums, and art galleries for the first time since the revolution. Personal income, luxury goods, and social security contributions were among those new items taxed. (Cuba Business, Vol. 8, No. 6, p. 3). Taxes on Cuba's 160,000 self-employed sector, as well as taxes levied against property and services were announced for 1995.

As a result of Cuba's adjustments to economic changes, Cuba's budget deficit shrank from 5.05 billion pesos in 1993 to 3.25 billion pesos in 1994. (CubaINFO, 1995). The value of the Cuban peso also faced an increase. The exchange rate changed from 120 pesos to the dollar in mid-1994 to 35 pesos to the dollar by the end of the year. All these economic reforms that the government implemented served to give Cuba a more favorable investment environment.

### **Cuba's Foreign Investment Laws**

Foreign investment is not associated with a privatization process in Cuba. It is rather focused on specific objectives, which complement national development efforts (Ashby, 2005). Hence, most importantly, those objectives are directed to offer/seek foreign capital involvement (Cuba Minrex, 2003).

In this section is a brief analysis of the new Foreign Investment Legislation (Law No.77) passed in 1995. This legislation is in line with international practice according to Ministry of Foreign Affairs, Republic of Cuba (2003).

In 1997, Cuba's National Assembly enacted Law Number 77 -"The Foreign Investment Act." (Ashby, 2005). In summary:

... (...) *Is intended to be augmented with further legislation on banking, real estate and duty free zones* (Ashby, 2005). Law 77 also guarantees transferability of profits to foreign countries and no expropriation without compensation, the right to transfer ownership to other foreign investors is assumed as well as protection against claims of third parties under Cuban law.

Three forms of foreign investment are allowed: international association contracts, joint ventures, and completely foreign-owned companies. For joint ventures, there is no limitation of foreign ownership (may reach 100 percent). This can be accomplished by either establishing a subsidiary of a foreign company in Cuba or creating a separate Cuban company to operate the business.

A process of negotiation and approval before foreign investment is authorized and required by Law 77. *Investments of more than US\$10 million, 100 percent foreign ownership, those involving a foreign country, those using natural resources, or that convey either government-owned property or projects involved in certain special sectors, such as: transportation and communication, require the approval of the Council of Ministers' Executive Committee* (Ashby, 2005).

All other investments should be approved by a commission previously created for that purpose by the Council of Ministers.

The establishment of duty-free zones and industrial parks open to foreign investment were enabled also by this law. According to Law 77, the free zones and the industrial parks must operate under a special system covering custom duties, exchange rates, taxation, labor, migration, public order, capital investment, financial operations, storage, production, manufacturing and foreign trade. Another law, Law 165 of 1996, was enacted to implement free trade zones and industrial parks regulations under more flexible investment and operational rules (Ashby, 2005). Three free trade zones and several industrial parks have been created since Law 165 came into effect. The success of these special areas, however, has been quite limited and will remain so until such time as trade with the U.S. is reestablished because there is not much manufacturing, assembly or storage business under present circumstances.

Law 77 also allows foreigners to acquire ownership and other property rights over Cuban real estate. The areas of investment are limited to real estate development in

the tourism sector, housing or offices of foreign companies established in Cuba and residences and other housing structures dedicated to private residences or private tourism activities for individuals who do not permanently reside on the island (Ashby, 2005).

### 6.2.3 Foreign trade in figures

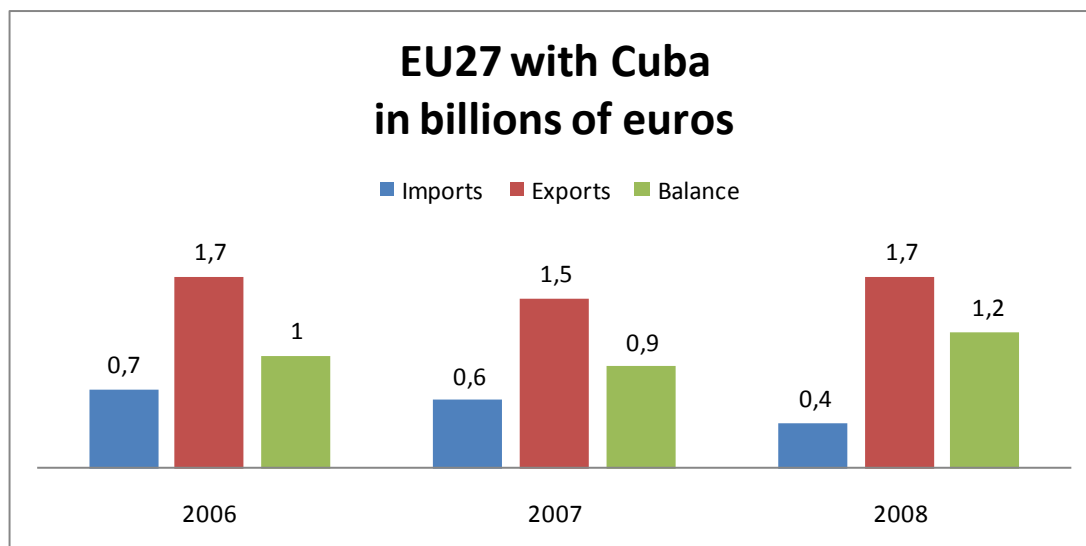
According to the International Merchandise Trade Statistics published by the United Nations (United Nations, 2009), Cuba's exports increased twofold from 2002 to 2006, (on average by 20.3 percent each year) and amounted to \$ 3 billions. US. During the same period imports increased on average by 24.9 percent each year and amounted to 10.2 bln US\$, resulting in a trade deficit of 7.2 bln US\$. Large deficits were recorded with Developed Europe (-2 bln US\$), Eastern Asia (-1.5 bln US\$) and Developed North America (-0.8 bln US\$). Trade, especially exports, was concentrated among a few partners. Four major partners mentioned above accounted for 80 percent of exports compared to nine major partners for imports. Figure 6-3 illustrate data from export and imports activities that Cuba maintains with the world in billions of euros.



**Figure 6-3 Export and imports activities Cuba maintain with the world. Adapted from DG Trade Statistics 2009**

From 2004 to 2006, top exported products were nickel mattes, cigars, cigarillos and cigarettes (United Nations, 2009). Europe is Cuba's second largest trade partner, after Latin America. It accounts for just under a third of Cuba's foreign trade. Though the value of Cuban trade with Europe has depreciated as a result of Cuba's economic crisis, Europe's relative rank has remained stable (Kaplowitz D. R., 1995).

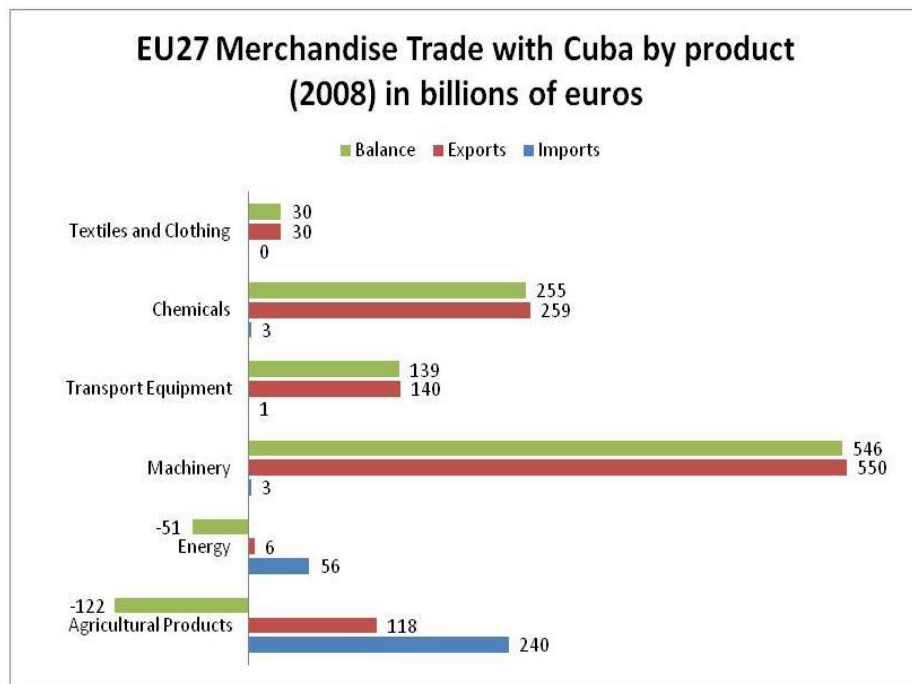
By 2006, Cuba's imports from the EU represented 0.7 millions of euros, and by the year 2008 the country was able to reduce the amount to 0.4 millions of euros; however the exports remained the same for both years, and in the year 2007 the exports of the country to the EU were reduced to 1.5 millions of € (figure 6-4).



**Figure 6-4 Trade between EU and Cuba Adapted from DG Trade Statistics (2009).**

By 2008, Cuba was able to reduce the imports from EU considerably if we compare it to the year 2006 while exports remained the same for both years (2006 and 2008). The balance experienced a relative increase if we consider that in 2007 the country was lowering that amount.

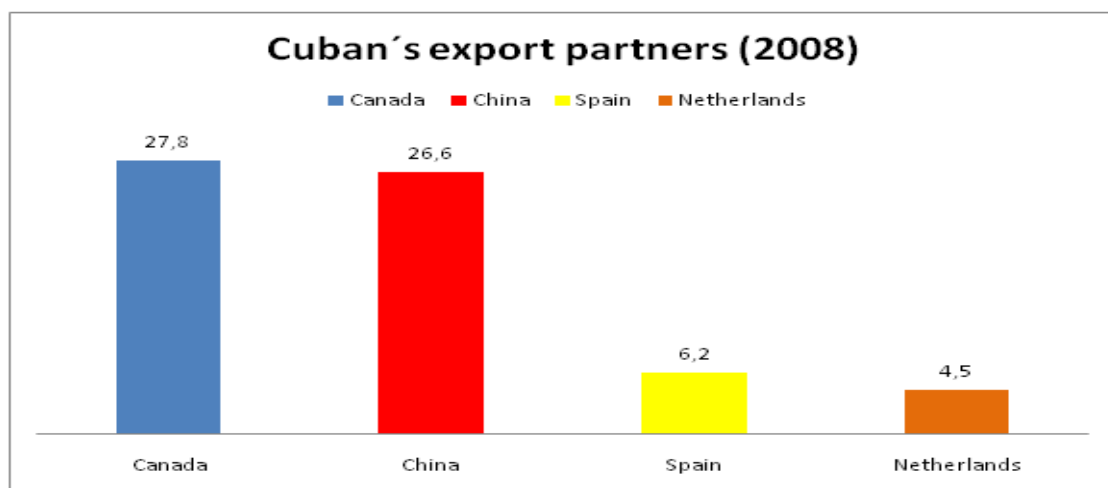
Figure 6-5 reveals very interesting data. Cuba, which has large availability of cultivable lands and an incredible fertile land, was importing more agricultural products in 2008 than it exported, which conducted to country's trade imbalances. Also interesting is that machinery products, chemicals, and transport equipment are the main products exported to the EU while the import of those products to the island is considerably low.



**Figure 6-5 EEU merchandise with Cuba. Adapted from DG Trade Statistics (2009).**

In 2008, the island main exports were sugar, nickel, tobacco, medicines and fishing products (CIA; 2008). In 2008, top imported products included petroleum oils, other than crude, crude and electric generating sets (United Nations, 2009).

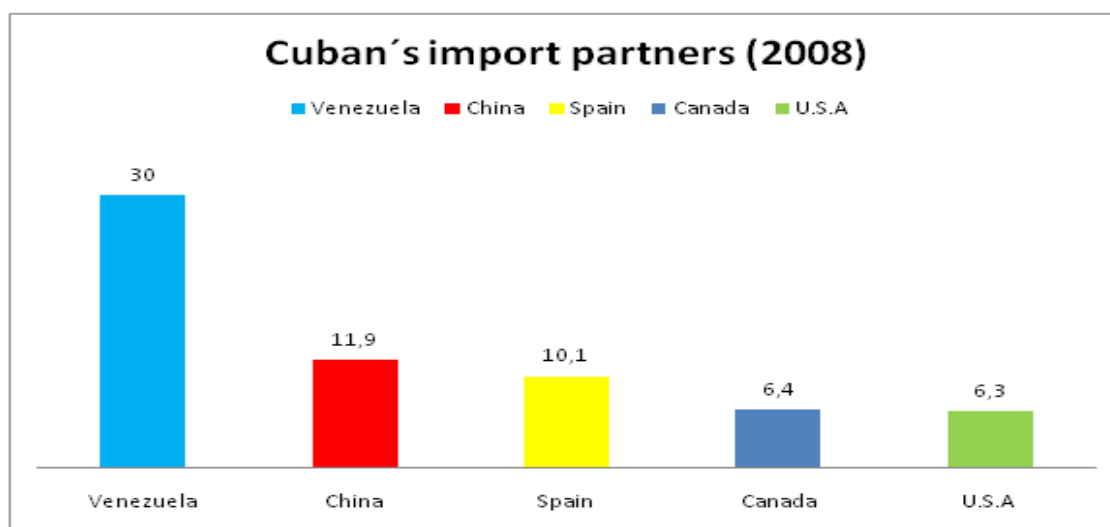
According to the CIA Factbook (CIA, 2008), the main Cuban's export partners in 2008 were Canada, China, Spain and the Netherlands (see figure 6-6).



**Figure 6-6 Cuban's export partners. Adapted from CIA, 2008.**

Even when the European Union represents about half of Cuba's foreign trade, Cuba's three main export partners are Canada (27,8 %) China (26,6%), and Spain (6,2%).

The country's top three import partners are Venezuela, China, and Spain (figure 6-7).



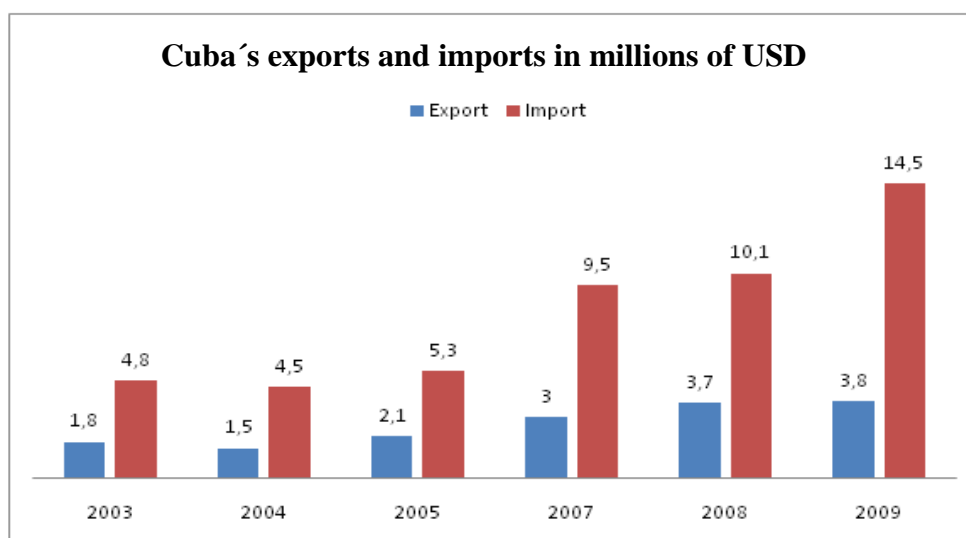
**Figure 6-7 Cuba's import partners. Adapted from CIA, 2008.**

Cuba's import main partners are Venezuela, which is not surprising due to the tied relationships between the two countries. China, also a communist country, Spain and Canada are the next main partners, which is not surprising due to long time economic and cultural relations those countries have with Cuba. Maybe a little bit surprising is the U.S. position, among the main import partners, if we consider the business limitations that the American government has tried to impose to the island for the last five decades.

Spain is Cuba's most important European trade partner and accounts for a third of all European trade with Cuba (Maynard, 1994). On the other hand, Canada is the largest generator of tourist income for the island followed by England, Spain, Italy, and Germany (Escambray, 2010).

In general, Cuba's imports have been increasing in the last 6 years from 4.8 million US dollars in 2003 to 14.5 millions USD in 2009 while exports have just increased by 2 million USD (see figure 6-8).





**Figure 6-8 Cuba's exports and imports Adapted from United Nations, 2009**

With respect to trade policies, it is important to consider that the government favors the establishment and development of local industry, primarily for the export market. Only in specific cases is the foreign investor allowed to access the local market. So, the foreign investor would compete with local "private" Cuban companies, which the government does not want at this point in time. Many areas of the economy are reserved. Cuba is a member of many international trade groups, but not a party of any tax treaties (United Nations, 2009).

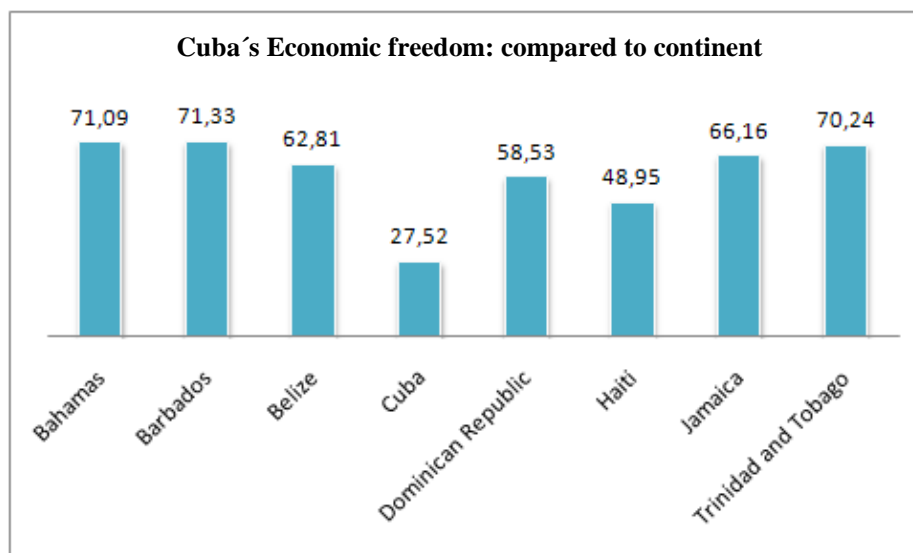
#### 6.2.4 Cuba: Economic Freedom

According to the 2009 Index of economic freedom (Index of Economic Freedom, 2009), Cuba's economic freedom score is 27.9, making its economy one of the world's least free, ahead of only Zimbabwe and North Korea. Its overall score is 0.4 point higher than the year before, reflecting marginally improved scores in trade freedom and freedom from corruption. Cuba is ranked at the bottom among 29 countries in the South and Central America/Caribbean region, and its overall score is less than half of the regional average. In addition, the Index Mundi economic freedom states that Cuba's overall economic freedom remains severely hampered by numerous institutional weaknesses, and the private sector is very limited.

**Table 6-2 Quick Facts. Data Source: Index of economic Freedom, 2009**

Population	Unemployment	Inflation (CPI)	FDI Inflow
11.3 million	<b>1.8%</b>	<b>3.6%</b>	<b>\$-0.7 million</b>

Figure 6-9, reveals that Cuba is the only country in the region that ranks so low in economic freedom. Even Haiti which is considered one of the poorest Latin-American countries ranks ahead Cuba<sup>2</sup>.



**Figure 6-9 Cuba's Economic freedom: compared to continent. Adapted from Global Property Guide, 2010**

According to Index Mundi (2009), the economic freedom of the island is mainly affected because of government control over almost every aspect of the economic activity and limitation of national entrepreneurship. Also the inconsistent and opaque application of regulations limits the creation of entrepreneurial activities. Corruption is common in customs and import and export activities are dominated by the government. Cuba's fiscal freedom is limited by the a high income tax of 50 percent and "*The top corporate tax rate is 30 percent (35 percent for companies with entirely foreign capital).*" Government expenditures is very high and represents the 72,6 percent of the GDP and government egalitarian policy remains an obstacle to fiscal management. Industry and services sectors remain dominated by the state. Another cause for Cuba's low ranking in economic freedom is the limitation of FDI to joint

## <sup>2</sup> Understanding economic freedom rating

Scores are from 0 to 100, higher scores are more desirable i.e. more conducive to economic growth. The lower the score, the greater the level of government interference in the economy and the less economic freedom a country enjoys.

- Free 80 - 100;
- Mostly Free 70 - 79.9;
- Moderately Free 60 - 69.9;
- Mostly Unfree 50 to 59.9; and
- Repressed 0 - 49.9.

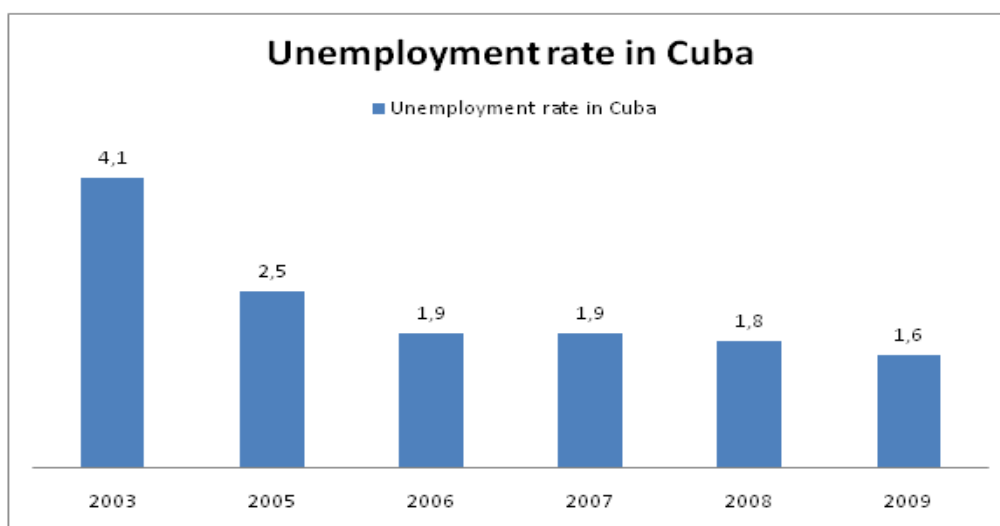
ventures activities and a series of complex and arbitrary regulations (Index of Economic Freedom, 2009). The government also maintains strict capital and exchange controls.

#### 6.2.5 Income distribution

Many Cuban families have access to remittances from family members living abroad or are related to tourism activities, and other sectors of the economy driven by foreign direct investment. The past decade has created new opportunities for income generation and social mobility for the people on the island. Still, for those who have neither of those opportunities, real income has declined and mobility prospects have narrowed and even worsened after the two natural disasters in 2008. The growth of poorer and more economically isolated households tend to concentrate in particular regions and the cities. Situation accentuated in the rural eastern areas of the island and even in particular neighborhoods, such as those on the periphery of the capital area of La Havana. Combined with a slowdown of the economic growth, these prominent new patterns may represent challenges for Cuba's economic and social policy, for its political life, and for the social equality that Cuba's leaders have promised to defend.

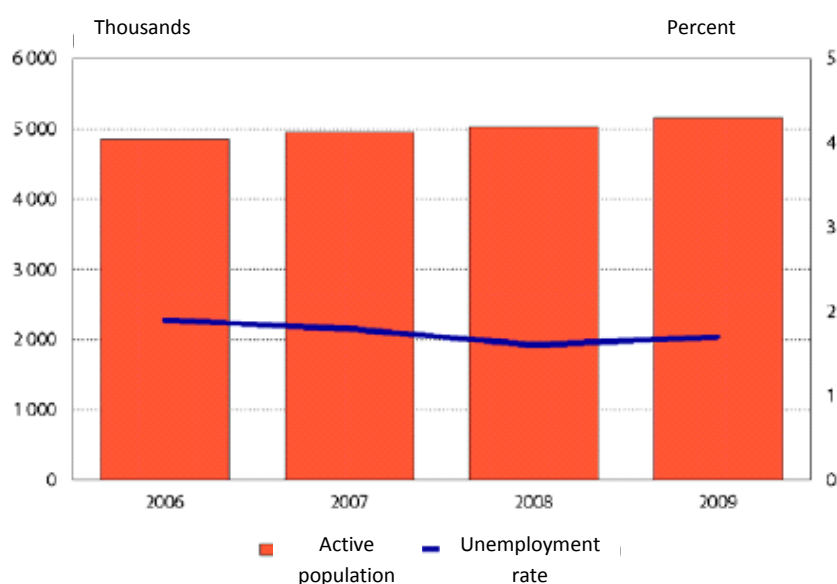
Despite its status as a low-income developing country, Cuba's social policy has been recognized for its significant gains in social indicators contrary to other Latin American countries. Clearly the income inequality has certainly risen, but the exact scope of poverty remains an issue of significant debate because of the lack of measurements of the impact of the multifaceted changes in the country. Non official data exist about it, and it is considerably difficult to approach it.

Unemployment in Cuba, as illustrated on figure 6-10 is very low (1.6 percent. 2008 est.) (IndexMundi, 2010), and Cuba has universal access to the educational and health systems. Cubans also have a monthly basic food basket, which has also recently been subject to policy revision (according to real life experience of the author). Wage differences are very small. In spite of such developments, the Cuban economic situation is still uncertain.



**Figure 6-10** Cuba’s unemployment rate Adapted from IndexMundi, 2010.

Cuba’s egalitarian policy to keep the total population employed has lead to the implementation of strict regulations intended to reduce unemployment. Those individuals who remain unemployed for a period of 2 years are considered as “vagos” and are classified as a threat to the society and could be subject to strict penalties (based on information and experience of the author). However, an analysis of the figure 6-11, reveals that unemployment has been stable during the last fourth years while the active working population has slightly increased.



**Figure 6-11** Cuba’s active working population and unemployment rate. Source:Oficina Nacional de Estadísticas, 2009.

Interesting and important note, 70 percent of Cuba's population is between 14 and 64 years of age. A considerably high number will enter the retirement age soon, and a considerable decrease on the number of total birth is a question mark. Will there be enough active working population in the next decades? What sectors of the population should firms target for its products?

Two important elements need to be addressed because directly affect income distribution on the island. The two elements are interrelated to how people see themselves, which had contribute to the creation of subcultures in the Cuban society. The first element is: tourism related jobs. Employees who work in tourism get a much higher income because of tips. Tips in tourism jobs can mean an extra income, which makes a big difference. Tips can reach a hundred times the wage paid by the government for jobs that even require higher education levels, such as doctors, engineers, and teachers. For this reason, tip-earning jobs, like porter, doorman, waiter, chambermaid and taxi driver are seriously in demand. Second element to consider is the remittances from family members and relatives who are resident in foreign countries. Today these remittances are an important source of income for many families. A small sum of money like USD\$ 100 can mean a tenfold increase in the home budget or the same as a salary for the entire family of five highly educated individuals or even more (according to author reference).

The government has tried to implement solutions to drawn back the differences in the social panorama created by the last element: the remittances. Some solutions to the problem that the government has implemented is the creation of taxes those remittances and the elimination of the free circulation of the US dollar by allowing only remittances in Euros or Canadian dollars. Such fiscal measures are limited, since those remittances are extremelly important for the weakened Cuban economy.

### **Remittances roles on the economy**

In 1993 the Cuban Government made it legal for its people to possess and use the U.S. dollar (Perez-Lopez, 1994). With the new monetary policy, the dollar become the major currency in use. Recently, this decision was taken back, and the U. S. Dollar was replaced by the Euro and the Canadian dollar.

Hard currency inflow into the island, in 2009, was estimated to be \$800 million to \$1 billion annually (Global Security Organization, 2009). To capture the hard currency, the government made arrangements for state-run dollar stores throughout Cuba that sold all kinds of products, such as food, household and clothing items and can only be purchased with “divisas” (a Cuban peso with the same value than the euro). The gap in the standard of living has widened between those with access to dollars and those without access.

Jobs that offer access to salaries in dollars or tips from foreign businesses and tourists are highly attractive, and eventually, those jobs are sold on the black market. As a result, highly educated personnel work on “low pay jobs.” In Cuba this concept: “low pay jobs” do not apply to Cuba’s actual situation since access to hard currency creates a higher social status and bring more economic freedom to those employees in the tourism sector. This explanation could be the used to answer foreigners who wonder about highly educated human resources, such as engineers, scientists and other such professionals who work in restaurants, hotels, souvenir shops, or taxis.

Remittances play a large role in Cuba’s accounts. These account for between \$800 million and \$1 billion per year in an \$18.6 billion economy. The majority of remittances come from families in the United States that are permitted by U.S. law to send to the island up to \$1,200 in a year. This provides nearly 60 percent of the Cuban population with some access to dollars (Global Security Organization, 2009).

#### 6.2.6 Taxation policy

Since 1 January 1996, tax on personal income in foreign currency is due to the state. It must be paid in US\$ by Cubans and foreigners currently receiving remuneration in US\$ for their work or for the lease of assets. The rate of income tax varies between 10 percent (for persons with income of less than US\$ 2,400 per year) and 50 percent (for those with income of more than US\$ 60,000 per year). Family money orders from abroad are exempt from the tax (Servicios Financieros, 2010).

Personal income in Cuban pesos (Pc) generated by self employed Cubans, must be paid in Pc. The rates vary between 5 percent and 50 percent of net income (Servicios Financieros, 2010). Salaries paid by the state, pensions, and donations are exempted.

A tax on income from the lease of rooms or houses is currently charged and has been since 1996.

Companies are subject to pay income tax at a rate of 30 percent (up to 50 percent in the case of mining enterprises) (Servicios Financieros, 2010), and for an employee a labor tax of 11 percent (the tax is paid directly to the hiring hall) plus a social security tax of 14 percent are charged (i.e. base salary times 1.25) (Servicios Financieros, 2010). In addition, certain export tariffs may be charged, as well as a transport tax and flat fees for certain (notarized) documents (e.g. company registration, and other services.)

The concept of a sales tax does not exist, except in the area of real estate purchases (i.e. stamp duty tax), where a charge of 2 percent is levied since 1996 (Servicios Financieros, 2010).

### **Tax Rates**

Information on consumption taxes is not easily found on the Internet, and there is no official data, which reflects the information required. However, according to [www.alibaba.com](http://www.alibaba.com) (2008), a chinese website completely dedicated to trade and supply activities, this information seems to apply to the Cuban reality. Due to the tight relationship between Cuba and China's governments, it could be taken as reliable information. Some information is possible to collect from Index Mundi (2009) and the Index of economic Freedom (2009), but information remains diffuse. According to data obtained from these web sites ([alibaba.com](http://alibaba.com), Index of Economic Freedom, and Index Mundi),<sup>3</sup> there is no VAT in Cuba, but there is a variable sales tax from 2.5 percent to 25 percent, depending on the type of product.

Taxed goods are those that are imported, partly produced in Cuba or goods that are bought for resale and are destined for consumption. Corporate tax information also reported a company tax of 30 percent on the taxable net profits.

Capital gains taxation: the taxation rate depends on the company's legal form. For companies with complete foreign ownership the rate is 35 percent whereas for

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<sup>3</sup> Although these web sites are considered not proper research to use as references in a master's thesis, I did it due to the absence of such a data in official documents.

companies of mixed economies and those of international economic association contracts, the rate is 30 percent.

Main allowable deductions and tax credit: Exemptions exist in certain cases such as foreigners and franchise holders located in free-trade zones or industrial estates are exempt of tax on profits and labor force tax.

Other corporate taxes: A tax on the use of the labor force exist at (Impuesto por la utilización de la fuerza de Trabajo): 25 percent (of the total value of the salary). In the case where the company is set up in a trade-free zone or an industrial estate, the investors are completely exempt from this tax.

### 6.3 Threats and opportunities in the Economical Environment

Cuba's comparative advantages for foreign investment, according to the Cuban Ministry of External Relations (CubaMinrex, 2003), are the following:

- A highly skilled labor capable of assimilating, in a short period of time, any new technology.
- Adequate infrastructure; 95 percent of the national territory is electrified. Additionally, the country's basic infrastructure in terms of power generation and distribution, oil extraction, prospection and refining, and communications has remained and even developed with support from foreign investment.
- Social stability and safety climate for foreign investors.
- Bilateral agreements on promotion and reciprocal protection of investments exist with more than 50 countries and 5 agreements for the avoidance of double taxation while other agreements are being negotiated.

Cuba has signed bilateral agreements (Cuba Minrex, 2003) for the protection of foreign investment with more than 40 countries. These provide mutual equal treatment of foreign investment, facilitate repatriation of profits, and establish procedures for arbitration of disputes. Cuba had signed 12 tax agreements for the principle purpose of avoiding double taxation.



Foreign Direct Investment is one way for Cuba to obtain financial resources, and the technology capable of improving industrial competitiveness. Foreign Direct Investment (FDI) has been, in the last decades, playing a significant role in financing development around the world, such as Asia and some Latin American countries, where results are encouraging. Still, it is not enough for Cuba to improve its foreign investment policy because Cuba needs to play a more important role in financing development in order to encourage FDI. More national efforts have to be taken in order to resuscitate growth and financial viability in the Cuban economy.

## 6.4 Social environment

Cubans combine southern joy of life with a northern work ethic plus an intellectual ability that makes them unique. The work ethic is evident in those who operate within the boundaries allowed for self-employment.

Education in Cuba is free and school is mandatory up to secondary levels. Cuba has one of the highest proportions of university graduates in the world (Ministerio de Educacion Superior, 2008). The Cuban government did spend in 2006, about 9.1 percent of the GDP on education (IndexMundi, 2010). Literacy rates, according to Index Mundi, are 99,8 percent of the total population, group age 15 and over can read and write. There is no difference between genders. According to census of 2002, Cuba ranks 9 at world levels on literacy rates (IndexMundi, 2010).

Despite the importance that Cuban families and the government place on education, motivation is becoming a problem. Students drop out of schools because they see little point in becoming a professional when jobs that require little education, such as waiters, guides, and “bicitaxis” make more money. Similarly, other Cubans just opt for quitting their jobs (usually women because according to social standards man must work) or even ask doctors to issue “certificados”, (certified medical excuses) to avoid work. Unemployment is a choice especially among the young generation which prefers that situation to jobs that pay little or are boring (according from life experience of the author who in addition, did work in Cuba as a teacher for a period of five years, at secondary levels). In response to the situation, the government has applied laws where if an individual remains unemployed for 2 years, becomes a social problem and can lead to prison. In addition, the government has applied education

programs, specially for the youngest where they are subject to assist in schools. They get paid 100 pesos or the equivalent of \$ 4,5 dollars as unemployment compensation and thus get away from becoming categorized as a “vago.” This strategy has reduced considerably the unemployment numbers reported to international entities.

Cubans are very indulgent with their children, and family bonds are strong. Cuba could be the model for "family values." Parents do not just take their children to and from school. They will travel many kilometres to bring them something to eat at break times in schools.

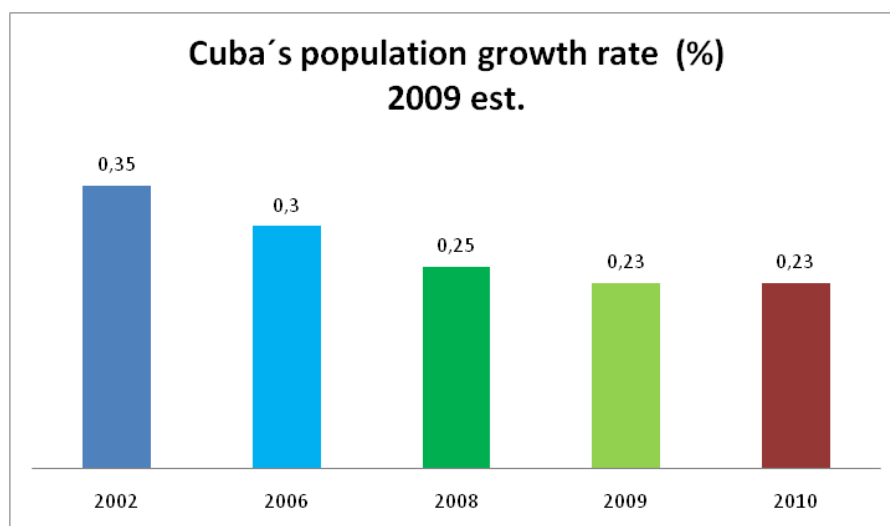
The prevalence of the family values does not mean an inhibiting moral code. Cuba is a sexually open-minded society and promiscuity is widespread. Both sexes are unusually daring. Cubans enjoy flirting, and both genders frequently exchange suggestive overtures. Christopher P. Baker says in the *Moon Handbook* (2006, p.107):

*"You should also know that Cuba is a sexually permissive society. Cuban men and women both pervade a joyous eroticism that transcends the hang ups of essentially puritanical Europe and North America. Seduction is a national pastime pursued by both the men and women of Cuba. The free expression of a high-spirited people confined in an authoritarian world. After all, Cubans joke, sex is about the only thing Castro can't ration."*

Cubans enjoy sharing, so they will share anything they have with their families, neighbors, and even visitors. It is not rare to find two or three generations living under the same roof where the older ones take care of the daily cooking and cleaning while some members of the family are entirely dedicated to work to help maintain the entire family.

#### 6.4.1 Demographics

According to Lisandro Pérez (1995), Cuba is a country with a demographic profile that resembles the situation of more developed nations. Birth and death rates numbers are low, and life expectancy is high. The proportion of the population in working ages is also high, and the number of elderly people is expanding rapidly. Cuba also has an educated population and a universal public education system.



**Figure 6-12 Cuba- Population growth rate. Adapted from Index Mundi (2008).**

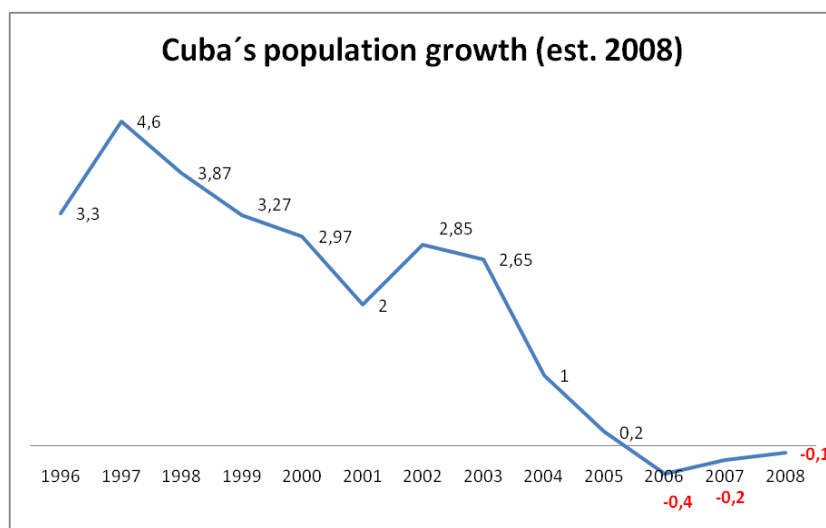
Population in Cuba is stable, and the current GDP growth is expected to bring significant improvements in living standards as well as higher consumer spending and government investments. However it is important to look at the close ties the country has with China and Venezuela, ties that could make the country vulnerable to changes in those markets because Cuba is still recovering from the Soviet Union fall.

**Table 6-3: Cuba- Population Growth rate the last two years. Source Index Mundi 2009.**

Year	Population Grow Rate	Rank	Percent change	Date of Information
2008	0.25	179		2008 est.
2009	0.23	179	-0.8%	2009 est.

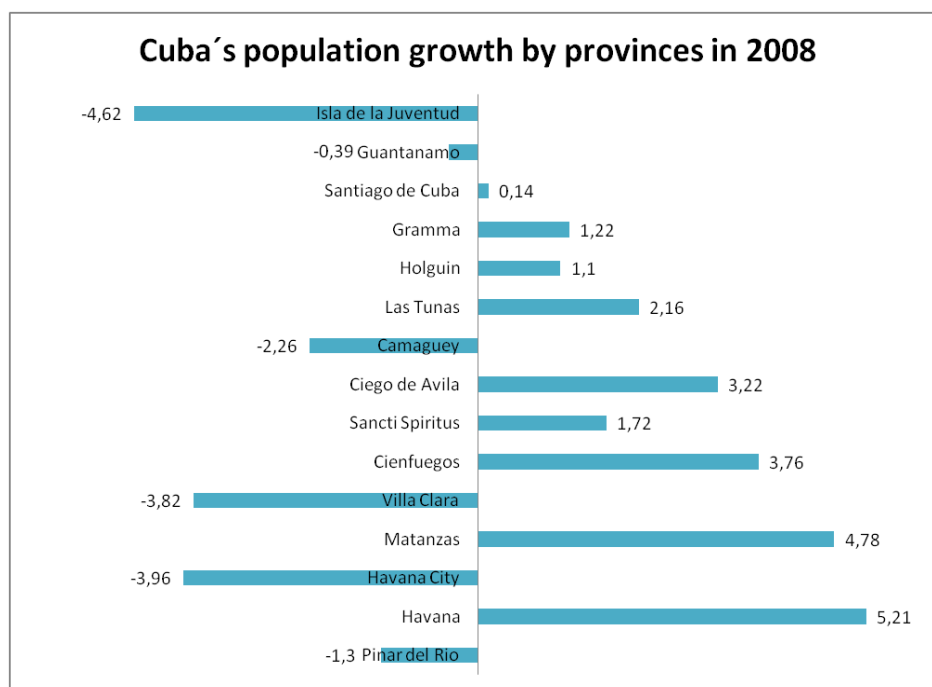
According to Index Mundi (2008), the total Cuban population in July 2008 was estimated at 11,423,952, and as figure 6-13 and table 6-3 shows, Cuba's population have been declining in the last 10 years.

Government agency forecasts a continuing population shrinking in the next 20 years (Mundi, 2008). Cuba's Center for Population Studies (International, 2008) attributes the decline to families having fewer children, increased migration rates, and an increased mortality rate for Cubans over 60. In addition, changes in the role of Cuban women within society and others factors related to economic limitations are considered important contributing factors too.



**Figure 6-13 Cuba's population growth. Adapted from Oficina Nacional de Estadísticas (ONE), 2008.**

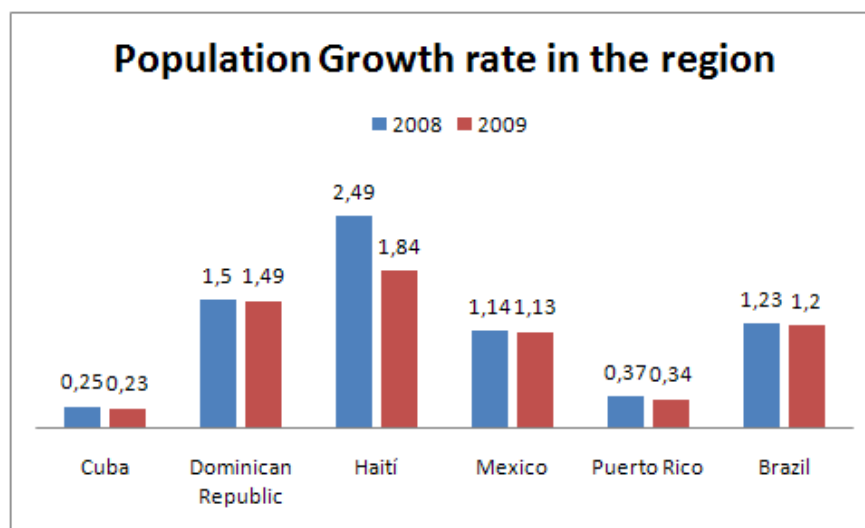
The population, just after the collapse of the Soviet Union, started a process of continued decline, which could be directly related to the extraordinary collapse of living standards of the Cuban population caused by the disintegration of the former USSR. In addition, the population shrinking is associated to some provinces of the country as figure 6-14 illustrate.



**Figure 6-14 Cuba's population growth by provinces in 2008. Adapted from Oficina Nacional de Estadísticas (ONE), 2008.**

In 2008, population growth was negative for 6 provinces out of 14. It is interesting that the provinces with lower population growth are located in the east of the country (Guantánamo, Santiago, Granma, Holguín). While those provinces that have experienced an extraordinary tourism development in the past years, such as La Havana, Matanzas and Cienfuegos, reported the highest levels of population growth.

Figure 6-15 point up the fact that population shrinking is a regional observable fact

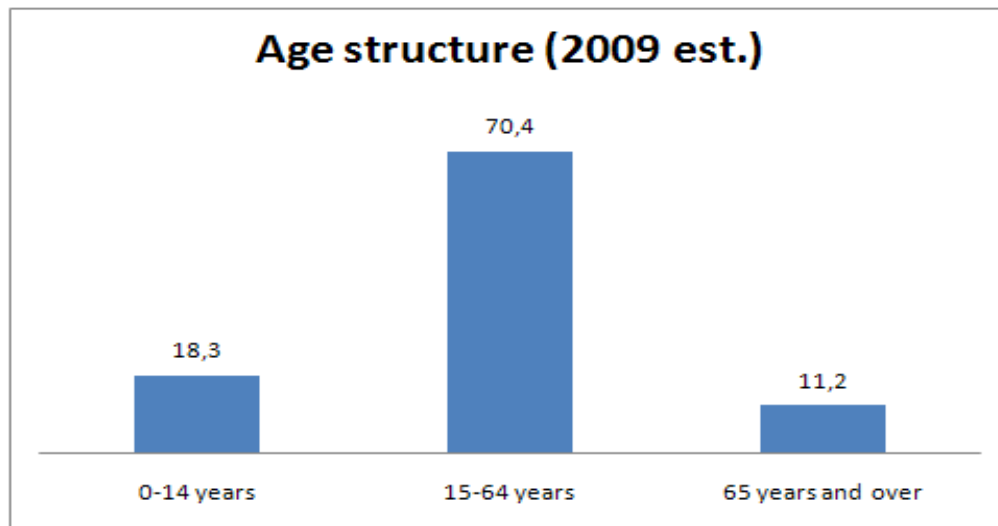


**Figure 6-15 Cuba compared to regional population growth. Adapted from Index Mundi (2010)**

Families having fewer children, increased migration rates, an increased mortality rate, changes in the women's role within society; and economic limitations are factors not only inherent to Cuba. Marketers interested on the region, must consider that population in countries, with lower education levels and with low incomes, has a tendency to be larger than in those with higher living standards.

As is known, the age structure of a population affects a nation's key socioeconomic issues. Countries with young populations (high percentage under age 15) need to invest more in schools, while a country with older population (high percentage ages 65 and over), needs to invest more in the health sector (CIA, 2008).

Figure 6-16 provides information about the distribution of Cuban population, divided by age group (*0-14 years, 15-64 years, 65 years and over*) in percents.



**Figure 6-16 Cuba age structure. Adapted from Index Mundi (2010).**

From data it is possible to conclude that the population in Cuba is getting older, a fact analyzed previously. According to Cuba's Office of National Statistics (2008), Havana, Villa Clara and Sancti Spiritus are the provinces that report a concentration of a population over 60 years old with respect to the total population.

Aging population is a determinant factor. Marketers planning to enter the Cuban market must consider this fact and put special attention on it. Actual demographic trends could represent a problem that marketers may face in the next decades.

## 6.5 Threats and opportunities on the Social Environment

Several threats and opportunities are present in the Cuban social environment.

Cuban population is aging, this fact could be a possible threat for workforce acquisition that organizations planning to invest in the Cuban market could face in a near future.

Existent demand of products and services, with a preference for foreign products, have not been addressed for many decades. This is a great opportunity for investors in the Cuban market.

Highly educated human resources are present in the island. With a better educated labor force growth, and economic productivity, firms that invest on Cuba's market could ensure the long-run economic success.

Cubans are entrepreneurs by nature. Establishing personal contacts with Cuban citizens is an opportunity that investors should not avoid.

Stable population growth and absence of social violence makes desirable the opportunity for investments. At the same time, frustration over lack of opportunity and low income is a potential trigger for violence.

Cubans are looking for job opportunities that guarantee higher living standards. Low living standards present on the island, can fuel criticism and competition for development benefits, besides a lack of confidence in the state's ability to provide essential services correlating with political change and civil unrest, which could be a threat and an opportunity as well.

Little or none understanding of private property could represent a threat. Employees tendency to steal or replace original products with an imitation, while could damage the image or the value of the products. Working morale could be the main threat to observe in this area.

## 6.6 Technological environment

Cuba has a fairly strong domestic pharmaceutical and biotechnological industry, which responds to the needs of the Cuban population and emerging export opportunities. Cuba has developed leading vaccines and drugs to treat HIV/AIDS, circulatory diseases and cancer. These could be of interest particularly to many developing countries in search of cheap generics or technology transfer. Cuba is recognized as a leading country on biotechnology, but some sectors still lack development.

Gakenheimer (1999), outlines a series of distinguishing features typically exhibited by developing countries, and if applied to Cuba's actual situation, the following list appears:

- In Cuba there is not a rapid pace of motorization due to the economic blockade and government policy.
- Travel demand exceeds the supply of facilities, especially road space.
- There is a high share of trips by public transport (Enoch, J Warren, Valdés Ríos, and Henríquez Menoyo, 2004).

- There is a desire for auto ownership but this desire is more close to a dream than a reality. Recently the government has introduced reforms, such as: allowance to Cubans to buy cars in foreign currency; access to hotel rooms and other tourist services, and more. Those reforms only benefit individuals who have access to foreign currency or remittances. In addition, those reforms are not aligned with government equalitarian policy, followed the last 50 years, and have enlarged differences in Cuban society.
- Development in the sector is slower than in other developing countries due to the lack of hard currency, which also affects directly street and highway maintenance.

Clearly, Cuba is a developing country, but on the other hand, its economic circumstances have been distorted by external economic effects for so long that it also exhibits a number of unique characteristics.

#### 6.6.1 The Cuban transportation infrastructure

The Cuban transportation infrastructure was before 1959 among one of the most developed in Latin America. After 1959 very little of the infrastructure has been updated.

Cuba has a good infrastructure of transport by road, by air and by rail, which facilitates the connection among all the points of the country in terms of hours. Still, it is necessary to distinguish between transportation paid for in dollars (of very good quality compared to the services paid for with Cuban currency but is not guaranteed that it will satisfy European standards) and transportation paid for with Cuban pesos (the national currency), in general of mediocre quality. Using this service means that a trip scheduled to be 8 hours can be prolonged up to 16 hours. Most tourists, obviously, will use services of transport paid for with dollars (data provided by the author of the thesis).

Cuba has 147 airports according to statistics from 2008 offered by CIA WORLD FACTBOOK (Countries of the World, 2010). It has railways that cover a total: 4,226 km<sup>4</sup> and roadways cover a total: 60,858 km from which 638 km correspond to

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<sup>4</sup> *note:* an additional 7,742 km of track is used by sugar plantations; about 65% of this track is standard gauge; the rest is narrow gauge (2006)



expressways and waterways, which cover 240 km (2008) (Countries of the World, 2010).

Cuba is an island, so ports and harbors are especially important. Cuba's 7 main ports and harbors include Cienfuegos, Havana, Manzanillo, Mariel, Matanzas, Nuevitas, and Santiago de Cuba (Encyclopedia of the Nations, 2000). The country's merchant marine fleet is comprised of twenty-six ships: two bulk, three cargo, one passenger, one liquefied gas, one petroleum tanker, two refrigerated cargo, one foreign owned (Spain) and registered in other countries: thirteen registered in other countries, one in Bahamas, one in Cyprus, one in Netherlands Antilles, and ten in Panama <sup>5</sup> (Countries of the World, 2010).

### **Rail**

The railways in Cuba are in possession of the Cuban government and run by the Union de Ferrocarriles de Cuba—Union for Railways of Cuba for passenger and freight traffic. Sugar-related transport is run by Ministerio del Azucar—the Ministry for Sugar.

In 2000, there was 11,151 km of railway track, of which 38 percent was dedicated for passenger use. The remainder was used primarily for freight (mostly sugar cane). With only slightly more than 200 locomotives and approximately 700 passenger coaches, passenger rail patronage is severely constrained by lack of diesel-powered locomotives. Currently, annual passenger volume is some 12 million, but demand is estimated at two-and-a-half to three times this value, with the busiest route between Havana and Santiago de Cuba, at 836 km apart by rail (Enoch, J Warren, Valdés Ríos, and Henríquez Menoyo, 2004).

The country has a wide railroad network where the general equipment has not been modernized and does not correspond to the European or American standards. The trains have little comfort and the itineraries frequently go awry.. Some travel agencies (Cuban Vacation Travel, 2004) do not recommend trains to tourists due to the non reliability of services and itineraries.

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<sup>5</sup> data correspond to the year 2008

EFE News Service (EFE News Service; Madrid, Feb 3, 2010) reported officials, of the Cuban government plans "significant investments" in the island's railway system this year by acquiring new equipment. According to Cuban Railway Union deputy director Miguel Acuña, Cuba has purchased 112 new locomotives, of which 52 freight and passenger trains have already been delivered. (EFE News Service; Madrid, Feb 3, 2010).

Passenger cars, freight cars, cement cars and a railroad telecommunications system will be acquired this year, Acuña said (EFE News Service; Madrid, Feb 3, 2010).

State media has labeled Cuba's railway communications system as "destitute." (EFE News Service, 2010). Excessive use of equipment, lack of trained workers, shortages of cars, and irregular service are among the problems plaguing Cuba's railroad industry, according to state media. The Cuban government periodically announces investments in the industry, including the purchase of 100 locomotives from China in 2008 and the acquisition of 28 more locomotives from Russia last year.

## **Roads**

There's almost nothing on the Internet about Cuban roads, but fortunately the writer is Cuban.

The most important road is the Central Highway that runs from Pinar del Río to Santiago de Cuba. The Cuban road system, like other parts of the national transport infrastructure, is decaying due to a lack of maintenance. Road surfaces have continued to deteriorate due to lack of resurfacing and only major repairs in certain areas have been undertaken (Enoch, J Warren, Valdés Ríos, and Henríquez Menoyo, 2004). The government has had to take a stance of limiting road resurfacing to every 15 years, rather than the intended 10 years. Due to this lengthened period, the renovation costs rapidly increased as roads deteriorate far more quickly the longer they are neglected. Currently, it is suggested that only 46 percent of all the paved roads are in a 'good' condition due to the lack of road maintenance (Enoch, J Warren, Valdés Ríos, and Henríquez Menoyo, 2004).

## **Road transportation: Cars and Taxis**

The use of road transportation offered in Cuba are the following:

**Cars:** In Cuba, cars tend to be:: privately owned, generally old cars bought before the 1959 revolution. Some vehicles from Eastern Europe, such as Lada from the former USSR and other countries, and the, there are Government/tourist cars usually Asian/Western European-built cars from 1990 onwards. Many of these are registered as taxis. Anyway, all of them face common problem, a severe strain on parts. High levels of recycling parts and the use of makeshift piecework are common solutions.

Taking a taxi is the easiest way to move around in Havana, the capital of the island but a taxi can be more like a tourist dream at the east region of the country. It is recommended when taking a taxi that is not governmental property, to make sure to deal about the fare before in the ride since you can be surprised when you are getting ready to pay. But if you are in the east of the country, it can take a couple of hours to get a taxi to your door if you are not at the hotel area. In Contrast taxi service in the West area of Cuba is better than on East of the island.

**Bus:** This is the means of transportation most extensively used when traveling long distances. The two types of buses are: those designated for tourist or hard currency transportation service and those designated to satisfy public demand.

Public transportation is quite good in La Havana, not in other areas of the country. In the East of the country the service is so reduced that people do not bother to wait and just walk or use the “bicitaxi”, a transportation method widely used in the island. Poor transportation or the lack of it, has contributed to two problems in the eastern area: unemployment and lack of transportation.

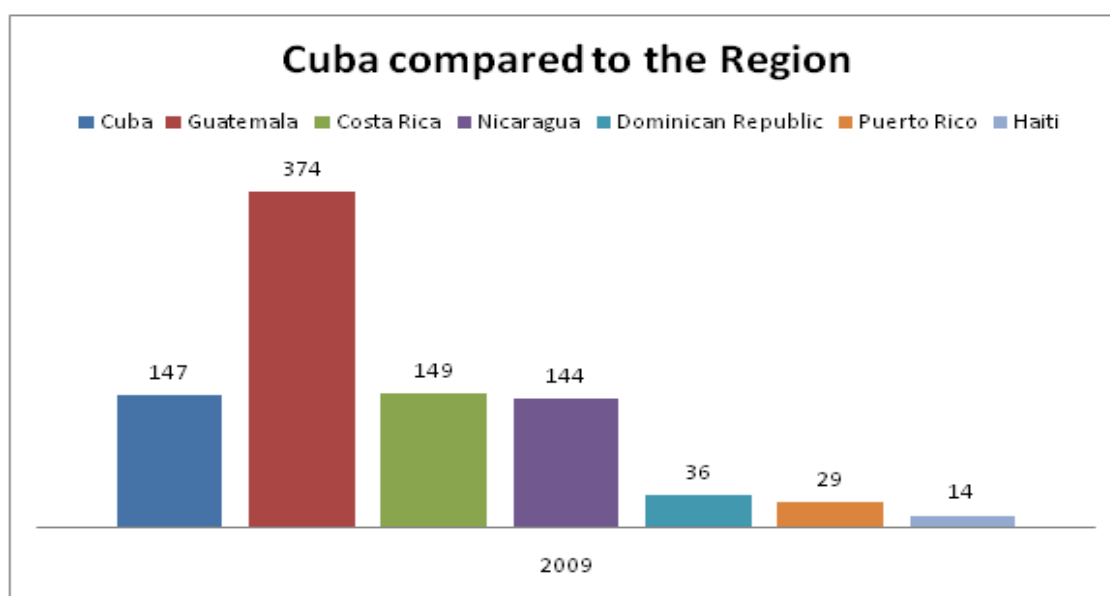
Bicitaxies give to Havana a special characteristic, and are used mainly by tourist and people in areas with no public transportion, such as La Habana Vieja (Old Havana). With many small streets that cross the city, bicitaixes are favorable as transportion method. They are quite expensive for regular Cubans in the Havana while in the East area of the country, with lower levels of access to hard currency and low number of tourist on the streets is a faster method to go between places.

Most Cubans either walk or bike. A few – especially in Havana – have motorcycles such as a scooter. If people have longer distances to go, they might opt for a hike. In

the interior of the country, people use regularly a wagon pulled by a horse or an old tractor – that follows a standard route, like a bus.

**Air:** According to data provided by the CIA World Fact book, Cuba counts with 136 airports (2009) and compared to the world it ranks 42 (Central Intelligence Agency, 2008). Almost every city in the country counts with an airport or in some cases more than 2. From all of them, a traveller can get a connecting flight or a direct flight to the capital of the country.

Figure 6-17 illustrate Cuba's number of airports compared to the region



**Figure 6-17 Cuba's number of airports compared to the region Adapted from IndexMundi, 2010**

Guatemala with 374 airports ranks first in the area, followed by Costa Rica and Cuba. However, we must consider that Cuba is a small island while the other two countries are considerably larger in comparison.

### 6.6.2 Communication infrastructure

Communication technology and policy have increased in importance in recent years due to rapid technological progress and massive global investment in telecommunication infrastructure. The Emergence of computer networks are an important manifestation of the growing importance of communication. Networks can improve the economic productivity, education, health, democracy, and human rights and quality of life of a developing nation, such as Cuba (Press, 1996).

## Internet Usage

According to data from Internet World Statistics (Internet Worlds Statistics, 2007) and represented in figure 6-18. Internet usage in Cuba at the end of 2008 represented the 11,5 percent of the total population of the island.

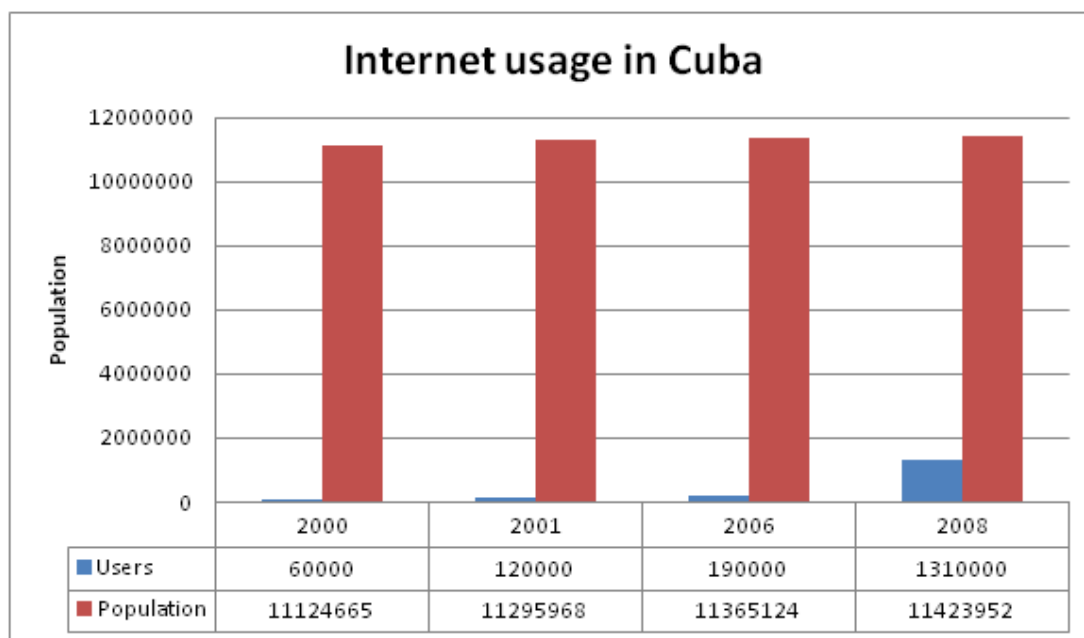


Figure 6-18. Internet usage in Cuba. Adapted from Internet Worlds Statistics (2007).

Ordinary citizens are not allowed to access the Internet without special authorization. Foreigners and Cubans with access to hard currency may access the Internet in large hotels but are subjected to firewalls. Some Cubans buy illegal passwords on the black market or take advantage of public outlets to access limited email and the government-controlled "intranet" (data provided by the author). In contrast to this situation, the government has recently allowed Cubans to buy computers and allowed travelers get into the island with their personal laptops, which are restrictedly registered and obligated to leave the country with them. In addition, personnel of the health care service have limited access to e-mail services.

Cuba has some 630,000 personal computers, 56 per 1000 people, of which 400,000 are "connected in network," according to Cuban national statistics (Oficina Nacional de Estadísticas, 2009). Its 1,450,000 reported "users" equal about 13 percent of the population residents state that most of these computers are at work places, such as ministries, factories, and hospitals. Also, most of these "users" are probably only on

the island's "intranet", a system which limits their access to mostly government web pages and domestic e-mails.

Even at 13 percent Cuba lags far behind other Latin American countries in Internet access. Cuba's rate is ahead of El Salvador, with 9.9 percent but behind Costa Rica's 35.7 percent and Jamaica's 53 percent according to Internet World Stats, an independent web site which tracks the industry. The average for all of Latin America and the Caribbean is 29.9 percent (Latin Business Chronicle, 2009).

### **Telephone system**

Cuba still has the lowest mobile phone rate in Latin America, one of the lowest levels of Internet, and is among the five lowest in terms of fixed-line tele density. Cuba's fixed-line services are a monopoly in the hands of government-controlled Empresa de Telecomunicaciones de Cuba SA (Etecsa) (Reuters, 2009), while mobile services are provided exclusively by Cubacel, a subsidiary of Etecsa (Baker, 2010). The government has blamed the embargo for the country's poor telecom development, as the difficult relationship with the US has prevented the implementation of submarine fibre-optic cables. Thus, Cuba has had to rely almost exclusively on satellites for international connectivity. Mobile rates are prohibitive for the vast majority of Cubans. Etecsa is controlled: 73 percent by the government and 27 percent by Telecom Italia. Etecsa holds a monopoly on both fixed and mobile services and offers GSM, TDMA, and AMPS services through its subsidiary Cubacel (Baker, 2010).

Greater investment beginning in 1994 and the establishment of a new Ministry of Information Technology and Communications in 2000 resulted in improvements in the system. Wireless service is expensive and has remained restricted to foreigners and regime elites until recently. Changes were made in March 2008 when Raul Castro, shortly after he took office, issued a decree, which allowed the use and ownership of use mobile phones by taking out pre-paid subscriptions to. Nevertheless, the same decree stipulated that contracts must be paid for in Cuban Convertible Pesos, a currency which, in spite of a thriving black market, is officially only available to foreigners or families, which receive remittances from abroad.

In Cuba, where the higher monthly salary is the equivalent of 20- 25 US dollars, it costs about 120 US dollars just to start service (data provided by the author).

However, Cubans welcomed new access to the service, despite its cost, which must be paid upfront in hard currency and is absolutely prohibitive for the majority of residents.

Many Cubans procure wireless service illegally with the help of foreigners citizens. Actually, in Cuba, domestic: national fiber-optic systems are under development; 85 percent of switches digitized by end of 2004; telephone line density remains low, at 10 per 100 inhabitants; domestic cellular service is expanding: (Atlantic Ocean region; Baker, 2010).

Modernization of telecommunications would without a doubt boost Cuba's drive to attract private investment. The existing antiquated telephone system is a major barrier to both business and personal communication, internally and internationally. Calling Cuba from abroad sometimes requires time and patience. Calling another internal number inside Cuba is often harder, and connections are usually poor.

## 6.7 Threats and opportunities in the technological environment

This section summarizes of the threats and opportunities present on the Cuban technological environment.

Some of the threats foreign investors might find are the following:

- Many of the island's infrastructures must be modernized to handle larger demand.
- Port delays and high transport charges due to limited shipping routes
- Old infrastructure is insufficient to meet current and future demands, which could increase travel time between places.
- Government communist policy (non market oriented) could represent a problem to companies investing in the sector.
- Inadequate energy-generating capacity could affect services related to different sectors of the economy.

- Inefficient bureaucracy could convert simple documentation processing into a real problem due to delays and negligence or lack of staff capacity.
- The existence of weak currency, not internationally recognized could pose some threats.
- The existence of the embargo on the island limits corporations from doing business with Cuba but only represents a limitation for those that play by U.S. rules.
- While Cuba's cellular sector is growing, other technological sectors like computers and Internet are stagnant or declining. Mobile telephone use will remain limited and costly in the communist-run Cuba for the predictable future because of the need to subsidize their social use and ensure communications with isolated areas (Reuters, 2009).
- E-commerce in Cuba is not developed and represents an unexplored opportunity.

On the other hand opportunities are also numerous:

- Cuba's geographic position offers extraordinary opportunities. For example, Cuba could become a center for large container vessels transiting the Panama Canal with the creation of lines of business, including bulk, break-bulk, containerized cargoes. In addition, there should be opportunities in cruise and passenger ferry traffic between the Americas if we consider that increased tourism will likely be an important driver of cargo and passenger traffic to and from the island once the embargo is lifted.
- The decaying situation of transportation in Cuba gives opportunities for auto spare parts businesses, and once the Cubans get access to higher salaries or access to hard currency, there will be a market of almost 13 million of people for the car industry to target.
- The region's mobile subscriber base has been witnessing significant growth in recent years, driven in particular by aggressive competition. Cuba has been an exception until now. Mobile use rates in Latin America and the Caribbean was



over 66 percent in early 2008, well above the world average, which was around 46 percent. Broadband grew at an annual rate of around 40 percent in 2007, but broadband penetration at the end of the year was only 3.4 percent, considerably less than the global average of 5.9 percent (Baker, 2010).

- Cubans, as many other Latin-Americans, like to use fashionable and developed electronic equipments. Mobile phone usage could be expected to be significantly higher in Cuba once the blockade has been lifted.
- Cuba could play a key role in the development of communications in the Caribbean, emerging as a hub that links countries in the area. Cuba's strategic geographic position is hard to ignore. Its well-educated and relatively cheap workforce has been mentioned as an advantage by a number of investors already active in Cuba. It could prove to be an asset in the development of the kind of services expected to increase. Providers of telecommunication-related services are unlikely to discount such possibilities.

## 6.8 Environmental: Cuban natural environment

Cuba might be considered an ecological paradise because of its excellent conditions for nature admirers and ecological tourism lovers with its exceptional biodiversity. Cave tourism, bird watching, observation of the flora and wildlife, horseback riding, scuba diving, river-rafting, mountain climbing and trekking along the natural trails are some of the activities and options for tourist and foreigners visiting the island (Solways Cuba, 2010). There are eight internationally recognized protected areas in Cuba of significant ecological, scenic, and cultural value.

Cuba contains a rich collection of plants and animals and is famous for its high biodiversity and large number of indigenous species. This is mainly due to the fact that Cuba is an island and to its incredible geological diversity, such as areas of limestone, slate and savannas with quartzite sand. The high level of endemic species is impressive: (Solways Cuba, 2010).

The Cuban government has formed several agencies to protect the environment. Among them are the National Parks Service, the National Commission of Environmental Protection and Rational Use of Natural Resources, the National

Environmental Education Program, the Academy of Sciences of Cuba, and the National Commission for the Protection of the Environment, and for Conservation of Natural Resources (Encyclopedia of the Nations, 2000).

According to the Encyclopedia of Nations (2002), Cuba's most pressing environmental problems are deforestation and the preservation of its wildlife. The government has initiated a reforestation program aimed at replacing forests which have gradually decreased to a total of 17 percent of the land area by the mid-1990s. Another major environmental problem reported by the Encyclopedia of Nations (2002) is the pollution of Havana Bay. 51 percent of the country's renewable water sources are used for agricultural purposes. About 95 percent of Cuba's city dwellers and 77 percent of its rural people have pure drinking water.

In Cuba exist numerous endangered species exist, such as the hutia (dwarf, Cabera's, large-eared), two species of crocodile (American and Cuban), and the Cuban tree boa besides a considerable number of mammal species, birds, and reptiles. The jutia (capromys) is the largest land mammal, an indigenous rodent that can measure up to 60 cm. Another rarity is the bee hummingbird (*Mellisuga helenae*), the world's smallest bird and barely the size of a cricket. The Cuban trogon (*Priotelus temnuros* or *tocororo*), elegantly garbed with the colors of the national flag still thrives in the forest (Solways Cuba, 2010).

Twenty-two percent of Cuban territory is under some category of environmental protection, based on the value of its biodiversity. Along with the Cienaga de Zapata, other standouts are the biosphere reserves in Guanahacabibes and Sierra del Rosario in the western province of Pinar del Río (Grogg, 2009).

There are more than 6,000 plant species, half of which are prevalent, such as the royal palm tree, which graces the national emblem. Among the endemic plant species are the rare and prehistoric cork palm tree (*Microcycas calocoma*), which survived the cretaceous period; the jaguey, a fig tree species with aerial roots; the Ceiba, considered the sacred tree, and the mariposa or the butterfly jasmine, which is also considered the national flower. Most of the southern coast is swampy and inhabited by several species of birds and fish while the northern coast is mainly rugged (Solways Cuba, 2010).

Cuba's fauna exhibits wonders such as the blind fish, which inhabits the clear water of underground lakes in the mineral caverns of Pinar del Rio; beautiful multicolored snails or polymite and Liguss, the smallest frog in the planet (*Eleutherodactylus limbatus* less than 1 cm long); the smallest bird on earth (*Mellisuga helenae*, a humming bird species 63 mm); dozens of species of rare and beautiful orchids and one of the two species of the exquisite translucent-winged butterfly (Solways Cuba, 2010). The land fauna includes reptiles such as crocodiles, iguanas, lizards, salamanders, turtles, and 15 species on non-poisonous snakes.

Rare mammals can also be observed on the island: the almiqui, a small native mammal, which is on the point of extinction; fossil fish species, such as the manjuari, which inhabits the rivers and lagoons of the Zapata swamps; dozens of rare species of orchids; marine mammals, such as the manati although impressive it is quite harmless; iguanas (some can measure up to 1.5 m in length); hundreds of species of birds, some noted for the beauty of their plumage or capacity to fill the fields and forests with melodious sounds (Solways Cuba, 2010).

One of the main characteristics of Cuba's flora and fauna is that they are not hazardous to man and do not represent a danger to those travelers who choose to camp. They can be without fear of being bothered except by mosquitoes, since both species of crocodiles that inhabit the island do not attack man (unless they are bothered), and the sharks found in Cuban waters are not as aggressive as their neighbors in Florida. Also, there are no poisonous snakes, amphibians, or spiders. Finally, aside from being scarce, the mammals in the forests are small and completely harmless.

There are also biosphere reserves in Buenavista in the Jardines del Rey archipelago, off central Cuba, and in Baconao and Cuchillas del Toa in the east. Despite Cuba's great natural riches, the environmental component represents just four percent of the island's tourism, which expected to bring in 2.36 million visitors in 2009 (Grogg, 2009).

#### 6.8.1 Natural resources

Cuba has been blessed with its rich land. It has concentrated mineral wealth in nickel, which is the most important Cuban mineral economic resource. Cuba has the

second largest nickel reserves in the world after Russia (Caribbean Magazine, 2008). Sherritt International, a Canadian energy company, operates a large nickel mining facility in Moa, in the north-east of Higuay, Cuba. Another leading mineral resource is cobalt, a byproduct of nickel mining operations. Cuba ranks as the fifth largest producer of refined cobalt in the world.

Other important Cuban's natural resources are: wood, and petroleum. In fact, Cuba has enough petroleum deposits in offshore wells to, once it develops the machinery and techniques required for extracting the oil, become self-sufficient and will not need to import oil. Besides mineral wealth, Cuba also has a strong fishing industry that caters to foreign markets (exports) and the tourist hotels in Cuba. Recent oil exploration has revealed that the North Cuba Basin could produce approximately 4.6 billion barrels (730,000,000 m<sup>3</sup>) to 9.3 billion barrels (1.48×10<sup>9</sup> m<sup>3</sup>) of oil. As of 2006, Cuba has begun to test-drill these locations for possible exploration (Caribbean Magazine, 2008).

Cuba has signed environment - international agreements, such as the Antarctic Treaty, Biodiversity, Climate Change, Climate Change-Kyoto Protocol, Desertification, Endangered Species, Environmental Modification, Hazardous Wastes, Law of the Sea, Marine Dumping, Ozone Layer Protection, Ship Pollution, Wetlands agreement (signed, but not ratified); Marine Life Conservation and others (IndexMundi, 2010).

## 6.9 Opportunities and threats on the natural environment

The existence of natural resources gives the island an extraordinary advantage, and the beauty of the island is highlighted by the culture of its people. Opportunities that the natural environment of Cuba has to offer are innumerable. Many natural reserves of fauna offer opportunities for investors in the tourism industry and also in the organic sector as well as the development of natural medicine and medical tourism. Tourism activities could be related to agricultural activities and thus increase job availability in the areas of operations and thus become accepted by natives. By doing this, the image of business will be highlighted with social responsibilities and could create a competitive advantage in the sector.

The island could face threats during the next decades if it continues to expand the tourism business into those more remote areas of the country, which might lead to

contamination and deforestation. Also, coral reefs could be affected by irresponsible diving activities. Thus the government may need to put serious attention toward further regulations in the next years since the tourism industry represents one of the main national income of hard currency. Green groups operating in Europe and other continents could also represent a threat to the industry's image if the appropriate intervention is not taken into consideration.

## 7 Entry modes to the Cuban market

Three forms of foreign investment are allowed according to law 77, which are: international association contracts, joint ventures, and totally foreign-owned companies. For joint ventures, there is no limitation of foreign ownership (may reach 100 percent). This can be accomplished by either establishing a subsidiary of a foreign company in Cuba or creating a separate Cuban company to operate the business.

Since the strategic choices of firms will be weighted by corporate executives, need or market size alone will not justify any FDI commitment in the Cuban market. According to analysis of internationalization theories, firms seek to diminish international risks by starting with low risk/low cost market entry options, such as exporting and advancing to higher levels of risk and control FDI generally, is justified only if beneficial to the firm and/or competitively necessary.

On the other hand, and from a corporate perspective, exports (foreign sales) might be the preferred entry method for a company to serve the Cuban market, which will help to minimize business and political risks (Whisenand, 1995). However, exports to Cuba will not directly contribute to the capital, technology transfers, or other desirable components of direct investments. These components will be needed in Cuba once the market opens to US business activities and the rest of the world. A firm looking to sell to Cuba is not equivalent to a firm investing in Cuba.

Firms choose to internationalize in order to: (1) gain access to a location specific natural resource, such as oil or minerals, or a tourist destination (resource-seeking investments); (2) to take advantage of lower local production costs (efficiency-seeking investments); or (3) to supply the local market (market-seeking investments) (Ferreira and Serra, 2008). Regarding resource-seeking FDI, Cuba will indeed attract the interest of companies around the world once the blockade is lifted, particularly in oil, nickel, agriculture, and tourism. Even under the very unfavorable conditions for FDI in Cuba, some international companies have begun to invest in these areas. The question might be how much will be left for US companies to invest in Cuba?

Cuba does offer low labor cost, as other developing countries around the world. However, the Cuban labor force is not equipped for the demanding labor requirements of a modern market economy (Ferreira and Serra, 2008). Still, the learning capabilities

of its population and professionals is considerably high and it will not take long training sessions to make the Cuban labor force ready to compete at international levels. On the other hand, it still implies costs.

In terms of market-seeking FDI, Cuba appears to offer a significant opportunity to companies seeking to invest in the geographical area. According to Ferrerira (2008), Cuba represents a poor market with minimal disposable or discretionary income. In addition, Cuba's comparative market size actually does not rate highly to be selected for a FDI directed to supply the local market but might be considered to be good enough for the geographical area.

Cuba is an emerging market and a country which still represents a credit risk not acceptable to most banks (Armeni, 2010). At the same time, it is a country with tremendous potentials. Given the necessary support, it can become one of the economic strongholds of middle and South America.

## 8 Business Environment

The business environment analysis (TASK), as mentioned previously, typically includes the industry, competitors, customers, techniques of production, suppliers, stock market, raw materials, market sectors, and perhaps the human resources and international sectors.

This analysis focuses on Cuban tourism industry potential (figure 8-1) mainly due to the lack of information available on the different industries available in Cuba. The objective is to help to determine possible existence of a market and business possibilities in the area.



**Figure 8-1: TASK environment analysis. Adapted from Czinkota and Moffett, 2002**

The TASK environment analysis for the Cuban tourism industry is intended to answer questions referring to the market, the customers, the competition and the distribution channels (Marketing Audit, 2009). During an analysis of the market, focus will be on the size of the market, industry growth, and opportunities to explore in the area. Industry's customers section will try to identify the main customers. Where is the demand for the industry? In addition, the competition and those factors that could have direct influence on competition and lead to product substitution will be also analyzed. Porter's Five Forces Model will be used in order to identify who are the



main competitors or industry factors to consider when entering the tourism industry in a future. A brief analysis of the existent distribution channels in Cuba will be also the focus of this section.

## 8.1 The tourism industry: market trends

The Caribbean Tourism Organization (2010) state that the aggregate tourist arrivals to the Caribbean declined by 3.6 percent in 2009. Quarterly data shows successive improvements during the year. Further positive note, is that tourism activity is still significantly high, recording 22.1 million down from 22.9 in 2008. This is also consistent with the decline in global tourism as recorded by UNWTO<sup>6</sup> (OneCaribbean.org, 2010).

The Caribbean Tourism Organization (2010) sees quarterly arrivals as a scenario of hope. Arrival activity showed signs of rapid recovery after double digit declines in the troughs of the global economic crisis (OneCaribbean.org, 2010):

- First quarter 6.6 percent decline
- Second quarter a fall of 6.0 percent
- Third quarter down 2.0 percent
- Fourth quarter actually rose 1.0 percent

According to USA Today (2009), in the middle of the world financial crisis Cuban tourism has remained strong while visitors to other Caribbean destinations have dropped. International travel operators give as a reason to the island's popularity the fact that many visitors can buy relatively cheap, all-inclusive packages and can budget trip costs well in advance. At the same time, the world financial crisis has not yet hit hard in Canada, the top source of Cuba's visitors (USA Today, 2009).

Data based on current trends and arrivals in the wider region as a whole in the first quarter of 2009, showed a modest increase of the order of 2-3 percent (OneCaribbean Organization, 2010): skewed by Cuba, Cancun and Curacao, Jamaica and other nations.

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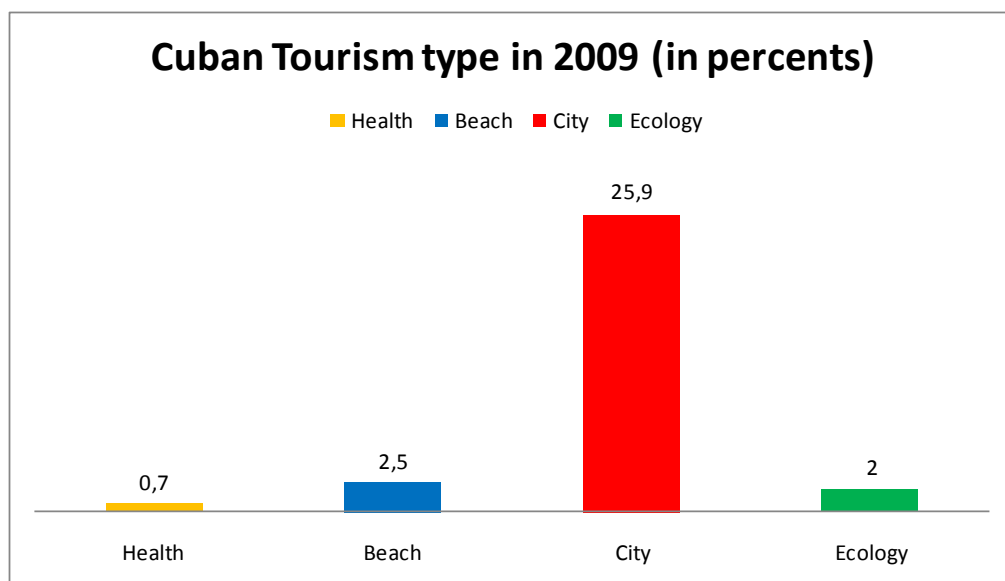
<sup>6</sup> Union of Nations World Tourism Organization

## 8.2 Cuban tourism industry

Cuban tourism has played an important role in the rescue of the whole Cuban society despite the difficulties Cuba's economy is facing.

Cuba's tourism promotion strategy is built around three main attractions: beach resorts, history and colonial architecture, nature and ecotourism. The tourism ministry has targeted eight regions around the island for tourism development. Initially, Havana and the Varadero beach resort received the lion's share of investment, and now the emphasis has shifted to other regions (Peters, 2002).

Figure 8-2 shows that tourists seeking the beach and sun represent 71.4 percent of the total of visitors in 2009. 25.9 percent seek culture and city activities while 2 percent visit the country because of its ecology, and 0.7 percent of the total of visitors go to the island in order for health recovery. This last group is the smallest one, but its increase in importance could be considered as a big opportunity for investors seeking to enter the Cuban market.



**Figure 8-2: Tourism types in the island. Adapted from National office of Statistics (Oficina Nacional de Estadísticas, 2009)**

Product strategy of product diversification could promote health tourism as an area for prospective growth in the island. Cuban health care institutions providing comprehensive care, especially for the elderly, could incorporate: the existent mineral water springs, alternative tropical medicines, and treatments and high quality care, and

hospitality. The most relevant point on developing this sector is that this type of tourism represents an opportunity for developing linkages with the Cuban pharmaceutical industry, agriculture, and the communities with springs, waterfalls, and other natural healing features.

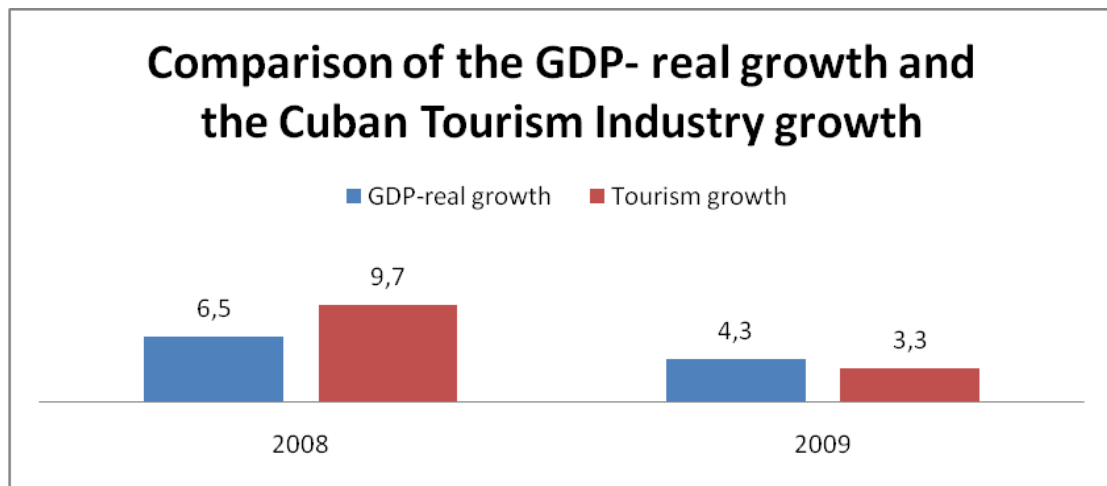
If the prohibition on traveling of Americans to Cuba is completely lifted, a large number of Americans will visit Cuba. Thus the island, in order to cope with a possible increase in number of visitors, could improve the existing tourism infrastructure. Also, it is widely known that in the U.S., health problems occur with the elderly American population, and the health sector of the tourism industry in Cuba could be, if organized, a big boom in the next years.

Cuban government has introduced various transformations in the Cuban economic panorama, by doing this, the government has opted to create an internationally competitive industry based on a cost leadership strategy, supported by the low price, low cost, and high volume of visitors to the island. The strategy adopted by the Cuban government with respect to the tourism industry has influenced the development of skills needed for the service industry. Cuban government has created schools where a large number of young people are trained in order to satisfy the demand for service in the tourist sector. Currently, the joint ventures activities, in the island have contributed as well to solve skills shortages the industry faced in the beginning.

The tourism industry in Cuba faces an interesting and even more important weakness: the lack of a competitive rival inside the country since the government keeps the control of innovation and improvement activities.

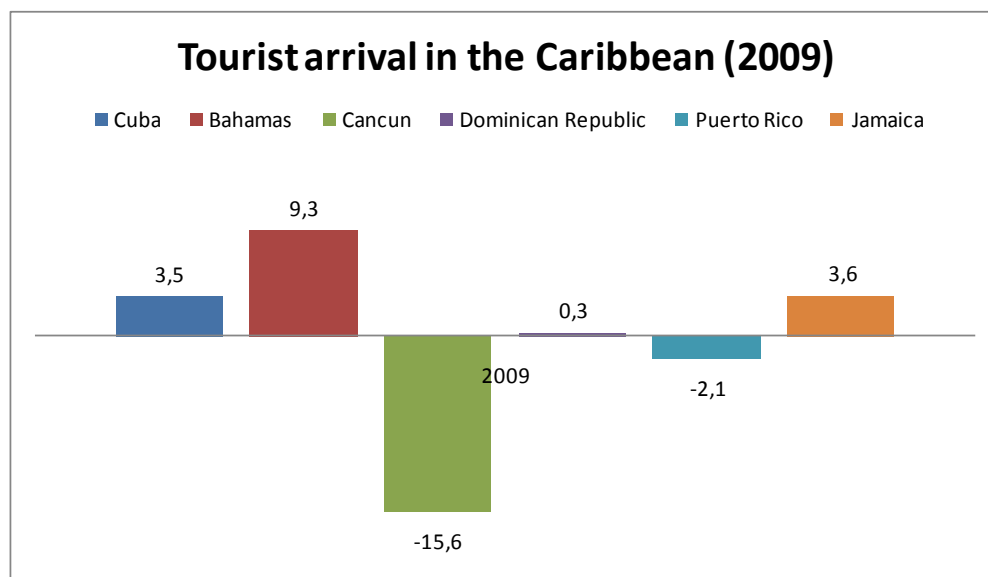
### 8.3 Size and growth of the tourism industry in Cuba

Cuba does not publish exact statistic on Cuban tourism growth and the revenues the industry offers to the island. However, after an exhausting research on statistics, which are published here and there we can get an estimate on the industry growth (figure 8-3).



**Figure 8-3: Comparison of the GDP-real growth and the tourism industry growth in Cuba. Adapted from Caribbean Update (2000)**

Statistics of 2008 reported the Cuban tourism industry greater potential given that the GDP-real growth was under the tourism industry growth. In 2009 a small decline in the industry opportunities occurred, but this was a similar situation to the rest of the countries in the area (see figure 8-4). The growth rates for the tourism industry in Cuba, however, have been reported well above the Caribbean average. Since 1988 until 2000, tourist arrivals in Cuba have grown by an average of 16.3 percent per year, three times faster than for the Caribbean as a whole (Caribbean Update, 2000).



**Figure 8-4 Tourist arrivals in the Caribbean (2009) Data obtained from (Caribbean Tourism Organization, 2010).**

Tourism revenue fell by 11 percent in 2009 due to visitors traveling for less time and spending less money per person (U.S Department of State, 2010). But when the percent change on tourist arrivals in the region is compared with tourist arrivals to the island, it is clear that Cuba continues to do well.

Tourism industry/product follows a life cycle in four phases (Abrams, 2003):

- 1- New: provides excellent entrepreneurial opportunities and the market is limited because customers are not yet comfortable with the product or the service. This stage has also been called the “discovery stage.” The social impact in this stage is generally small and resident attitudes are fairly positive towards tourism (Geography Field Work, 2010).
- 2- Expanding: enjoys rapidly growing markets as customers begin to recognize the need for the product or service. Competition becomes brisk as well founded companies begin to enter the field. Companies are vulnerable. During this stage the number of incoming tourists increases. The host community responds to the increasing numbers of tourists by providing facilities (Hwang and Park, 2007; Geography Field Work, 2010).
- 3- Stable: industries have arrived at a plateau with markets leveled off at a reasonably high level. Growth rate is slow, and customers maintain strong brand loyalty. The industry becomes difficult to enter. At this stage, saturation is reached. The quality of tourist services falls, while demand levels off, and the environmental degradation of the tourist destination begins to be obvious and worrisome. The tourist destination at this stage is said to have reached 'maturity' (Hwang and Park, 2007; Geography Field Work, 2010).
- 4- Declining: decline is a result of technological, demographic, and sociological changes and overwhelming foreign competition. Few major companies fight to survive. Falling profits lead to foreign-owned businesses withdrawing, and the community is left to "pick up the pieces" (Kotler and Keller, 2006; Hwang and Park, 2007; Geography Field Work, 2010).

**Table 8-1: Maturity industry chart for the Cuban tourism industry. Based on Kotler and Keller (2006).**

	Growth rate	Competition	Market leaders/standards	Marketing goals	Market share strategy	Product range	Customer loyalty
<b>Development stage: Expanding</b>	High growth rate	Shake out	Emerging market leaders	Differentiate from competitors	Build market share	Expanding	Hardening

According to an analysis of the literature a maturity industry chart for the Cuban tourism industry was developed by the author's thesis (table 8-1), who considers the industry at the expanding stage.

## The Customers

According to figures released by the Cuban National Statistics Office (ONE), Cuba recorded 809,937 tourist arrivals during the first quarter of 2009, setting a new record for the peak tourist season in the Caribbean region, as reported by Cuban News Agency (2010).

The figure 8-5 offers an overview of the tourism industry in the island early in 2007.

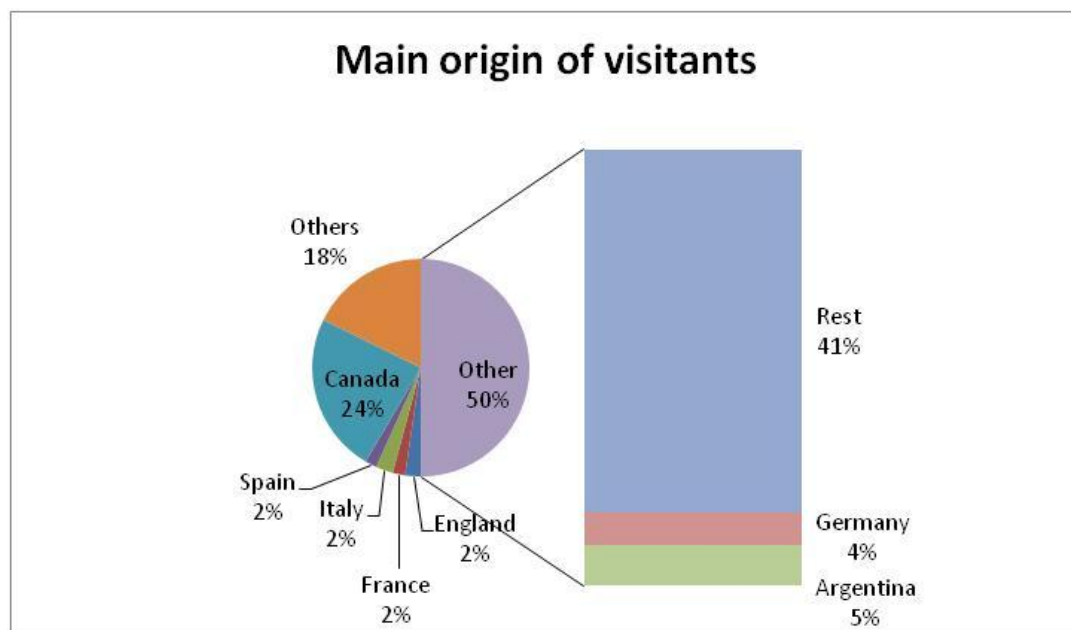
VISITOR ARRIVALS			
Tourist Arrivals → → Summer → Winter	2,152,221 58.4% 41.6%	Cruise Passengers	NOT AVAILABLE
VISITOR PROFILE			
Average Length of Stay (nights) <sup>1</sup>	10.5	Tourist Arrivals by Purpose of Visit → Holiday → Business → Other	93.8% 0.6% 5.6%
TOURISM AND OTHER RELATED ECONOMIC STATISTICS			
Total Expenditure (US\$ millions) <sup>1</sup>	\$2,404.0	GDP at Factor Cost (US\$ millions) <sup>II</sup> # Hotel and Restaurant contribution to GDP <sup>IV</sup>	\$28,393.1 28.8%
ACCOMMODATION STATISTICS		SOCIO-ECONOMIC STATISTICS	
Rooms Room Occupancy Rates	47,103 60.9%	Land Area (square Kilometres) Population (thousand mid year 2006)	110,860 11,241.4

<sup>#</sup> Figure used is Gross Social Product

**Figure 8-5: Overview of the tourism industry in Cuba early in 2007. Source: One Caribbean Organization. 2008.**

As figure 8-5 illustrates, Cuba does not enjoy the benefits, which cruise passengers offer to the industry. This is mainly due to U.S. sanctions, which establish that any cruiser that arrives at Cuban Harbors is subject to economical sanctions.

Early in this year (2010), the bulk of Cuba's visitors were from Canada (figure 8-6).



**Figure 8-6 : Main origin of visitants in the first quarter of 2010. Source: One Caribbean Organization (2010).**

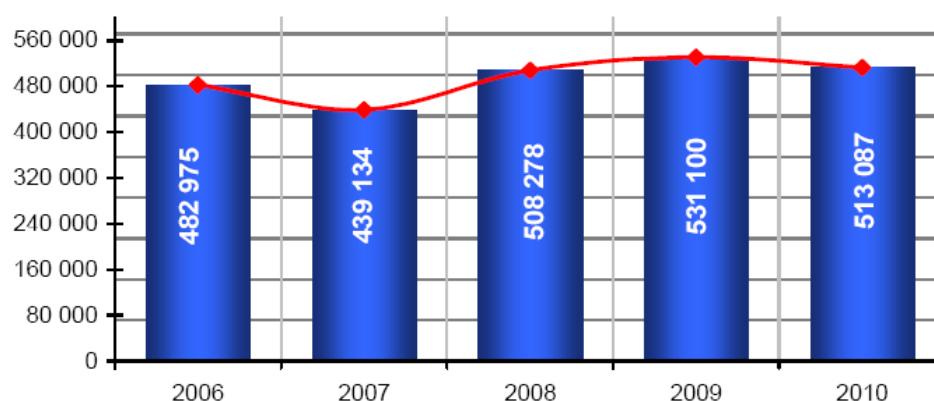
In the first quarter of 2010, Canadians registers as the highest number of tourists in Cuba, followed by visitants from Italy, Britain, France, Spain and Germany. Cuba's economy largely relies on its tourism industry. Tourism, one of the highly resistant sectors of the Cuban economy, may suggest some strategic ways to support the economy at a time when the global economic general picture is not very optimistic.

According to original comparison between the years 2009 and 2010 the number of visitors to the island faced a minor decrease (figure 8-7).

Countries	January- February 2009	January- February 2010	(%) 10/09
<b>Total</b>	<b>531 100</b>	<b>513 087</b>	<b>96.6</b>
<b>Canada</b>	<b>270 387</b>	<b>243 804</b>	<b>90.2</b>
<b>Italy</b>	<b>26 558</b>	<b>26 140</b>	<b>98.4</b>
<b>England</b>	<b>27 471</b>	<b>24 316</b>	<b>88.5</b>
<b>France</b>	<b>18 351</b>	<b>18 877</b>	<b>102.9</b>
<b>Spain</b>	<b>19 090</b>	<b>18 039</b>	<b>94.5</b>
<b>Germany</b>	<b>16 430</b>	<b>16 858</b>	<b>102.6</b>
<b>Argentina</b>	<b>12 552</b>	<b>13 617</b>	<b>108.5</b>
<b>Mexico</b>	<b>10 030</b>	<b>9 469</b>	<b>94.4</b>
<b>Russia</b>	<b>7 805</b>	<b>8 731</b>	<b>111.9</b>
<b>Holland</b>	<b>4 939</b>	<b>5 579</b>	<b>113.0</b>
<b>Chile</b>	<b>4 307</b>	<b>5 124</b>	<b>119.0</b>
<b>Venezuela</b>	<b>4 466</b>	<b>3 704</b>	<b>82.9</b>

**Figure 8-7 Arrivals by origin. Adapted from Oficina Nacional de Estadísticas (ONE), 2009.**

Clearly, in the first months of 2010, this trend has not changed and Canadians remain as the main source of visitors to the island. Despite the devastation of the two hurricanes that affected the island in the second half of 2008 and the economic downturn in 2009, the Cuban tourism industry enjoyed a considerable number of arrivals (see figure 8.8). Numbers of visits to the island in the first quarter of the year 2010 are very optimistic and significantly high if it is taken into consideration the actual economical situation in the world.



**Figure 8-8: Tourist arrivals in Cuba the last five years. Source: Oficina Nacional de Estadísticas (ONE), 2009).**

Figure 8-8 illustrates that in 2008 the number of visitors increased. The increase of tourist arrivals in Cuba in 2008 was particularly important to the island, especially because it came about in the middle of the world economic crisis that has affected the tourism industry world-wide. Cuba's tourism officials are optimistic and are predicting higher numbers for the end of the year 2010. Most importantly, the main



sources of visits to the island are Canadians, and Canada has not yet faced economical shortages due to the world economic downturn.

## 8.4 Distribution Channels

Distribution channels are increasingly regarded as one of the most critical elements in marketing as they determine the competitiveness and profitability of organizations (Christopher, 1991; Gattorna, 1990; Stern and El-Ansary, 1992).

According to Buhalis (2000) several generic functions and benefits are therefore enhanced by the tourism distribution channel, such as:

- Identify consumers' needs, requests and expected experiences
- Assemble tourism products from different providers according to customer expectations
- Assistance in legal requirements for consumers (e.g., visas) and suppliers
- Facilitate communications between consumers and suppliers especially in multilingual and multicultural environments
- Reduce the perceived risk for consumers
- Assume risk when pre-purchasing tourism products
- Promotion of particular products or packages, in co-operation with suppliers

Cuban distribution system is inadequate and cannot be expected for on-schedule deliveries, and the government lacks capacity for importing products and services needed to care for customers of the Cuban tourism industry. Difficulties to get hard currency make the Cuban tourism industry vulnerable as a low cost destination with low quality international standards

In addition, tourism distribution channels, such as travel agencies and tour operators, are operated and controlled by foreign firms who select destinations and proposes packages according to their own interest, and since each member of the tourism distribution channel has different commercial and strategic interests, as well as operational procedures, several intra-channel conflicts could emerge inevitably that could affect the industry (Buhalis, 2000).

Tour operators have direct access to the clientele and are able not only to attract bookings and sell packages, but rather to influence and shape demand and buying behavior (Buhalis, 2000). For Cuba, tourism is an important contributor to economic growth and government revenue, and the volume of sales derived from package tours is an important boost to the economy. The development of the tourism industry is an important source of employment creation and infrastructure development. Although coastal areas in Cuba are not generally the poorest areas, they nevertheless are usually important focuses for the tourism industry and consequently for economic growth and domestic migrancy while the employment tourism create indirectly support rural families. Without mainstream tour operators, Cuban tourism industry would not survive simply because infrastructure and local businesses are not set up to effectively serve this market.

The increasing number of visitors to the island requires an improvement in general infrastructure: roads, public transportation, and rails but the economic situation of the island does not cope with this problem.

## 8.5 Industry Competitive environment

The intention of this section is to analyze Cuba's tourism industry strategy and industry profitability based on Porter's five forces model.

Porter suggests the five forces model to help identify industry profitability. The rules of competition are embodied in competitive forces, such as the entry of new competitors, the threat of substitutes, the bargaining power of buyers, and the rivalry among existing competitors (Porter M., 1990).

A difficult threat to overcome in the general business environment in Cuba is the U.S. policy towards Cuba. The United States government has tried since 1959, to impede or reduce the performance level of the Cuban economy which simply increased competition on the Cuban market. U.S policy has forced the island to keep competition above or parallel to other Latin-American countries.

This section, however, is designated to analyze those threats identified by Michael Porter (2008), which shape the competitive environment of the tourism industry in Cuba.

### 8.5.1 Threat of entry

The major threats identified in this section are the threats of entry, which any investor could face in Cuba, according to Porter's theory (Porter, 2008).

The Cuban tourism industry is based on the strategy of offering lower costs (tourist packs) because they can spread fixed costs over more units. All visitors seem to have in common that they are willing to pay for services/products the Cuban tourism industry offers, regardless of that the Cuban tourism industry does not enjoy the latest technology or quality standards prevalent in the rest of the world. Thus, switching cost appears not to be a threat that Cuban tourism industry face at the moment however, must be considered that other destinations in the Caribbean offer same aspirations of sun and beach and higher quality standards than the Cuban tourism industry possesses.

Capital requirements can be also a threat to consider when investing in the industry but they do not represent a higher threat of entry. Labor cost is low and the industry is in a growing stage that guarantees in some way the capital return for those investing in Cuba.

Cuba has plenty of favorable locations to exploit for the tourism industry and entering the market at an early stage will without a doubt guarantee the best places. Still, there are fabulous places, especially in the East of the country, with natural resources and natural wonders, which are available for investments in the tourism industry in the island. As Cuba is entering a privatization stage in its policy, the main authorities of the island have recently declared that it is very important to take advantage of what the industry has to offer.

New entrant firms have become active in Cuba since the government opened to FDI investments and are active on encouraging new FDI on the island. An important entry barrier to consider is the managerial know-how. Firm's know-how development can take several years and is a capability new entrants do not have easy access to, which justifies the importance of moving into a market which has such growing opportunities in the early stages of development and become a "first mover." A growing market for the Cuban tourism industry and the potential for high profits could encourage new firms to enter the Cuban market and persuade present firms in the Cuban market, to create and increase value delivered to customers.

Cuban government is considered one of the biggest barriers to entry since it operates as a regulated monopoly. The government also has stated on many occasions that it is in a better position to ensure that specific products or services are provided to the population at reasonable prices than competitive market forces. Industries, such as electric power generation and elementary and secondary education have been (and do not show signs of a changing status) protected from competitive entry by government restrictions on entry, and they are industries that currently are, directly linked to the tourism industry.

Other significant barriers to entry to consider is the fact that the process for business licenses to operate in Cuban market and identification of opportunities and work through the entitlements necessary to develop the idea can be time consuming and complicated for a business that does not have experience in the area.

### 8.5.2 The threat of substitutes

A substitute performs the same or a similar function as an industry's product by different means (Porter, 2008). Within the Cuban tourism industry, there are not significant buyer switching costs: tourism products/services are generally standardized, and buyer can easily switch to another product, so the bargaining buyer power is strong.

The Caribbean region has many competitive destinations, and they pose an important threat of substitutes to the Cuban tourism industry. Also, in countries where the economical crisis has taken over, the natural trend is that people just choose to vacation on a national basis in response to the higher costs of a trip abroad.

Rivalry among tourism industry in the region is high, but inside the Cuban market, there is not a dominant market leader. In the Cuban tourism market there is low-rivalry, and competitor's moves are to be constrained informally by the Cuban government.

Supporting industries are entirely controlled by Cuban government and this poses a high threat to firms operating in the tourism industry. Many goods produced by Cuban entities lack high standards of quality and usually do not fit tourist demand for products and services, especially products such as: meat, fruits and vegetables as well as consumer goods and durable goods (data provided by the author).

Absence of basic products, and low quality of the service/product the Cuban tourism industry offers, affect visitors' perceived value (data provided by the author).

- Communication services are limited and controlled by governmental agencies and can be time consuming for those wishing to make use of them.
- Transportation services are poor and do not respond to international standards of quality and other requirements, such as seat belts in a taxi.
- The use of air condition in the hottest season can be very difficult due to shortage of energy resources in the country, and the existence of the equipment on the hotel room does not guarantee that it will work.
- Black outs can affect general activities a firm must need to perform, and formal paperwork can be delayed. Even though the government has put in all efforts to reduce these blackouts, they occur occasionally. They are also influenced by weather hazards and bad maintenance of electrical lines.

Linkages of the Cuban tourism industry to other industries can represent a threat concerning consumer demands, which could damage consumers' value perception of the delivered product/service to Cuba's visitors. However, Porter (2008) argues that advanced technology or innovations are not by themselves enough to make an industry structurally attractive (or unattractive). He also warns about some common mistakes firms make when choosing a market to enter. Growth does tend to mute rivalry because an expanding pie offers opportunities for all competitors. A narrow focus on growth is one of the major causes of bad strategy decisions.

However, tourism in Cuba has created a demand that has contributed to the revitalization of other sectors of the country's economy. The policy implemented by the Cuban government has been aimed at supporting national production intended to meet the requirements of tourism while observing tourism industry competitiveness, stability and quality (MINREX, 2003).

### 8.5.3 The power of suppliers

Cuban suppliers do not depend on a large scale for the revenues of the tourism industry. The government remains as the most powerful supplier, which captures more of the value for themselves by charging higher prices, limiting quality and availability of services, and shifting costs. Thus it is possible to state that the main suppliers for

the Cuban tourism industry are Cuban owned monopoly suppliers. As a consequence, there is an absolute lack of competition between suppliers within the local market, and government suppliers are extremely strong.

Switching costs are high since the importing of products is subject to taxes and transportation and conservation costs, which make the product more expensive than those offered by Cuban suppliers, so this may affect the service/product value chain. Switching suppliers is not an option within the Cuban tourism industry because current limitations of import of products and services, as a result of U.S. policy towards the island. Firms doing business with Cuba are subjected to U.S. sanctions.

The quality of goods and services provided by Cuban governmental owned suppliers is considerably low, and it affects the quality of the product delivered to the tourists. Products are not exactly differentiated since there are not other sources of suppliers and substitutes products can be costly to acquire.

#### 8.5.4 The power of buyers

Buyers are powerful if they have negotiating leverage relative to industry participants, especially if they are price sensitive and might affect price (Porter, 2008).

Tourism demand is influenced by many factors. The quality of the tourism product (ECLAC, 2010) is probably one of the most critical influences on demand for the Cuban tourism industry, since demand determines the level of competitiveness of the overall product. Tourists generally put a premium on high quality services delivered in an efficient and timely manner. Further, with the advantage of information technology, which today's technological world environment offers, the tourist is more cost conscious. Thus the tourist has the ability to weigh a basket of options through a scenario analysis and is more familiar with standards. Tourists also demand a wider variety of attractions and services than traditional natural resource based tourism can provide (ECLAC, 2010).

Within the Cuban tourism industry, there are not significant buyer switching costs. Tourism products/services are generally standardized and the buyer can easily switch to another product. Thus, the buyer's bargaining power is strong since low switching cost means increased rivalry.

The Cuban tourism industry has entered a highly competitive industry where the presence of powerful buyers is a fact. In addition, brand loyalty and switching cost remain very low, but at the same time, Cuban tourism industry needs to compete at strict international quality standards. These facts represent very strong pressures for firms intending to enter the Cuban tourism market.

#### 8.5.5 Rivalry among competitors

Competition in the Cuban tourism industry is strong from the outside view if it is considered that Cuba is competing in an area that for many years has been considered as very important for the tourism industry. The main regional competitors are: the Dominican Republic and Jamaica. Both competitors have an advantage over the Cuban tourism industry: they target the U.S. market and the embargo prevents Cuba for doing so. In addition, the Dominican Republic and Jamaica enjoy revenues from the cruiser tourism sector, and Cuba is limited because of the U.S. embargo. Competitive devaluations are also more feasible in these other Caribbean countries than in Cuba.

Rivalry within tourism industry in the region is high, but inside the Cuban market there is not a dominant market leader. In the Cuban tourism market, rivalry is low and competitor's moves are constrained informally by the Cuban government.

### 8.6 Investing and Doing Business in Cuba's Tourism Industry

Investing in Cuba tourism industry can be time consuming and exhausting and it has very often been described as very complicated. There is not actually a complete guide to investing and doing business in Cuba, and the information can be vague and confusing at times. In the book *Investment in the New Cuban Tourist Industry: A Guide to Entrepreneurial Opportunities* by Henthorne and Miller (1997, p. 115) eight steps to follow through the investment process in the tourism industry are outlined, as follows:

1. Getting started. In this first step it is important to make the first contacts. There are many players to choose from: government, public/private agencies, joint venture associations and more. But the authors suggest "(...) when you enter the system" what really matters is with "who you start

talking.” They also warm about that most of the players know each other, and are tightly interconnected.

2. Courtship: finding a partner. According to Henthorne and Miller (1997), the most important part of the role of the chosen partner, could be interpreting government policies, preferences and priorities for development.
3. Proposal development. Cuba does not count with a published, detailed plan for tourism development, and proposals are negotiated in individual basis.
4. Joint-venture formation with a Cuban partner agent, is the next step. The process is detailed in the Foreign Investment Law in article 21.
5. Financial packaging is also governed by the Foreign Investment Law, chapter XII, from article 38 to 51.
6. Real estate development and construction
7. Management
8. Marketing is limited by government laws that prohibit advertising activities.

With this outline Henthorne and Miller (1997) intended to provide a flexible guide to the process. They suggest that investors may enter the process with a headstart, such as: a preliminary proposal already in hand, or a particular partner already in mind.

## 8.7 Conclusions resulting from Cuba’s business environment analysis

Cuba’s tourism industry represents a competitive threat to the region. This conclusion is based on three sets of industry forces (Wood, 2004) that estimate the competitive attractiveness of the Cuban market.

- 1- How easily competitors can enter or leave the market,
- 2- How much power buyers and suppliers have; and
- 3- Whether substitutes are available for the company’s products and the resulting effect on industry rivalry .



Cuba can, as well as the Central American and Caribbean nations, have many advantages and access three of different unique competitive advantages that could explain this potential as a tourist destination in the following way:

- 1- Cuban's geographic location makes the country a bridge between North and South Americas, the Central American region, and the Caribbean area. The country is well positioned and could easily be a centrally located manufacturing and service platform.
- 2- Cuba owns unique environmental resources and has ecological diversity with clusters, such as eco-tourism and medical-tourism. Environmental technology and natural pharmaceutical offers great potentials.
- 3- The country enjoys yearlong growing conditions for a variety of agricultural products. Moreover, it does not experience extreme seasonal changes and enjoys long hours of sunlight per year. Agricultural land is of high quality, and it has the potential to become a sophisticated agricultural center, able to supply the region during winter seasons. Until now, this sector has remained unexploited, and a large number of Cuban farmers are expecting new opportunities in the sector that could stimulate their will to produce. Furthermore, the tourism industry could link its operations to agricultural activities in the rural areas in order to self supply and provide/guarantee the quality of products, such as vegetables and fruits. This, in addition, could create jobs for Cuban citizens, who will be more than satisfied with attaining the opportunity of increasing quality of life by being linked directly to tourist operations in the area.

Currently, Cuban farmers are bound to the government who pressure them to sell, only to government entities their entire production at prices that do not satisfy the production expenses, and the needs and demands of the farmers. However, a process of privatization where nationals can now own land has started recently in Cuba and this creates underlying opportunities.

Natural disasters do tone down GDP, but government effectiveness in the mitigation of its causes and prevention is highly recognized around the world. This was evident in 2008 when the hurricanes Ike and Gustav almost devastated the island.

Transportation infrastructure is not as bad as it looks at first glance. Cuba has 10 international airports served by 100 airlines connecting to 40 cities worldwide (Smith, 2006), not to mention that connections between the national regions is rather good.

The impact of “chance” as an industry factor to consider, were made clear in 2008. Two major hurricanes struck Cuba, inflicting extensive general damage, upsetting tourism operations, and damaging the country’s major tobacco-growing region and housing. The impact of the 9/11 attacks was another major unanticipated “chance” distress to the Cuban economy and the tourism industry in the island when uncertainty dominated the world and holiday’s cancelations represented a threat to profit gains. Less dramatically, but still importantly, Cuba is subject to the same general external trends especially in the tourism industry, as any other global competitor (García Jiménez, Caballero Figueroa, Alfonso Nichar, and Esperón Zaldivar, 2006).

In 2008, the international economic downturn increased the economic problems of the island, combined with the two hurricanes and the slowdown of the economic recovery since the Soviet Union collapse.

Cuba’s government policies cannot prevent or even significantly influence such external elements of chance in the tourism industry, such as the actual international economic crisis. Of course, the position of government is complicated in the case of Cuba, because nearly all aspects of the economy ultimately are the concern of the government. These aspects include strategic coordination and marketing, developing and delivering training programs, and encouraging higher education and research programs that support the clusters related to Cuban tourism industry. In addition, government policy plays an important role since it can either encourage or hold back competitive entrepreneurship and rivalry (Porter, 2008).

The attractiveness of Cuba as a destination can be reflected by the feelings and opinions of its visitor’s perceived ability of the Cuban tourism industry to satisfy their needs. The more Cuba is able to meet the needs of the tourists visiting the island, the more it can be perceived as attractive and the more the island is likely to be chosen as a destination. The attractiveness of Cuba as a tourist destination could encourage people to visit and spend time on the Caribbean island. Therefore the major value of Cuba tourism attractiveness is the pulling effect it has on tourists. Without the

attractiveness, tourism could not exist, and there could be little or no need for tourist facilities and services (Crouch and Ritchie, 1999).

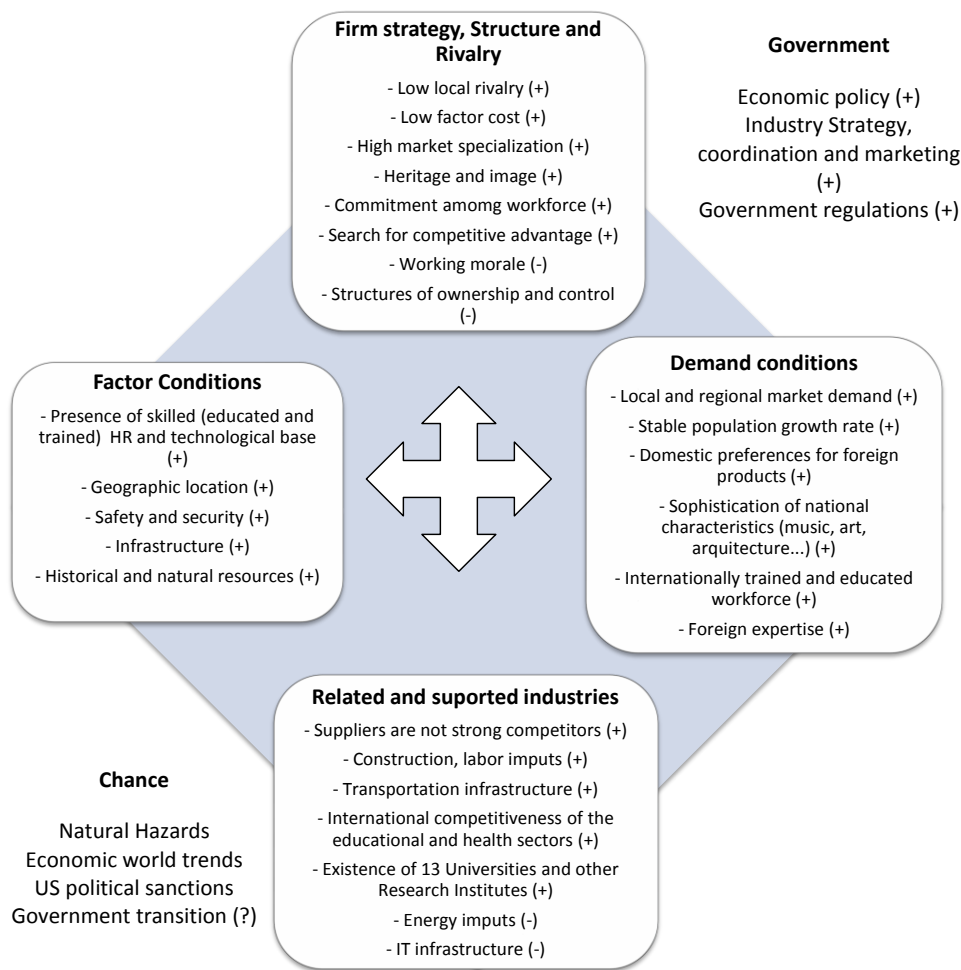
Peace, safety, and security could be taken also as primary requirements for growth, attractiveness, and competitiveness of Cuba as a tourism destination. Without the safety of the Cuban panorama, it could not successfully compete on the regional markets as a potential. Tourists do not feel like visiting places perceived as unsafe.

The competitiveness of the Cuban tourism industry is subjected to the global (macro) environment, and is concerned with the threat of substitutes, which typically impacts the tourism industry through price competition. There can be other concerns in assessing the threat of substitutes (Crouch G., 2006). Macro environment is global in its scope since events in one part of the world can affect tourist destination in regions completely different. On the other hand, a destination competitive environment (micro) is made up of organizations, influences and competitive forces that lie within the destination's immediate area, which tend to have more immediate impact than the global (macro) environment as a general rule (Crouch and Ritchie, 1999)

It is possible to conclude that Cuban tourism industry is competitive in terms of the security/safety for visitors, political stability, value for money in destination tourism experiences, value for money in accommodation, the use of IT by firms and value for money in shopping items, but less competitive in the areas of collaboration between the public and private sector, access to venture capital, the investment environment, the use of e-commerce, and manager capabilities

The most significant is the tourism sector's ability to add value to its products (Crouch and Ritchie, 1999). While Cuba's natural gift is clearly a very important factor of competitiveness in the Cuban tourism industry, it alone does not represents an opportunity for tourism development. In creating value, other resources must be present, and these are becoming ever more important in the actual Cuban panorama. A competitive advantage for the Cuban tourism industry can only be created by improved responsiveness to customer needs and preferences, innovativeness, service quality, price, and the so-called non-price factors.

Figure 8-9 resumes the anterior analysis of the Cuban tourism Industry.



**Figure 8-9 Porter's Diamond analysis for Cuban tourism industry. Adapted from Porter, 1990.**

Cuba's government needs to take several priority actions to improve tourism industry competitiveness.

Some of the priority actions needed in the national infrastructure, are the following:

- Improvement on national transportation infrastructure
- Upgrading national communications
- Upgrading higher education through coordination
- Integrating regional markets
- Creation of an efficient energy network
- Expansion of information access and sharing

Priority actions relative to National governance are the following:

- Development of a regional communication and marketing strategy
- Improvement of national institutions

#### Policies towards trade and competition

- Elimination of trade and investments barriers within the private sector and regions
- Development and encouragement for national competition between regions.

#### Priority actions related to regulations:

- Simplified paperwork and reinforcement of cross regional coordination.
- Incentive for productiveness
- Eliminate unbalanced growth and development between provinces.

Tourism managers entering the Cuban market have to identify and explore competitive advantages, and scrutinize Cuba's competitive position. The degree to which Cuba can benefit from its tourism sector depends largely on this sector's competitive position in the international tourist market.

## 9 Conclusions

The world and Cuba, as part of it, is changing constantly. Cuba can be called the sleeping Caiman of the Caribbean, which after more than 50 years is awakening, hungry, and still strong and ready to battle for its survival. Marketers need to approach the Caribbean Caiman very carefully in order to enter the market successfully.

The main conclusion from this thesis is that the main entry mode to use by investors in the Cuban market is a joint venture. No other favorable entry modes exist, which do not represent higher risk for firms operating in international markets. Collaboration with government entities will ensure a successful market entry and future market operations. Despite the limitations that the government role and policies poses to the attractiveness of FDI in the island, a close collaboration with Cuban government will ensure market knowledge and experience that can be very important in the near future. In addition, collaboration will reduce time and cost for foreign investors, so reduced risks for decision's maker can be expected.

In Cuba, the transportation and communication systems are in a deplorable state due to a lack of resources, investments and maintenance. The current infrastructure is favorable to business development, so business opportunities are still open.

Cuba offers an excellent and strategic geographic location, and local exports are gradually improving while import increases are a reality. In addition, the warehouse sector offers excellent opportunities. As companies migrate to Cuba, demand for warehousing, office space and manufacturing facilities will become widespread. In Cuba, the creation of tax free zones and bonded areas offer inherent advantages for warehousing. Furthermore, the island could work as a bridge between continents for manufacturing activities, transportation, or even for main offices for firms or organizations operating in the region.

Investors must consider that housing is in a stage of deterioration, especially in the capital area, while in the rest of the country the lack of resources keeps housing in very poor condition. Building permits are strictly required in order to build or rebuild houses in Cuba; in addition, the origin of the products must be acknowledged by Cuban authorities. The Cuban government exclusively sells, all building materials in

foreign currency. Opportunities for construction experts, equipment, and building materials are present.

The presence of natural resources offers a wide number of opportunities, such as oil drilling, natural healing centers (maybe related to tourism activities), agriculture, and tourism development.

Most importantly, investors must get involved in a collaboration with an insider/national with no political influence and should not be influenced by politics. The insider could work as a personal assistant or secretary for the director of the firm in the entry period to help to reduce cultural distances and to build internal networks or relationships that can improve business effectiveness.

Recently, Cuban government has initiated a period of privatizations that gives the starting signal to every one with eyes on the Cuban market. Thus, investors must be ready to enter a gradually changing market, which offers innumerable business opportunities at national and regional levels.

The author suggests to continue deeper research on the theme and to explore the Cuban market by other economic and cultural points of view. Firms need personal assistance of an individual or entity, familiar with the environment, culture and language to be successful in a Cuban venture.

The theories of internationalization approached in this thesis to analyze the Cuban market could have broader applications to the Caribbean region as a whole. The conventional view of the region is that its resources are highly homogenous; they all compete for the same market with essentially the same product: sun and beaches; and they all grow the same crops. However, their culture and development patterns have created the differences. Cuba's development patterns, its history, and its highly differentiated opportunities made Cuba unique among others.

The main sources used are secondary data, which makes the research relatively inexpensive. The methodology used is not exempt of disadvantages. It has been especially difficult to gather information since the Cuban government does not offer detailed information of the different economic issues and other related aspects. The integrity of the information was not always adequate, and different information

appears on the same topic in the various sources. However, from the experience of the researcher, those sources considered more relevant and secure were used. In addition, a deep evaluation of sources's origin was needed, which took a great deal of time and patience.

The use of online databases were required to gain understanding of Cuba's business environment, and the use of standard topic headings helped to successfully obtain the required information. In addition, data was not usually classified in categories, which could have made the work of collecting data easier. Sometimes the same data is reported by multiple and independent organizations, making the evaluation of the reliability of the data easier. Also, some data appeared outdated and even worse, political points of view affected the clarity of data relevant to the research. A great amount of neutrality on the researcher's part was a key to the success with the collection of the data. The Internet is plagued with information contaminated by political views of those who are opposed or support Castro's regime. Impartial views of the situation was very important for the author in order to summarize all aspects around the Cuban market environment. The national origin of the author, which is not politically influenced, was very helpful in order to obtain information. The author's language skills in Spanish was also helpful since knowledge of languages is indispensable to the interpretation of Spanish data in several locations of sources.

To identify and seize the great Cuban market opportunities investors must see the island with his/her own eyes and feel in his/her heart the sound of bongo drums.



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