

**Multinational Corporations and the Politics of Vertical Integration:  
The Case of the Central American Banana Industry in the Twentieth Century**

**Marcelo Bucheli**

Assistant Professor of Business History

Department of Business Administration

College of Business

University of Illinois at Urbana-Champaign

350 Wohlers Hall

1206 South Sixth Street

Champaign, IL 61820

United States of America

1+ (217) 244-0208

E-mail: [mbucheli@illinois.edu](mailto:mbucheli@illinois.edu)

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**Abstract**

I combine the methodologies and theoretical achievements of business history, international business, and political science to study the politics of vertical integration of multinational corporations operating in the primary sector in underdeveloped countries. By doing a long-term study of United Fruit Company's operations in Central America, I argue that multinationals with an overwhelming political and economic power in the host country are capable of integrating within its structure not only the different stages of the value chain, but also the host country's politics. The degree of political integration depends on the host country's dependence on the multinational, the existence of political opposition, the political and economic relations between the home and the host country, and the company's capability to generate economic stability to the host country. The article studies the conditions that permit the integration of local politics and the conditions that can to the collapse of this integration.

Keywords: Banana Industry, Business History, Central America, Multinational Corporations, Political Economy, Vertical Integration

## INTRODUCTION

No issues have generated more dialogue between business historians and management scholars than the study of the development of the multidivisional enterprise and the rise of large vertically integrated enterprises. The works of Alfred Chandler (1962, 1977) on the rise of the big business corporations initiated an unprecedented dialogue between business historians, management scholars, and economists, who used Chandler's findings and the works of those following his lead to test or develop theories (Kipping and Üsdiken, 2008). Sadly, particularly in the United States, this promising dialogue was short-lived. After the 1980s, the increased focus on purely quantitative studies and the wane of book-length research monographs among management scholars, the move away from economic issues by historians, and the slow death of economic history in economics departments led to an interruption of this rich interdisciplinary interaction (Kipping and Üsdiken, 2008; Lamoreaux, Raff, and Temin, 2008). In recent times, several scholars have argued that this mutual neglect has been detrimental for all the disciplines involved, and have called for a return of the use of management and economic theory in business historical studies, and for the use of historical case studies by management scholars (Jones and Khanna, 2006; Harvey and Wilson, 2007; Kipping and Üsdiken, 2008). Additionally, management scholars in the field of corporate political activity have called for more historical research (Hillman, Keim, and Schuler, 2004). Although I strongly sympathize with these calls (and this paper is partially a response to them), here I advocate for a wider interdisciplinary dialogue in which business historians

and management scholars combine their research with the theoretical achievements of political science.

In this paper I combine the three disciplines to analyze the particular case of vertical integration by multinational corporations (MNCs) operating in the primary sector in underdeveloped countries. Vertical integration is traditionally defined as the process by which a firm establishes control over the different aspects of the value chain, from acquisition of raw materials to distribution and marketing (Harrigan, 1985). I argue that vertical integration is not only an economic process, but also a historically determined political one. This is particularly apparent for an MNC investing in primary production in a small underdeveloped country. In this case, a company might feel encouraged to vertically integrate its operations if the host country's political regime is friendly to foreign investment and the company in particular. If the political conditions are not optimal for the multinational and the foreign company is disproportionately important for the economy of the host country, the multinational will try to integrate the host country's local polities *within* its corporate structure. In this way, the company can *create* the host country's political regime. This government will make local conditions favourable for the company and will benefit from the company's operations. Under these circumstances, the foreign corporation will benefit more from totalitarian regimes, rather than from more democratic ones.

The integration of the host country's local polities within the foreign multinational's corporate structure cannot be as complete as the integration of production and distribution aspects. Some issues, such as certain social

developments, are out of the company's control. If strong political opposition to the political integration rises within the host country from different political actors (such as the labour movement), or from the company's home country, this integration will become increasingly costly and risky and the company will be encouraged to de-integrate its operations (Boddewyn and Brewer, 1994).

I prove the above-mentioned dynamics by studying the particular case of the American banana producing and marketing corporation United Fruit Company (now Chiquita, and hereafter UFCo) and its operations in Central America during the twentieth century. In the first decades of the twentieth century, UFCo built a vertically integrated structure that included production centres in Central America, transportation systems, and distribution networks in the United States. The company, however, gradually divested its operations after the 1950s and focused on marketing. I show that very favourable international political conditions (absolute political power of the United States in Central America), together with the overwhelming economic power of the company in the producing countries permitted UFCo to not only vertically integrate its production and distribution operations, but also to absorb the local polities of some of its host countries within its structure. After the 1950s, however, changing social and political conditions (the rise of labour unionism and hostility to the company from the US government) and external shocks (the 1970s oil crisis) made this integration increasingly costly and risky, leading the company to sell its producing assets in Central America.

## **THE POLITICAL ECONOMY OF VERTICAL INTEGRATION: THEORY AND EVOLUTION OF A CONCEPT**

A concern about the role of politics in vertical integration has been more present in studies of multinational corporations than in those that analyze firms operating within a single nation. The rise of nationalism in the underdeveloped world and the expropriations of foreign property in the 1960s and 1970s provided material for management scholars to develop the Obsolescing Bargaining Power Theory (Vernon, 1971a, 1971b; Wells, 1977; Fagre and Wells, 1982), while simultaneously encouraging a large group of historians and sociologists to analyze the political role of MNCs under the scope of Dependency Theory (Cardoso and Faletto, 1979; Frank, 1971; Dos Santos, 1970, 1973; Evans, 1979). Before these scholars, most studies explained vertical integration as a strategy by which firms sought to reduce the uncertainties of the market and transaction costs involved in the different stages of the value chain (Coase, 1937; Williamson, 1971, 1981, 1985). The analysis was expanded by Dunning (1971) to explain the existence of MNCs. According to Dunning (1971), when a firm vertically integrates its operations, it is internalizing otherwise external markets, endowing it with a power its competitors did not have (what he defined as *internalisation advantages*). Casson and Buckley (1976) add the concept of transaction costs to Dunning's (1971) analysis, and maintain that vertical integration responds to the specific technical particularities of the industry in which the firm operates. Some industries require closer coordination than others, and effective coordination is more difficult when operating between different countries. Although Dunning (1971) and Casson and Buckley (1976)

acknowledged the relevance of politics in the host and home country, they did not make it a central element of their analysis.

The addition of politics to the analysis of vertical integration by management scholars led to the development of the concept of 'obsolescing bargaining power'. With this concept, they describe the situation multinational corporations face after investing in the extractive industries: with an investment in fixed assets already made, they maintain, the MNC faces an increasingly vulnerable bargaining position with respect to the host government (Vernon, 1971a, 1971b; Wells, 1977; Fagre and Wells, 1982). For business school scholars, the nationalization wave of the 1970s was a rational move by the host governments because they had already acquired the knowledge the multinationals could provide; as a result, they no longer needed the multinationals (Kobrin, 1980, 1984; Minor, 1994).

Parallel to the development of the 'obsolescing bargaining power', a group of historians and sociologists (mostly from Latin America) developed a body of scholarship later known as Dependency Theory. These scholars explained the origins of the poverty of underdeveloped nations as a result of the way those countries had been historically inserted in the world economy. By 'dependency' they understood a situation in which 'some countries (the dominant ones) can expand and can be self-sustaining, while other countries (the dependent ones) can do this only as a reflection of that expansion' (Dos Santos, 1970, p. 231). Dependency scholars put multinational corporations at the centre of their analysis, because these corporations created some of the most important linkages between the dependent countries and the dominant ones. Some Dependency scholars argued

that although the multinationals generated linkages with the rest of the world, they did not generate benefits for the host country's population and allied with repressive regimes (Frank, 1971; Dos Santos, 1973). Others argued that there were two kinds of countries: those in which production system was in local hands, and those in which it was in hands of foreigners, something that negatively affected every aspect of social and economic development of the countries dominated by foreigners (Cardoso and Faletto, 1979; Evans, 1979). Thus, under a Dependency scope the MNCs were not only economic but also political actors; the more they invested in production facilities in the dependent countries (vertically integrating their operations), the more politically involved they would be.

In the 1980s and 1990s, scholars influenced by the rational choice theory and the writings of Douglass North (1990) began a new type of analysis of the relationship between multinationals and politics. Some of them argued that democratic regimes in which the government could not change the rules at its will created a better environment for foreign investors (Henisz, 2000; Feng, 2001; Jensen, 2003, 2005, 2006). Other, by contrast, found that multinationals benefited from repressive governments (Oneal, 1994; London and Ross, 1995; Durham, 1999), and still others found that the stability of the regime (either democracy or dictatorship) is ultimately more important for foreign investors than the form the regime takes (Clague, et al, 1996; Li and Filer, 2007). Most of these studies, however, take the political system as given, to which MNCs must adapt.

International business scholar Jean Boddewyn and political scientist Thomas Brewer challenged the view of the government as a given variable by using the concept of internalization for political aspects (Boddewyn and Brewer, 1994; Boddewyn, 1988). According to these two scholars, MNCs can partner with local governments to 'alleviate natural market failures and generate unnatural market imperfections' in which the maximum manifestation of this partnering 'involves internalizing the market for political products –that is, turning politicians and government officials into agents of the [foreign] firm by incorporating them into its internal hierarchy' (Boddewyn and Brewer, 1994, pp. 130-131). Here, the state is a transaction cost the companies will try to minimize. They add that this situation will prevail when three conditions are met: '(a) states are willing to correct for natural market failures or to generate unnatural market imperfections, (b) both sides perceive the situation as a positive-sum game, and (c) they have sufficient power to affect the uncertain outcomes of their bargaining over the division of the resulting mutual gains' (Boddewyn and Brewer, 1994, p. 131).

The theoretical approaches developed by political scientist Guillermo O'Donnell (1982, 1988) complement those of Boddewyn and Brewer to explain how this partnership (or integration in its extreme form) can collapse. O'Donnell considers the case of totalitarian right-wing regimes in very close partnership with foreign multinationals. He argues that a totalitarian right-wing regime will create favourable conditions for foreign investors. These conditions include a local bourgeoisie that benefits economically from the MNCs operations (although subordinate to the MNC) and a low-paid working class. In order to control the

demands of the working class, the MNCs, the local bourgeoisie, and the totalitarian regime will ally themselves against the workers. However, if the country faces a sudden economic crisis (not anticipated by the government, the multinationals, the bourgeoisie, or the working class), O'Donnell predicts the following outcomes: the working class will increase its demands, generating more uncertainty among private investors, while the foreign and domestic firms will try to accumulate as much as possible in a short time, generating a political crisis out of an economic one. Under these circumstances, the government can choose to co-opt the labour movement by giving attention to some of its demands, but without threatening the existing capitalist system and the privileges of the bourgeoisie. O'Donnell also argues that if foreign investors perceive long-term transformations in the host society of a nature that might negatively affect their operations, they will gradually adapt to these transformations by increasing the participation of local actors (which can include the government and/or the bourgeoisie) in the business in which the multinational is involved. With a sudden economic crisis, however, this gradual adaptation is not possible.

The concepts developed by O'Donnell and Boddewyn and Brewer are relevant for business historians analyzing the operations of MNCs. While Dependency scholars considered the MNC a political actor, they neglected to analyze the companies' internal structure and corporate strategy in the light of its role as a political actor. The obsolescing bargaining power theorists, by contrast, considered the MNCs political action and the role of politics in vertical integration, but did not consider the local governments as part of the integration. And most international

business studies consider the state as a pre-existing entity and not created or shaped by the MNC.

Using the theoretical approach of O'Donnell and Boddewyn and Brewer, I now want to show how existing literature on the political economy of foreign direct investment might be enriched through a long-term case study. Large mega databases used by scholars studying the relationship between MNCs and governments (Jensen, 2003, 2005) provide useful results for analysis for relatively short-term periods (around thirty years, a short period for historians), but can create distortions for more long-term calculations. It is in this way in which I believe a qualitative long-term case study can contribute to the literature with evidence hard to obtain in large mega databases.

## **METHODOLOGY**

This paper uses the concepts developed by O'Donnell (1982, 1988), Boddewyn (1988), and Boddewyn and Brewer (1994) assuming the state as a cost the MNC will try to minimize. This ability, however, depends on the strength of the local institutions and the relative power differential between the multinational and the local state. I also assume that the company's organizational structure (vertically integrated or not) is determined not only by the economics of the firm but also by the negotiations between the company and the host state (Gomes-Casseres, 1990).

I study the integration of political elements by showing the degree of UFCo's political intervention in the producing countries' local and external affairs, its importance in the host countries' domestic economies, the close economic relationship between the company and the countries' rulers, and the overwhelming political and economic power of the United States in the region. I also consider the countries' internal political development by analyzing how pluralistic or totalitarian they were, and how this affected its relation with UFCo. To understand the process of de-integration and the relationship with political development, I show how the social and political changes in the producing countries affected UFCo's profitability and risk perception by calculating the company's profit rates, the perception of financial analysts, and by calculating the company's yield on common stock (a widely accepted risk ratio) and comparing it with the top 200 companies traded in Wall Street. The yield is calculated by dividing the share's dividend earnings by its market price. The higher this ratio is, the riskier an investment is considered. Finally, I analyze the degree of integration or de-integration by analyzing the company's asset composition. My study focuses on UFCo's operations in Costa Rica, Guatemala, and Honduras, which were the company's main centres of operation in Central America.

### **VERTICAL INTEGRATION AND THE CREATION OF THE BANANA EMPIRE**

Previous business historical studies of UFCo's vertical integration used the Chandlerian paradigm to explain the company's integration process (Read, 1983):

the company integrated backward and forward to create a mass market of bananas in the United States. Although this interpretation is correct, its neglect of politics does not permit us to understand why the company vertically de-integrated in the 1960s. In what follows, I show that the enormous power the company had in the region during the pre-WWII period permitted it to informally integrate the local polities within its vertically integrated structure to different degrees. The company had to abandon its vertical structure in the 1960s, when it could no longer control the region's local polities.

### **United Fruit's economic vertical integration in the early 20<sup>th</sup> century**

The creation and growth of the banana industry was led by United Fruit Company (established in 1899 in Boston), considered the first and most successful firm at vertically integrating its operations in the agricultural sector at the international level (Wilkins, 1974). Imports of bananas to the United States started in the 1860s, but most companies failed to remain in business because of the very nature of bananas: they rot quickly, they require careful handling, and they cannot be stored or frozen, so a close coordination between producers, transporters, and retailers was crucial. This lack of coordination led to a very high mortality rate among the banana companies: from 114 banana companies established between 1870 and 1899, only 22 survived by 1899 (Read, 1983).

The problem of coordination in the banana industry was solved after the creation of UFCo in 1900. The company was the result of a merger between the

businesses of US entrepreneurs Minor C. Keith and Andrew Preston, whose interests complemented each other perfectly: Keith owned lands and an extensive railway line in Central America, and controlled the banana market of the Southwest U.S.; Preston, on the other hand, owned the Great White Fleet (which eventually became the largest privately owned steamship fleet in the world), plantations in the West Indies, and controlled the banana market of the Northeast (May and Plaza, 1958). In 1913, the company created the Tropical Radio & Telegraph Company to keep in constant communication with its ships and plantations (Wilkins, 1970, 1974; Bucheli, 2005a). By the 1920s, the company had an extensive network of plantations (which included housing, schools, and hospitals), telegraph and telephone lines, ports, and railways. The company also integrated forward by acquiring the Hamburg Line and the British banana company Fyffes to market the fruit in Europe and by establishing the Fruit Dispatch Company to distribute and market bananas in the United States (Bucheli and Read, 2006; Jenkins, 2000). Until the late 1950s, UFCo controlled 70% of the US banana market (Bucheli, 2005a).

The company also integrated its operations through acquisition of smaller companies. In the 1920s, the New Orleans-based Cuyamel Fruit Company, owned by Samuel Zemurray, became serious competition. Zemurray had acquired generous concessions from the Honduran government in the 1910s after financing a military coup against President Miguel Dávila and replacing him with Manuel Bonilla, who once in power granted Cuyamel generous land and tax concessions. After a fierce price war, UFCo acquired Cuyamel and gave Zemurray a seat on the board of directors. The acquisition of Cuyamel meant 250,000 more acres of land in

Honduras, fifteen more steamships, port facilities and a railway concession. During this period UFCo acquired other smaller American banana companies operating in the region (Kepner and Soothill, 1935; McCann, 1976; Bucheli, 2005a).

### **International Political and Economic Environment**

UFCo created its 'Banana Empire' in times of unprecedented favourable political and economic conditions. The company's home country, the United States, was the only and unchallenged economic and political power in the Caribbean Basin. The Central American governments competed for American approval by repressing opposition and generating favourable conditions to foreign investment (Coatsworth, 1994). In addition, the US showed its military strength whenever its interests or those of its allies were in danger. Before 1945, the US had already invaded Honduras (1903, 1907, 1912, 1919, 1924), the Dominican Republic (1903, 1914, 1916), Haiti (1914, 1915), Nicaragua (1907, 1909, 1915), Cuba (1906, 1912, 1917), Panama (1912, 1918, 1925), Guatemala (1920), and El Salvador (1932) (Langley, 2002). UFCo and other American corporations, took advantage of the situation by expanding their business in Mexico, Central America, and the Caribbean behaving as if these regions were natural extensions of the United States (Wilkins, 1974). In addition, UFCo enjoyed a tariff-free system to banana imports with an ever-growing demand, which encouraged further investments in production (Bucheli, 2005a).

## **INTERNALISING LOCAL POLITIES IN CENTRAL AMERICA**

The internalisation of local polities by UFCo was not uniform in the different states in which it operated. First, the more a host country depended on the company's operations, the more vulnerable this country was to have its polities internalised by UFCo. Second, the less democratic a country was, the easier it was for UFCo to internalise its polities. As I show below, in many cases UFCo had a strong influence at imposing dictators in some countries.

### **United Fruit's economic power in Central America**

In Tables I and II, I show the degree of dependence each of these countries had on the banana export industry and on the American market. UFCo dominated the market by more than seventy percent, and no domestic company in the producing countries ever achieved to create a serious banana export industry to compete against UFCo (May and Plaza, 1958; García, 1997). The tables show that banana exports were highly important in all the Central American countries where UFCo operated, but not equally important. The most extreme case is clearly Honduras, whose economy depended mostly solely on banana exports. The main trade partner of the three countries was the United States (see table III).

---- INSERT TABLES I II, AND III AROUND HERE-----

During most of the twentieth century Honduras and Guatemala were highly unstable countries ruled by totalitarian regimes, while Costa Rica had a more

pluralistic system (see table IV). The next section shows not only that UFCo was more successful at integrating local polities into its internal structure in countries with more repressive governments, but also the company directly helped to the creation of some of these totalitarian regimes.

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### **Internalisation in Honduras and the creation of the 'Banana Republic'**

Honduras is considered the quintessential 'Banana Republic'. In fact, the term 'Banana Republic' was coined by American writer O. Henry (1912) in his novel *Cabbages and Kings* inspired by the operations of Cuyamel Fruit Company in Honduras. In 1911, Cuyamel's president (and future president of UFCo) Samuel Zemurray funded and provided men for a rebellion against the government of General Miguel Dávila who had approved some timid measures limiting foreign ownership in Honduras. Cuyamel's funded rebels succeeded at overthrowing Dávila and the new governments of Francisco Bertand and General Manuel Bonilla quickly eliminated Dávila's legislation and granted Cuyamel generous tax benefits and land concessions, which eventually benefited UFCo when it acquired Cuyamel in 1930 (Kepner, 1936; MacCameron, 1983; Taracena, 1993).

Parallel to Cuyamel's expansion, UFCo sought to gradually increase its own power in Honduras. In 1914, describing how UFCo was increasing its land concessions, the US Ambassador in Tegucigalpa wrote the US Department of State

'in order to obtain these concessions and privileges and to secure their undisturbed enjoyment, [UFCo] has seen fit to enter actively into the internal politics of these countries, and it has pursued this course so systematically and regularly until it now has its ramifications in every department of the government and is a most important factor in all political movements and actions' (Euraque, 1996, p. 43-44).

The competition between Cuyamel and UFCo led the two companies to stronger political interventionism. In 1917, Honduras and Guatemala were on the brink of war over a territory disputed by the two companies, and in 1928 the two countries finally went to war over this territory. The conflict was encouraged and supported by UFCo on the Guatemalan side and Cuyamel on the Honduran side (Dosal, 1993). The US government settled the conflict and afterwards the two companies decided to merge their interests when UFCo acquired Cuyamel.

UFCo not only did acquire Cuyamel's assets, but also its political connections. Juan Manuel Gálvez, a congressman (1925-1929) and Honduras' minister of war (1933-1949) had simultaneously been Cuyamel's main lawyer and after the merger he represented UFCo. In addition, UFCo's lawyer Presentación Quezada was Honduras' vice-president (1925-1929), and Plutarco Muñoz, another company's lawyer, was president of the national congress (1933-1949) (García, 1997).

UFCo's political power in Honduras increased even more after the election of General Tiburcio Carías in 1932. With a presidential campaign financed by UFCo, Carías turned his government into a dictatorship that lasted until 1949 (Posas, 1993; Díaz Chávez, 1982). Carías supported UFCo when the company's workers and

providers went on strike after the multinational decreased wages and purchasing price of bananas and granted the company with more concessions and tax exemptions (Bulmer-Thomas, 1987). The US ambassador noted in 1933 that 'no fruit company... ever exercised a more powerful influence and control of a Honduran government than does [UFCo]... with Carías' (Euraque, 1996, p. 58). In the 1930s, UFCo also owned the country's main radio broadcaster and the main economic and a national newspaper (Barahona, 2002). The company also acted as an important bank for the Honduran government: between 1931 and 1949 the company loaned the government around \$2.4 million mostly to purchase weapons and pay the military salaries (García, 1997).

### **Guatemala: Bananas, Coffee, and Dictatorship**

UFCo also wielded disproportionate power in Guatemala, but its capacity to completely internalize internal politics was constrained by the existence of an important coffee export industry controlled by domestic entrepreneurs (table I shows a lower dependence on banana exports than Honduras). Domestic opposition to UFCo proved to be more efficient with democratic governments than with dictatorships.

UFCo started operations in Guatemala during the dictatorship of General Manuel Estrada Cabrera, who ruled the country between 1898 and 1921. Estrada granted UFCo with banana production concessions, banana export tax exemptions for thirty years, and a 99- year railway construction and management concession

(Dosal, 1993; Taracena, 1993). After Estrada's fall, Guatemala enjoyed a ten-year interlude of political opening and relatively democratic regimes, during which coffee growers criticized UFCo's excessive control of means of transportation and pressured the government to revise some concessions. The democratic governments of the 1920s conflicted with UFCo over taxes and monopoly of ground transportation and managed to earn some modest gains from UFCo. In addition, the democratic governments did not grant UFCo concessions as generous as those previously granted by Estrada (Dosal, 1993).

The political scenario changed again in favour of UFCo when the right wing dictator Jorge Ubico took power in 1931. This change was reported as positive by UFCo's railway affiliate the International Railways of Central America (IRCA) (1931). After taking power, Ubico signed a contract with UFCo in which the company committed to build a port in exchange of land. In 1936, however, the company dropped the port project so as not to compete with IRCA. The port was never built, but the company kept the land and did not pay any reparation, and Ubico's dictatorial style did not permit the coffee growers to protest against these actions (Dosal, 1993; Gliejeses, 1991)

Ubico's dictatorship ended because of the opposition of the small but growing Guatemalan middle class, composed of schoolteachers, government officials, and small businessmen, who felt that a country controlled by the land-owning oligarchy and UFCo did not leave room for them. In 1944, a group of young army officers supporting striking schoolteachers overthrew Ubico and called for

elections (Schlesinger and Kinzer, 1990). For these revolutionaries, UFCo became the symbol of the exploitation of their country by foreign powers and focus their efforts in diminishing the company's influence in the country. The rebels included Colonel Jacobo Arbenz, who in 1951 was elected president.

### **Costa Rica: weak internalisation and weak opposition**

Costa Rica has traditionally been considered an exception in Central America, because of its relative internal political stability, relatively high standard of living, and lack of long-term totalitarian regimes. UFCo achieved a strong political influence in Costa Rica, but the legal political opposition constantly challenged its power.

Keith, one of UFCo's founders, had been a very influential man in Costa Rican local politics before 1900. Keith built the country's main railways, married the daughter of a former president, and was the main negotiator of the Costa Rican government with foreign banks in the 1890s (Schlesinger and Kinzer, 1990). Before forming UFCo, the Costa Rican government awarded Keith banana export concessions with no export taxes. However, the existence of a congressional opposition made of this concessions source of heated debates (Gaspar, 1979). Congressman Ricardo Jiménez, one of UFCo's hardest critics, approached independent banana growers who provided the company with part of the fruit, and plantation workers to pressure the government to change the banana policy. In 1910, Jiménez was elected president (Chomsky, 1996).

Having a president critical of UFCo was not enough to decrease the company's power. First, the company threatened on leaving the country if taxes were increased and, second, it provided a much-needed loan to the government to pay its foreign debt (Gaspar, 1979; Chomsky, 1996). It was only until 1926 when the government successfully negotiated a tax increase in exchange for new lands for the company. Congress, however, took too long at approving the land grant and by the time it did, UFCo decided it did not need the lands any longer (Gaspar, 1979).

A new and more aggressive action by the Costa Rican government took place in 1934. Using a banana workers' strike for its advantage, the government negotiated a new contract in which UFCo allowed small planters to use part of its lands and regulated the contracts between the company and its local providers. In exchange, the company received new land grants (Bulmer-Thomas, 1987; Chomsky, 1996; Gaspar, 1979). In this occasion, the company did not behave as a tough negotiator. Aware of the problems political opposition could generate to his business, Zemurray decided to give in to these modest local demands (Gaspar, 1979). By this time, the company's connections in the government were still important: the Costa Rican foreign affairs minister was also a UFCo's lawyer (García, 1997).

The Costa Rican case shows that a pluralistic system permitted open opposition to UFCo's privileges, but these challenges were constrained by the country's lack of power to impose its will to the company and the company's threats to leave the country. The local political system, however, forced UFCo to follow

formal procedures and consider political opposition when negotiating concessions with the government.

### **SOCIAL CHANGES, RISK, AND DIVESTITURE**

After World War II, UFCo gradually dismantled its vertically integrated structure. The company decreased its land ownership in the producing countries and focused its activities in the marketing of the fruit. Table V shows the change in asset composition with a decrease in land ownership and an increase in the importance of the steamships. Table VI shows the constant decrease on land acreage in the countries where the company operated. The company's profit rates were not increasing with these changes, as my calculations of return on assets for the post-World War II period show in table VII. Despite the falling profit rate the company divested because owning assets in the producing countries became a source of political risk and the company's relationship with the more totalitarian regimes stopped being mutually beneficial, which is consistent with the predictions of Boddewyn and Brewer (1994).

--- INSERT TABLES V, VI, AND VII AROUND HERE---

#### **Investors' fears and political uncertainty**

UFCo was operating in an area of political instability, and after World War II, investors started to believe that the company did not have the power to shape or

control unstable polities. In 1949, Moody's Investors Service warned that although UFCo was a good investment option, 'future political developments remain an uncertainty' (Moody's 1949, p. 528). This warning coincided with a gloomy letter of the company's president to the shareholders in which he reported interrupted shipments from Guatemala due to labour unrest and labour problems in Costa Rica (United Fruit Company, 1949). In 1951, Moody's explained the company's lower performance to labour troubles, and when analyzing the company's negotiations with Guatemalan striking workers, Moody's worried about the possibility of a domino effect: 'If the company compromises [with the workers], labour in other countries would probably demand similar concessions' (Moody's, 1951, p. 133). Even in its annual report, the company complained about changing labour relations, in which according to UFCo's president 'extremists... have kept the labourers in constant state of unrest' (United Fruit Company, 1951, pp. 9-10).

UFCo faced its strongest challenge after the election of president Arbenz of Guatemala in 1951. In 1953, Arbenz developed an agrarian reform and expropriated some of the company's uncultivated lands to distribute among poor peasants. This generated an international conflict in which the US government conspired with members of the Guatemalan Army, landowning class, and neighbouring government of Honduras to successfully overthrow Arbenz in 1954 (Schlesinger and Kinzer, 1990; Gleijeses, 1991; Coatsworth, 1994).

Before Arbenz's fall, the company was pessimistic about the outcome of the conflict and announced it was not going to increase its production capacity: 'as long

as the political atmosphere remains inimical to American enterprise, the company must of necessity follow a policy of retrenchment' (United Fruit Company, 1954, p. 4). Moody's worried about broader implications: 'this is not a question of immediate crucial importance to the company's earning power. More important is whether Guatemalan events are indicative of what may happen elsewhere in Latin America where UFCo operates' (Moody's, 1953, p. 561). UFCo reported Arbenz's overthrow in 1954 with optimism (United Fruit, 1955), but Moody's still warned investors that 'further political disturbances in the Caribbean area can never be ruled out' (Moody's, 1955, p. 589), and in 1956 it emphasized that 'the company's operations are subject to natural and foreign political hazards beyond its control' (Moody's, 1956).

The company's political problems were not limited to Central America. In 1954, the US Department of Justice filed a lawsuit against UFCo for violating the anti-trust legislation. As a result, the company was forced to divest its Guatemalan properties and sell its holdings in IRCA (Dosal, 1993).

In 1959, the Costa Rican congress passed a law requiring all employers to pay employees an end-year bonus. UFCo refused to comply for considering that the legislation was discriminatory against it and violated the company's contracts with the government. The workers reacted with a strike supported by the government. Analyzing these events, Moody's reported 'UFCo has been hurt by political troubles... Management is currently attempting to combat its problems... but any

appreciable effect will be far in the future... We therefore see no reason to hold the stock' (Moody's, 1959).

### **Divestiture and risk reduction**

The gradual changes in the local polities, which had negative effects in the company's business, led UFCo to also gradually transfer parts of its business to local actors. Consistent with the predictions of O'Donnell (1982, 1988) and Boddewyn and Brewer (1994), the economic internalisation represented increasing risks and the company adapted to the new situation by divesting itself.

In 1960, UFCo appointed Thomas Sunderland as president and he quickly announced a readjustment program. Sunderland's new business model included transferring production to local growers instead of producing in the company's plantations, a strategy a Harvard Business School study said 'could contribute to the development of stable conditions in the tropics... gain partners who would be valuable allies... and reduce the frequent attacks by trouble makers' (Arthur, Houck, and Beckford, 1968, p. 148). Moody's, however, received these changes with cautious optimism (Moody's, 1961, 1962). It was only until 1968, when the divestiture process was well advanced and the company was settling the anti-trust suit that Moody's recommended a buy for UFCo stock (Moody's 1967, 1968).

In the late 1960s, UFCo's management made it clear to its shareholders that it was aware of the social and political changes in Latin America and that the company

had no other choice than to adapt. In his 1968 report, the company's president wrote, 'no matter how successful we are in this process [of adaptation and divestiture], we still will be perceived, however, I am sure, as a threat to national independence and sovereignty' (United Fruit Company, 1968). Finally, in 1970, after the merger of UFCo with AMK Corporation to create United Brands, the company's report justified its sales of lands by saying 'while these operations are in stable countries with enlightened governments, the fact is that all Latin American countries are being swept by strong winds of nationalist aspiration. [We] must adjust to change... Since 1952 the company has divested itself of 65% of its holdings in [Central America]' (United Brands Company, 1970). The merger also permitted the company to diversify its business, in times in which the banana consumption per-capita in the US was decreasing (Bucheli and Read, 2006).

Table VIII compares the yield on common stock between UFCo and the top 200 companies traded in Wall Street. It shows that the perception of the firm as risky gradually decreased as long as the company divested itself of producing assets in Central America. The years in which the stock was considered riskier coincide with those in which the company reported issues having a 'significant' effect on earnings. Similarly, when the company announced divestiture, the stock was perceived as less risky. As the table shows, most of the issues had to do with politics and labour relations.

--- INSERT TABLE VIII AROUND HERE-----

## **EXTERNAL ECONOMIC SHOCKS AND THE FINAL COLLAPSE OF THE COMPANY'S POLITICAL POWER**

The oil crisis of 1973 precipitated a sudden crisis that forced the Central American governments to realign their alliances. O'Donnell (1982, 1988) predicts that this kind of change will force governments to realign itself allying with the working class in order to avoid the generation of a political crisis out of an economic one. The events after 1973 are consistent with this theory and with Boddewyn and Brewer's (1994) prediction of the end of the partnership between the MNC and the government when this partnership stops being mutually beneficial for both parts. The Central American governments not only allied themselves with the working class against the MNCs, but also created a common front to deal with UFCo.

This process was apparent in Honduras, the country where UFCo (under its new name United Brands) always felt safer. By the time of the oil crisis, the country was ruled by General Oswaldo López Arellano, a military who came to power for the first time in 1963 in a military coup against president José Villeda, a civilian who had tried to create the first agrarian reform in Honduras. Villeda, however, faced great opposition from the country's conservative sectors represented by López Arellano. After the coup, López Arellano banned the National Peasant Federation and jailed peasant leaders and intellectuals. The repression, however, did not stop the peasant movement and during the second half of the 1960s, the Honduran countryside experienced increased turmoil. As a way to decrease tensions, López Arellano distributed some lands among peasants, but this process was stopped by his

successor, Ramón Cruz, who took power in 1969. Cruz, however, was overthrown in 1971 in a military coup that brought López Arellano back to power.

In 1974, López Arellano signed an agreement with the presidents of the other banana export countries (Costa Rica, Guatemala, Honduras, Panama, and Colombia) creating a banana export cartel called UPEB (Banana Export Countries Union, in its Spanish acronym) and modelled after OPEC. UPEB's main goals were to increase taxation on bananas exported by the multinationals and to control supply in order to increase prices (Vallejo, 1982). United Brands' local providers (a growing number due to the process of divestiture), also demanded their governments to make the company increase the purchasing price of the fruit, which in real terms had decreased as a result of the inflation generated by the oil crisis (Bulmer-Thomas, 1987).

UPEB's founders claimed that their countries had historically received an unfairly small share of the banana export industry (11%), while the MNCs received 37% and the retailers in the consuming countries received 19% (López, 1986). With trade deficits reaching historic highs due to the oil crisis, an increase of the income of the countries' main export was imperative to avoid social problems (Bucheli, 2008). So, in order to increase the indefinite average tax of \$0.80 per ton, up to what the governments considered a fair \$55 per ton, the governments of Costa Rica, Honduras, and Panama passed laws that nullified the previous contracts between the governments and the companies in 1974, 1975, and 1976, respectively,

and eliminated some of the many generous concessions UFCo had enjoyed until then (United Nations, 1986).

UFCo (and its main rival, Standard Fruit) did not remain passive during these events. The companies joined forces and threatened the countries with export strikes and layoffs. UFCo reduced its Costa Rican exports in 30%, something that generated a workers' strike in support of the government and UPEB (Presa, 1975; Vallejo, 1982). The foreign companies' aggressive response led López Arellano to go forward with the most radical agrarian reform in Honduran history. He expropriated lands from Standard Fruit and distributed them among 44,700 families and created 900 cooperatives (Guerra-Borges, 1993).

The US government did not support United Brands in this conflict. All the opposite, US-dominated multilateral institutions such as the Inter-American Development Bank and the International Monetary Fund provided these countries with loans to support UPEB's programs (Inter-American Development Bank, various years; International Monetary Fund, 1975). In September 1974, United Brands finally accepted the new conditions created by UPEB.

Both United Brands and the local governments announced the company's acceptance of the new terms as the beginning of a new era in the relationship between both parts (United Fruit Company, 1975). However, the year after, an investigation by the Securities Exchange Commission uncovered a scheme with which United Brands had paid \$1.2 million in bribes to Honduran officials to avoid some UPEB's agreed new taxes. Among those receiving the bribes was president

López Arellano, who immediately denied the accusations (McCann, 1976). Although the US government punished United Brands for this and the Honduran government also punished some of the officials accused of accepting bribes, this event showed that although the relationships between the company and the host nations had changed, certain degree of political interventionism had not disappeared.

## **CONCLUSION**

This paper has brought together three disciplines into dialogue with each other: management studies, political science, and business history. By analyzing the particular case of United Fruit Company in Central America, I have shown the benefits of integrating the achievements of the three disciplines for our understanding of the political economy of vertical integration by MNCs operating in underdeveloped countries. The paper makes a contribution to the scholarship in three ways: first, I seek to complement the studies made by scholars studying the political economy of foreign direct investment, by highlighting the value of the case study. In recent times, these scholars have made remarkable contributions by studying the politics of foreign direct investment by using and creating complex quantitative methods. It is well known, however, that the quantification of aspects like political regimes of degree of democracy in combination with mega databases of capital flows can create distortions in very long-term studies. A detailed case study that uses the corporations' and governments' sources can compensate for this tendency, and complement the conclusions of quantitative studies. Moreover, as

this case shows, some changes in strategy and structure take place in very long periods of time, and therefore, require long-term (meaning historical) analyses. For instance, some scholars (Henisz, 2000; Feng, 2001; Jensen 2003, 2005, 2006) have found that democratic systems create a good environment to foreign investors, while others (Oneal, 1994; London and Ross, 1995; Durham, 1999; Ross, 2001; Barndt, et al, 2005) claim that repressive regimes are friendlier to MNCs, and a third group claims that MNCs working in the primary sector tend to generate more political instability and violence (Kobrin, 1979; Karl, 1997; Le Billion, 2001; Alfaro, 2003; Li and Mihalache, 2006). While some of my findings are more consistent with the second two groups of scholars than with the first one, they also show that the politics and societies in host countries change slowly and over time, resulting in regimes friendly to the MNCs under certain conditions, and hostile to them when the initial conditions change. In this aspect, O'Donnell's theory of the effect of gradual versus sudden political and economic changes in the relationships between MNCs and local governments are particularly useful (1982, 1988). Equally useful is Boddewyn and Brewer's challenge to the idea of the state as a 'given' variable (1994).

Second, I show the benefits business historians can reap by taking into account theories hailing from both management studies and political science. No corporation operates in a political vacuum, and so the theories dealing with the role of the state under capitalism can open enormous research possibilities, and can also help us to challenge previous findings. It is worth highlighting the fact that most of the recent scholarly production on the relationship between politics and

international business has been generated in departments of political science, rather than in business schools. The potential benefits for business historians from considering knowledge created by political scientists is enormous.

Third, vertical integration in international business is a historically determined political process. The political complexity of this process is greater when analyzing firms from rich countries operating in the primary sector of poor countries. No sector generates more economic nationalism than the extractive sector in less developed countries. Nor does any other sector require higher levels of investments in infrastructure by the foreign company. In no moment in history, from the nineteenth century onward, has the entry of foreign multinationals into poor countries been a smooth process, and the political conditions of the twenty-first century do not suggest that this will change. Thus, an accurate analysis of the operations of multinational companies in Third World countries requires including the political element in a historical perspective.

The particular case I studied in this paper shows a company whose reputation has been deeply tainted by its political activities. Although at some point it wielded incredible power in Central America, this power gradually decreased as a result of internal changes happening in the producing countries. If an epilogue were to be written about the narrative of this paper, it would not benefit the company. In the 1990s, the company (under its new name of Chiquita) embarked on a political war against the regulations on banana imports created by the European Union. Excessive payments to lobbyists and horrendous miscalculations on European

demand led the company to bankruptcy in 2000 (Bucheli, 2005b). Later, in 2007 the company was accused for financing right-wing paramilitary groups in Colombia. This case of internalisation of illegal political actors provided strong arguments to those opposing the company's operations (Teitelbaum, 2007; Chomsky, 2007). The company was doing this also in times of heated debate about the benefits and costs of globalization to underdeveloped countries. MNCs have been criticized in several fronts, from first world 'nativists', to the Latin American 'New Left', to radical Islam, in times in which these corporations are increasing their operations in the primary sector due to an unprecedented rise in the price of primary goods. The whole world is being affected by the politics of this process, so a deeper understanding of the long-term evolution of the political economy of MNCs operations in underdeveloped countries can shed us lights of the processes taking place in the early twenty-first century.

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Table I: Exports of bananas as a percentage of total exports

	Costa Rica	Guatemala	Honduras
1913	50.9	5.7	50.1
1929	25	12.9	84.9
1955	41	18	50
1960	26	11	43

Sources: Arthur, Houck, and Beckford (1968, p. 46), Bulmer-Thomas (1987, p. 58), May and Plaza (1958, p. 76).

Table II: Percentage of banana exports exported to the United States

	Costa Rica	Guatemala	Honduras
1931	65	70	73
1935	100	97	71
1940	100	100	99
1945	89	89	88
1950	75	70	85
1955	67	67	79
1961	93	65	95

Source: Calculations made with information from Bulmer-Thomas (1987), Ellis (1983).

Table III: Percentage of exports to the United States of total exports (selected years)

	Costa Rica	Honduras	Guatemala
1920	65	-	83
1925	43	43	52
1930	29.7	50	40
1935	36.3	29	54
1940	-	-	91
1945	-	36	48
1950	44.6	22	71
1955	54	61	59
1960	52	57	55
1965	50	58	30
1970	42	52	25
1975	42	48	30

Source: calculations made with information from Oxford Latin American Economic History Database; Mitchell, B. R. (1998); United Kingdom (1938).

Table IV: National Executives and political transitions

**Guatemala**

<b>President</b>	<b>Years in office</b>	<b>Form of succession</b>
José Reina	1892-1898	Assassinated
Manuel Estrada Cabrera	1898-1920	Overthrown
Carlos Herrera	1920	Overthrown
General José Orellana	1921-26	Died of illness
General Lazaro Chacón	1926-30	Died of illness
Baudilio Palma	12-16 December 1930	Overthrown
General Manuel Orellana	31-Dec-30	Resigned
José Reina	31 December 1930- 14 February 1931	Resigned
General Jorge Ubico	1931-1944	Resigned
General Federico Ponce	July- October 1944	Overthrown
Military Provisional Junta	1944-1945	Concluded term with elections
Juan Arevalo	1945-50	Served electoral term in office
Jacobo Arbenz	1950-54	Overthrown
Colonel Carlos Castillo	1954-57	Assassinated
Luis González	July- October 1957	Resigned
Guillermo Flores	1957-1958	Concluded term with elections
General Miguel Ydigoras	1958-63	Overthrown
Colonel Enrique Peralta	1963-65	Concluded term with elections
Julio Mendez	1966-70	Served electoral term in office
Colonel Carlos Arana	1970-74	Served electoral term in office
General Eugenio Kjell	1974-78	Served electoral term in office
General Romeo Lucas	1978-82	Overthrown

## Honduras

<b>President</b>	<b>Years in office</b>	<b>Form of succession</b>
Manuel Bonilla	1903-07	Overthrown
Miguel Davila	1907-11	Overthrown
Francisco Bertrand	1911-12	Concluded term with elections
Manuel Bonilla	1912-13	Died of natural causes
Francisco Bertrand	1913-19	Overthrown
Francisco Bogran	1919-20	Concluded term with elections
Rafael López	1920-24	Overthrown
Vicente Tosta	1924-25	Concluded term with elections
Miguel Paz	1925-29	Served electoral term in office
Vicente Mejía	1929-33	Served electoral term in office
Tiburcio Carías	1933-49	Resigned
Juan Galvez	1949-54	Overthrown
Juan Lozano	1954-56	Overthrown
Roque Rodríguez	1956-57	Concluded term with elections
Ramón Villeda	1957-63	Overthrown
Oswaldo López Arellano	1963-71	Concluded term with elections
Ramón Cruz	1971-72	Overthrown
Oswaldo López Arellano	1972-75	Resigned

## Costa Rica

<b>President</b>	<b>Years in office</b>	<b>Form of succession</b>
Ascención Esquivel	1902-06	Served electoral term in office
Cleto González	1906-10	Served electoral term in office
Ricardo Jiménez	1910-14	Served electoral term in office
Alfredo González	1914-17	Overthrown
Federico Tinoco	1917-19	Overthrown (popular revolt)
Francisco Aguilar	1919-20	Resigned
Julio Acosta	1920-24	Served electoral term in office
Ricardo Jiménez	1924-28	Served electoral term in office
Cleto González	1928-32	Served electoral term in office
Ricardo Jiménez	1932-36	Served electoral term in office
Leon Cortés	1936-40	Served electoral term in office
Rafael Calderon	1940-44	Served electoral term in office
Teodoro Picado	1944-48	Overthrown
José Figueres (junta)	1948-49	Concluded term with elections
Otilio Ulate	1949-53	Served electoral term in office
José Figueres	1953-58	Served electoral term in office
Mario Echandi	1958-62	Served electoral term in office

Sources: Adapted from Fauriol and Loser (1991), Busey (1961), Posas and Del Cid (1981).

Table V: Asset composition (Lands, Steamships, and railways as percentage of fixed assets)

	Lands/fixed assets (%)	Steamships/fixed assets (%)	Railways/fixed assets (%)
1900	78	2.5	9.7
1915	33	31	26
1920	18	24	22
1925	14.6	23	25
1930	16	22	17
1935	15	35	16
1940	14	18	19
1945	13	31	15
1950	9	18	15
1955	6	23	12.6
1960	2.3	42	7.8
1966	3	35	4

Source: Calculations made with information from United Fruit Company (various years).

Table VI: United Fruit banana land ownership in Latin America (selected years)

	Acres
1900	38,463
1915	128,827
1920	138,290
1925	172,262
1930	189,165
1935	121,036
1940	121,729
1945	116,214
1950	142,197
1955	145,846
1960	134,593
1967	74,837

Source: See table V.

Table VII: United Fruit Company: return on assets (selected years)

	Return on Assets
1900	6.8
1905	14
1910	30
1915	15.6
1920	15.5
1925	36.7
1930	6.1
1935	1.3
1940	8
1945	15.4
1950	12
1955	8.6
1960	0.64
1965	5
1969	5.8

Source: See table V.

Table VIII: Comparative yield on common stock. United Fruit vs. Top 200 companies traded in the NYSE

	Yield United Fruit	Yield Top 200	Issues highlighted as having a very significant impact on earnings in the Annual Reports
1946	3	3.95	
1947	3	4.38	
1948	7	5.98	
1949	7.9	6.62	Labor problems in Guatemala, Colombia, and Costa Rica decreased production and interrupted shipments
1950	6.2	6.27	
1951	7	6.12	Labor unrest in Guatemala plantations. The company has problems at solving the conflict.
1952	6.1	5.5	Slow recovery of the Guatemalan operations after the strike.
1953	6.9	5.49	Expropriation of some of the company's lands in Guatemala under Jacobo Arbenz. UFCo reports problems in the negotiations.
1954	6.5	4.75	The US Department of Justice files an anti-trust suit against UFCo.  The company faced a ten-week strike in Honduras.
1955	5.4	4.06	Big losses for weather problems.
1956	6	4.07	Heavy windstorms provoke new losses.
1957	6.8	4.33	The company losses a lawsuit from a group of IRCA's shareholders.
1958	6.2	4.05	The company announces the change of banana from Gros Michel to Cavendish to decrease potential losses from windstorms and Panama Disease.
1959	4.1	3.31	Conflict with the Costa Rican new government for a "discriminatory" new labor legislation. Followed by big strike in the fields.  The Cuban Agrarian Reform Law made the company's lands subject to expropriation

			.The company is pessimistic.
1960	1.8	3.6	UFCo announces a long-term plan to restructure the company that includes a much larger role of the associate producers.
1961	1.3	3.07	The company reports no labor problems parallel to the larger participation of associate producers.
1962	2.5	3.37	Losses due to windstorms.
1963	2.4	3.17	
1964	2.9	3	
1965	5.1	3.06	UFCo announces that it will lose about 15% of its gross revenue when the anti-trust legislation consent is implemented.
1966	1.2	3.57	
1967	2.1	3.35	
1968	2.3	3.25	
1969	2.6	3.42	

Sources: United Fruit Company (various years), *Wall Street Journal* (various issues), Moody's Investors Service (various years).