México, D. F., August 27, 1956

Dear Jimmy:

You asked me for some observations about I.E.M., which I am very glad to give you. I can give you a pretty good picture of the background of the company and of certain developments and of some aspects of the present situation and prospects, but I am not in this letter going into the financial reorganization of the company which took place I believe during the last year. Any information which you may want concerning the financial structure of I.E.M. I think you can get from the annual report, which should be available to you through Kuhn, Loeb & Company in New York or through Westinghouse International in New York.

First a bit of general background. I think that I.E.M. was originally a Mexican conception and of people within the government with the idea that Mexico should do something towards producing certain types of electrical equipment. I do not recall just when the first steps were taken towards the organization of I.E.M., but they must have been in 1941 or 1942. When I came here in 1942 as Ambassador, the plans for I.E.M. had already been made and they were, as you know, on a considerable scale and far beyond the needs of the Mexican economy for the articles which it could reasonably be expected to produce in the normal process of development of a company of that kind. From the beginning the Mexicans I believe were mostly in the government who desired the establishment of such a plant and they realized that they would need the collaboration of foreign techniques, if not foreign capital. They entered into conversations with the Westinghouse in the United States and the net result of these conversations was that Westinghouse agreed to let I.E.M. use its patents and processes and its name for certain products, and would supply certain technical skills. The original agreement of I.E.M. with Westinghouse provided only for the use of the patents and the supplying of skills, including perhaps certain administrative people who might be necessary, especially those experienced in factory operation and production. For its services Westinghouse was to receive a certain amount of the common stock of the company, for which it paid nothing. In other words, originally...
Westinghouse had no investment in I.E.M. in money, but it did have a good deal of investment in I.E.M. through the permitting of the use of its name for certain products which from the point of view of the reputation of Westinghouse was naturally most important. The original capital came almost entirely from the Mexican government through the Nacional Financiera.

At the time that I arrived in Mexico in 1942 this project and the plant, which was already under construction, were a matter of concern to the Embassy. In the first place, in those days we were naturally interested in reducing the demand on the United States for imports, so as to ease the strains on our own war economy. We were interested that things should keep going in Mexico and that production should increase in general rather than decrease as a result of the restrictions on exports, which was inevitable during the war. We had to follow the whole project in the Embassy very closely because a great deal of the equipment, if not all, came from the United States and much of it was in the way of lathes and similar equipment, which of course was in short supply. Our policy, however, on the part of our government and of the Embassy was to do everything we could to facilitate the construction and putting into operation of the plant for the reasons above mentioned.

We had our fingers very much crossed from the beginning because we knew that users of equipment which would eventually be produced by I.E.M. would be under considerable pressure to buy from I.E.M. rather than from the United States, and because the plant was originally conceived and constructed on too large a scale it was quite obvious that the costs of production would be high and higher than in the United States, in spite of certain cheaper factors here. I think the blame for putting up I.E.M. on too big a scale at the outset is about equally divided between the Americans and the Mexicans. You know that our Mexican friends always like to go into things in a big way and in some ways are not realistic, but in this particular case I think that it was Westinghouse who was as much responsible for the scale on which the plant was established as the Mexicans. In any event, the plant was put up which was about four times the size of what could be used during the first four or five years of the operation of the plant, and this meant very considerable handicap in the way of overhead from the very outset.

As the Mexicans had practically no experience in the manufacture of this type of electrical equipment, you will remember that White, who was formerly a President of Westinghouse International, was appointed General Manager and I believe he was also President of I.E.M. White was a salesman all his life rather than a factory manager or production expert. From the very outset his management of I.E.M. was not to the advantage of the company. He was a man of very extravagant ideas and was very unrealistic and he made the Mexicans believe that there were many things that they could do in a few years which it was quite obviously impossible for them to do for years to come. From the very beginning the Banco Nacional de Mexico was one of the private interests which took a direct participation in I.E.M. and don Luis Legorreta, the head of the Banco Nacional, was very much interested in the company. You may recall that I told you of a conversation which took place while you were in Mexico here with us, which conversation took place between Maryssael and myself and don Luis Legorreta and White. In that conversation White told Legorreta and told us that within two years I.E.M. would be able to produce turbines and generators of any size which Mexlight or the Federal Power Commission or the other electricity producers in Mexico could need. This was only one of the many extravagant and completely unrealistic statements which he made and it was in that conversation that I
spoke very frankly and said that while Mexlight wanted to collaborate with I.E.M.
in making purchases as much as it possibly could, it had to make it clear that we
had to operate and buy on the basis of price, quality and deliveries, and that as
we saw it the program of I.E.M. would have to gradually develop and that it would
be many years, indeed many years, before it would be desirable or possible even
to build small generators, not to speak of good sized ones. There is little doubt
but that as a result of these extravagant attitudes taken by White that the
Nacional Financiera and the Banco Nacional de Mexico and others interested in
I.E.M. lost their faith in White and found that it was necessary to change the
management. During those days Maryssael and I and our engineers made many trips
to I.E.M. We followed a policy in the company of helping to develop production
of various items in I.E.M. Although the factory worked under great difficulties
because of its heavy overhead and high costs and basically unwieldy financial
structure, through the assistance which Nikiforoff and Del Buste and Jennings
and others of our engineers were able to give to their people, and with the aid
of the Westinghouse people sent from the United States, the factory was able to
get into the production of small transformers and this program has been gradual-
ly developed until they are now building fairly good sized transformers.

We were from the outset the principal customer of I.E.M. The next most
important customer was the Federal Power Commission. The Impulsora did not buy
very much; as you know they were not doing anything in the way of new construc-
tion during those years. From the outset the factory was designed to produce cer-
tain electrical equipment for general household use and they entered into the con-
struction of freezing machines and cooling machines and certain types of household
equipment. The business went very badly and always at a loss. Af

After White’s forced resignation as President and General Manager of
I.E.M., the Mexican government and Westinghouse took a more realistic attitude,
but they could not overcome the cumbersome and too-great heavy financial struc-
ture under which they were obliged to operate. It was quite obvious that before
I.E.M. could really get into a competitive position, not to speak of making any
money, it would be necessary that a complete financial reorganization of the company
would have to take place. Before this, however, the operation was carried through
by Kuhn, Loeb and Company for the listing of the I.E.M. stock and the issuance of
new stock. I do not go into that phase of the matter but you will recall that the
stock was sold at a price which was obviously too high under the circumstances,
with the result that within a year it had dropped to I believe less than half the
value for which it had been sold. As the I.E.M. became quite a burden on the
Nacional Financiera, and the Mexican government, it was quite obvious that some-
ting had to be done, and about a year ago I think it was that under the pressure
of Carrillo Flores and of Luis Legorreta, something was done to try to improve the
situation. I do not have the details of the financial reorganization. I think
you can get those by comparing some of the old reports with the last report of
I.E.M. and you may be able to get details from the Westinghouse company and Kuhn,
Loeb and Company. If you are not able to get them up there, I will endeavor to
secure them here, but I would frankly prefer not to have it known that I was
going into that aspect of I.E.M.’s problems. Their reorganization took place and
it is my understanding that under this reorganization I.E.M. has taken a 25% stock
interest in the company and has put up some cash. Just as important, however, as
was the reorganization of the capital structure, were the changes involved in
management. Alatorre, a Mexican who was head of the company, was retained and he
is a relatively good man. As a matter of fact, I think that he is a good man.
He of course knows little about factory management and techniques except what he
has been able to learn since his association with I.E.M. A man by the name of
Danforth, who was formerly the manager of the General Electric production operations in Mexico, has been taken into I.E.M. and is now in charge of the I.E.M. factory here and of production methods. They have established under him systems of line production somewhat approximating methods in our factories in the United States, and this has already brought about a considerable reduction in manufacturing costs in the plant. Danforth is a good man and I think he has absolute charge of the production. The two men in our company who have followed the situation in I.E.M. are Nikiforoff and Del Busto, and more latterly Del Busto as he is the Chief Electrical Engineer of Mexlight. Both Nikiforoff and Del Busto and Jennings have been of a great deal of help in a technical way to I.E.M. during the years, and I think that this is appreciated by the people in I.E.M. and by certain people in the government. After receiving your letter I asked Del Busto how things were going in I.E.M. and he says that things are going very much better since the last reorganization which I have just mentioned. He says that this man Danforth is a very good man. He says there is no doubt that production costs under the new methods of factory operation have gone down. So far as the quality of the material which we buy from them is concerned, you know it is our policy to place trial orders and if the equipment comes out all right, we buy in larger quantities. It is my understanding from our company that the quality of the material produced in I.E.M. has steadily improved and the material, such as transformers, etc., which we have bought from them, has stood up. Del Busto tells me that he thinks the prospects of I.E.M. are a good deal better, but that of course the development of I.E.M. depends entirely upon the way things go in the general electricity picture in Mexico and on the government's policy, particularly towards the private companies.

You are quite right that the situation at I.E.M. depends very largely on what happens in companies like Mexlight and in the government policy towards the private companies in general. The demand for power is still growing now at about 10 1/2 to 11% a year instead of the 7% a year cumulative which we were experiencing when you were with us here. This increase in demand is tremendous, and if things go well in Mexico the demand will run I think around 10% for some years to come, although it will not keep up to 11 and 12% where it has been during the last 18 months. If the government does not follow a reasonable policy towards the electricity companies (private), it will not be able to raise the money for the Federal Power Commission out of its own resources and from private sources in Mexico. In other words, if the private companies are not put into a position where they can do their part of the job, the Federal Power Commission will not be able to do the job, and that means a general arresting of development in Mexico, and therefore a general arresting of the demand for electrical equipment. Just how that is going to come out I do not know. While the government has declared its policy in very firm ways publicly of supporting the private companies, in actual practice you know what difficulties the private companies are having, as are exemplified in the tariff increase which we so desperately need now at Mexlight and which was promised for October 1 last year and which is still not in effect. The electricity study which was undertaken by the government in collaboration with the World Bank some three years ago and on which all of us in the government and in the companies placed so much hope has apparently been completed, but I still do not know just what is in it and whether it will be published or not and made publicly available I do not know. On that point we should have some information within the next month. Even though the report may be published and even though the report may be favorable and sound, so far as the private companies are concerned, the report means nothing until it is implemented by law—
that is, by changes in the basic Electricity Law—and I do not see any such changes of a fundamental character being made during the present administration. It is the policy of the present administration to delay and delay and delay action about matters of this kind which are of such fundamental importance in the economy. Up to now the economy has been going forward on the sound bases laid down during the Avila Camacho and the Alemán regimes, so far as treatment of private business is concerned. This momentum will in due course run out unless the government by concrete acts carries into effect the policies which meant so much for Mexico. All this is still a good deal of a question mark at this time. I am personally inclined to believe that good sense will finally prevail but I am inclined to think that we are going into a more difficult period for the next few years rather than better times.

So far as Mexlight is concerned, you know we have to spend a good deal of money during the next years. Our program which we started with the World Bank loan, etc., is completed, and we are starting on a new program, the first step of which is the new additions to the Lechera plant. We estimate that in the next six or seven years, or perhaps six to eight years, Mexlight will have to spend about 230 to 250 dollars in dollars and pesos in new production and distribution facilities—that is, if we do what we should properly do in our area.

Whether we will be able to do this depends entirely on the policy of the government towards the private companies, which I see a little bit uncertain at this moment. The fact that some months ago the Apulco hydraulic concession which we wanted and were prepared to go ahead with was given to the Federal Power Commission has been taken as an indication in informed quarters here and in certain informed quarters in the United States as that the government is not really sticking to its policies of letting the private companies do the work which has to be done when they are able and willing to do it. Here Mexlight was ready to do the job, releasing funds of the government for use by the Power Commission in other areas but the Apulco concession, which is in our area, was given to the Federal Power Commission. Under the circumstances I do not think they can borrow any money from either the World Bank or the Ex-Im Bank or from anyone else for the Apulco project. Neither the World Bank nor the Export-Import Bank under their statutes and practices can lend to a government for government projects when private companies already established are willing and able to do jobs. I only mention the foregoing Apulco project because it is one of the things which gives one to doubt, and only one of the things which gives one to doubt what the real intentions of the government in the electricity industry are, so far as the private companies are concerned.

I do not know the present volume of business of I.E.M., but our orders run from 2 1/2 to 3 million pesos a month from them. I think we have been buying according to Del Busto, anywhere from 20 million pesos a year to 30 million pesos a year from I.E.M. I think the Federal Power Commission is a close second to this. Now that the American & Foreign are going to do some work, or say that they are going to do some work, it is likely that they will be buying more in Mexico in connection with their development programs and will of course be under the same necessity of buying certain things from I.E.M. that we in Mexlight have been. I would say that if the government's policy towards the private companies is not firmly established so that the electricity program can go forward in an adequate manner, the whole program of electrification will be slowed down tremendously because the Power Commission simply cannot get the money outside and there are limits to what the Mexican government can put into the Power Commission from its tax funds. I think in another two or three months we will see this electricity picture in Mexico a bit
more clearly. If the right policy is followed by the government towards the private companies, then the electricity program can go forward, and I think the prospects of I.E.M. are quite good.

If I were familiar with the details of the financial reorganization, I would perhaps be able to speak more definitely on this phase, but as I have already told you, I do not know these details and have not thought it wise to go into it myself here. I would not be surprised if in due course the I.E.M. may have to go through the wringer again, but if things go well here it is possible that this may be avoided and that they will be able to make some money. There are the imponderable factors, a few of which I have wished to point out, as well as the financial structure as it now is--itself.

The best that one can say of I.E.M. is that it is in a better position today than it has been at any time since it started.

I realize that in spite of the length of this letter it is still rather sketchy and what you are interested in is as accurate information as possible. One of the saving graces in the situation is that the Banco Nacional de Mexico is extremely interested in the project, because it has a very considerable financial interest in I.E.M. The Mexican government is increasingly interested because of the heavy financial participation of the Nacional Financiera in the company. Certainly the management is better, certainly the financial structure has been improved. Certainly the production methods have been improved. Certainly sounder basic policies are prevailing in the company. Because of the financial interests, which I understand is 25% in stock, of Westinghouse and the actual cash investment which they now have, they are following it more closely.

If there is any additional information which you think that I can give or get for you, please let me know. I have not asked anything of Draper or Maryssael in connection with your inquiry because I feel sure that Del Busto, who is in this practically daily contact with I.E.M. and who is the Chief Electrical Engineer of Mexlight, is more aware of the actual situation in I.E.M. than any of us. Certain financial data of course can only be secured from I.E.M. itself or from the Banco Nacional de Mexico or from Kuhn, Loeb and Company. To what degree the Westinghouse people and Kuhn, Loeb will be willing to be communicative, I do not know.

Hoping that these scattered observations may be of some use to you, and with all good wishes, believe me,

Cordially and faithfully yours,

George S. Messersmith

GSM/cbc