

Chapter 19

The Rationality of Dumping: The Case of Guatemala

Mauricio Garita

Rafael Landivar University, Guatemala

ABSTRACT

Central America is an interesting region for developing business, and its proximity to South and North America makes the isthmus a strategic region for growth. Guatemala is seen as an emerging economy with the capacity for growth and expansion. The cement industry is now one of the most competitive industries in Central America and has expanded to different countries in the region. However, this was not the case in 1999 when the Mexican Firm Cruz Azul entered via a price predation strategy into the Guatemalan market. Game theory demonstrates the advantage of price predation and the rational decision-making behind the strategy, and also demonstrates that a business smaller than its competitors can win a price predation battle by cooperating. The analysis is based on the dissertation by Garita (2008).

PRICE PREDATION

Price predation can be defined as the reduction of price that is only profitable based on the assumption the predator will be able to gain market share by eliminating or inhibiting competition of its rivals or potential rivals (Bolton, 2006). The reduction of price established by the price predator

can be lower than the cost of the product, therefore differentiating from dumping which establishes that the price is lower in the selling country than the country of origin. Price predation is a business strategy determined as a non-ethical strategy which seeks to vanquish the competition by reducing the price below cost thus making it impossible for the rivals to compete.

Guitinan (1996) defines price predation as an unreasonable reduction of price that is not profitable aiming to weaken, eliminate, or to block

DOI: 10.4018/978-1-4666-4745-9.ch019

the entry of a new rival. Concerning the definitions stated, price predation could be defined as an unreasonable financial strategy that seeks to gain market share to eliminate, inhibit, or block the entry of a new rival. The word unreasonable is based on the financial strategy that the predator establishes because it could be below total costs, variable costs, average costs, fixed costs, or sunk costs. Areeda-Turner (1975) explains that the predation often occurs on the average unitary production costs excluding fixed costs, which define that the equilibrium should be below the average variable cost.

Price predation can be viewed in two stages when analyzing the predation strategy: the predation stage and the post-predation stage. The predation stage is when the predator sells below some measure of economic cost with the intent of driving away competition from the market. The post-predation stage is when the competition has left the market and there is an absence of competition which causes *supra-competitive* level that recovers the losses incurred during the predation stage and secures the earnings of the monopolist thereafter (Weisman, 2006).

Figure 1 exemplifies the logic behind the predatory analysis and explains clearly the intentions of the predator. Before entry the predator had excess that provides the leverage of continuing with the predation process when the new competitor enters the market. The excess is utilized to maximize the predation strategy. It is important to consider that the predation is only effective if there are financial reserves to guarantee the predation strategy. If this does not occur, the predator can run out of financial arguments to sustain the strategy and could be end out of the market.

Hüschelrath (2003) established an analysis to measure predation based on the case of Lufthansa vs. Germania. The macroeconomic analysis established that in the first scenario there is a consumer surplus which assists the predator in the second stage – the predation period. The strategy explains that a monopolist has more le-

verage than a duopolistic market because there is a bigger surplus when there is only one industry in the market. The second scenario is when the competition enters the market (t entry), demonstrating that the predator will lower profits below the excess of a duopolistic market and will be competing under losses. The time for this strategy is not defined because the period where this strategy can be sustained depends on the excess that the predator had before entering the market.

The third scenario is when the competitor is expelled from the market and the market conditions return to monopolistic or duopolistic characteristics. The predator then arranges the prices in order to recuperate the lost profit and works again under excess. In this type of competition it is possible to maintain the same characteristics that were developed before the entry of the competitor.

Game Theory

Game theory can be analyzed under different perspectives, but the major objective theory is to define rational strategy. Stanford (2006) defines game theory according to the “Encyclopedia of Philosophy” as the study of strategic interactions between players based on different preferences which lead to different results. A second definition is the one offered by McMillan (1996) which states game theory is a rational analysis that has the purpose of understanding interdepending relations between players.

Game theory is a rational approach to decision-making that does not include judgments by the players. The players are the different actors in the situation analyzed that will have different decisions to choose. Game theory has to be understood by the definition of rationality defined by New Oxford American Dictionary (2012) as “the stage of choosing under a system or set of principles underlying the arrangements of elements in a computer or electronic device so as to perform a specified task.” McMillan (2006) explains that the rationality of a player has to be considered under

7 more pages are available in the full version of this document, which may be purchased using the "Add to Cart" button on the publisher's webpage:

www.igi-global.com/chapter/the-rationality-of-dumping/94107

Related Content

Why and How Did Health Economics Appear? Who Were the Main Authors? What is the Role of ITCs in its Development?

Ana Pinto Borges and Erika Laranjeira (2015). *Economics: Concepts, Methodologies, Tools, and Applications* (pp. 1382-1398).

www.irma-international.org/chapter/why-and-how-did-health-economics-appear-who-were-the-main-authors-what-is-the-role-of-itcs-in-its-development/128558

Inward and Outward Foreign Investments of the Asian Economies in Transition and India: Determinants of FDI and India's Prospects in CLMV

Ishita Ghosh and Sukalpa Chakrabarti (2016). *Global Perspectives on Trade Integration and Economies in Transition* (pp. 212-237).

www.irma-international.org/chapter/inward-and-outward-foreign-investments-of-the-asian-economies-in-transition-and-india/156971

To Spur Social Sustainability in the Pharmaceutical Supply Chain: A Literature Review

Adeel Shah, Musawir Ali Soomro, Urooj Nazir and Arham Khan (2022). *International Journal of Circular Economy and Waste Management* (pp. 1-35).

www.irma-international.org/article/to-spur-social-sustainability-in-the-pharmaceutical-supply-chain/309987

Evaluating the Nexus Between Honesty and Integrity in the Hospitality and Tourism Teaching Industry

Rekha Maitra and Tarun Bansal (2022). *International Journal of Circular Economy and Waste Management* (pp. 1-17).

www.irma-international.org/article/evaluating-the-nexus-between-honesty-and-integrity-in-the-hospitality-and-tourism-teaching-industry/306213

The Circular Economy, Resilience, and Digital Technology Deployment in the Mining and Mineral Industry

Peter Jones and Martin George Wynn (2021). *International Journal of Circular Economy and Waste Management* (pp. 16-32).

www.irma-international.org/article/the-circular-economy-resilience-and-digital-technology-deployment-in-the-mining-and-mineral-industry/271258