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Cement in Central America: Global players in a local industry

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ABSTRACT

This case discusses the origins of cement operations in Central America, and how Cemex, Holcim and Lafarge acquire these operations during 1994–2001. The case explains the manufacturing process of cement and discusses the main drivers of cost, together with data on prices, production and trade. During this period, prices rise significantly. Using case data, the reader can evaluate whether the contact of these firms across the region's national markets reduces their incentive to cut prices. If so, the expected increase in profitability may be a source of the value added for multinational investment.

1. Introduction

In the mid-1990s, the production of cement becomes increasingly concentrated as major global players pick up the pace of their international acquisitions in Eastern Europe, Asia and Latin America. By 2006, Holcim, Cemex and Lafarge control almost the entire 8.8 million metric tons of cement production in Central America. The impact of these new players on the regional market is not clear.

Consumers complain about frequent price increases. “The first week of January, I was told that three bags of cement would cost ¢ 9480; three weeks later I had to pay ¢600 more” complains Luis Alfaro, a resident of Cartago, Costa Rica (Navarro, 2005). At the other extreme of the consumption spectrum, the Panama Canal Authority, in a study for the third set of locks, considers cement prices one of the important factors that could lead to cost overruns (ACP, 2006).

According to cement industry associations, firms simply pass on higher input costs, particularly the costs of energy. Erasmo Barahona, the former president of the Honduran Construction Bureau, disagrees: “There is an oligopoly where firms agree to fix prices and supply certain zones” (López, 2006). A report of the United Nations states that “In countries where the multinationals coexist they compete but not on prices” (Schatan & Avalos, 2003).

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2. History

2.1. The origins of the industry in Central America

Holcim, Cemex and Lafarge, currently the three major players in the global cement industry, originate to serve a national market. Holcim, or Holderbank until 2000, sets up operations in Switzerland in 1912, Lafarge starts in France in 1833, and Cemex begins in Mexico in 1906. Whereas Holcim expands to neighboring markets in the 1920s, Cemex does not venture outside Mexico until the 1990s. Overall, internationalization spreads slowly.

Central America follows the same pattern. The production of cement in Guatemala begins in 1901, at the Novella owned La Pedrera plant. The rest of the region depends on imported cement until the Canal Company starts operations in Nicaragua in 1940 with the backing of President Anastasio Somoza. In June, 1946, Cementos Panama starts operations in Quebrancha, Panama. Local entrepreneurs establish CESSA in El Salvador in 1949 and Cementos Honduras (Cenosa) in Honduras in 1958. In Costa Rica, Holderbank helps finance the INCSA plant, near Cartago, in the 1960s, as part of its early expansion to North and South America.

Over time, these companies invest in new capacity to accommodate greater demand. During the 1970s, several governments in Central and South America invest in “strategic” sectors, such as telecommunications, steel, electricity and cellulose, on the belief that the private sector serves their consumers poorly. In 1975 the government of Panama establishes Cementos Bayano. State-owned Cementos del Valle and Cementos del Pacífico go into operation in Costa Rica in 1978 and 1980, while the Honduran government starts Industria de Cemento Hondureña S.A. in the 1980s. The Nicaraguan firm Canal becomes a state enterprise after

Table 1
Multinational company operating data by segment.

	Cemex			Holcim			Lafarge		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
Net sales (million US$)	8149	15,321	18,249	10,657	14,774	19,175	17,095	18,910	22,315
Cement	5867	7201	8577	6927	9249	12,168	8069	9001	11,671
Concrete and aggregates	2282	8120	9672	3730	5525	7007	5624	6373	8502
Operating income (million US$)	1852	2487	2945	1815	2653	3508	2456	2649	3534
Cement	1648	1791	2111	1525	2209	3066	1782	1989	2549
Concrete and aggregates	204	696	834	290	444	442	398	448	719
Sales volume									
Cement (million metric tons)	65.8	80.6	85.7	102.1	110.6	140.7	119.0	123.0	132.0
Concrete (million m^3)	23.9	69.5	73.6	29.3	38.2	44.2	37.2	39.0	43.0

Sources: based on company financial reports (Cemex, 2007; Holcim, 2007; and Lafarge, 2007).

the Sandinista government nationalizes the company in 1979, and the same happens to Cementos Honduras in 1981.

Rivalry between these new state-owned firms and the private incumbents at times evolves in unexpected ways. The largest state firm in Costa Rica, Cementos del Pacífico (CEMPASA), begins operations in 1980, just as the economy enters a severe recession. This recession leads to a brutal price war with the existing private firm that only ends at the close of 1983 when the small state firm (CEMVA) shuts down. In 1984, state-owned CEMPASA and privately owned INCSA agree to share the Costa Rican market.

2.2. Multinational expansion to Central America

During the 1970s, while state-owned enterprises start operations in Central America, the cement industry worldwide continues a gradual process of internationalization. Holderbank makes its biggest move outside Europe when the company acquires plants in the U.S., where the industry remains fragmented due to government regulations and shows declining profits.

In the 1980s, Holderbank and Lafarge shift their investments to Europe and to the production of aggregates (sands and gravel) and ready-mix concrete. Cemex also focuses on these downstream activities and attempts to access the U.S. market from plants near the U.S.–Mexico border. In 1989, the U.S. imposes countervailing duties on Mexican cement imports, starting a long trade dispute that lasts until 2006.

Cemex does not invest outside Mexico until 1992. Only after Holderbank invests in Mexico in 1989 does Cemex acquire Valenciana and Sansón in Spain, a country the firm until then supplies through exports. Thereafter, international investment takes on steam and in 2000 Cemex becomes the largest producer in North America. During the Asian crisis, the three operators acquire plants at bargain prices in countries that have been growing rapidly. Shortly after, these companies start to consolidate their position in Central America.

Table 2
Multinational company operating data by region in 2006.

	Cemex	Holcim	Lafarge
Net sales ($m)	18,249	19,175	22,315
North America (incl Mexico)	7805	4416	4575
Latin America	1586	2940	1424
Europe	7495	6354	9807
Africa	705	1669	3503
Asia	346	3796	3006
Operating income (%)	16%	18%	16%
North America (incl Mexico)	28%	12%	13%
Latin America	22%	27%	15%
Europe	9%	18%	20%
Africa	19%	29%	15%
Asia	17%	15%	7%

Sources: based on company financial reports (Cemex, 2007; Holcim, 2007; and Lafarge, 2007).

From 1998 to 2001, Holcim expands its footprint in Central America, buying minority shares in Cementos de El Salvador CESSA in 1998 and Cementos Progreso of Guatemala in 2000. Holcim also enters a joint venture with Grupo Argos to buy Cementos Panama in 2000 and, in 1998, invests in a mill that starts producing cement in Nicaragua using imported clinker.

Cemex and Lafarge enter the region by acquiring state-owned plants. In 1994, Cemex takes control of the Panamanian company, Cementos Bayano. In 1996, it does the same with state facilities in the Dominican Republic and Colombia. In 1999, Cemex gains control of Cementos del Pacífico in Costa Rica through a tender offer. Then, in 2001, it leases the government owned plant of Canal. The third international player, Lafarge, enters Central America in 1998 when the company buys a controlling share of Incehsa from the military regime in power at that time in Honduras. Cemex completes its Central American footprint with the acquisition of Cementos Global in 2006.

Cemex's international expansion is remarkable, considering that just fifteen years before this company operated only in Mexico. Cemex develops distinctive advantages in information systems and communications that allow the company to guarantee the delivery of concrete within 20 min to some markets (Ghemawat & Matthews, 2004). In Mexico, Venezuela and Colombia, Cemex develops "*Construrama*", a program to help small and medium sized hardware stores improve their infrastructure and marketing practices.

Cemex also benefits from bold financial moves, such as raising capital in Spain rather than Mexico, where capital costs are higher. As Cemex acquires operations in countries with mismatched business cycles, it is able to stabilize its cash flows (Ghemawat & Matthews, 2004).

Cemex maintains strict control over its operations with daily reports on kiln operating metrics around the world. By mid-2007, the company becomes the world's largest producer of cement and related products

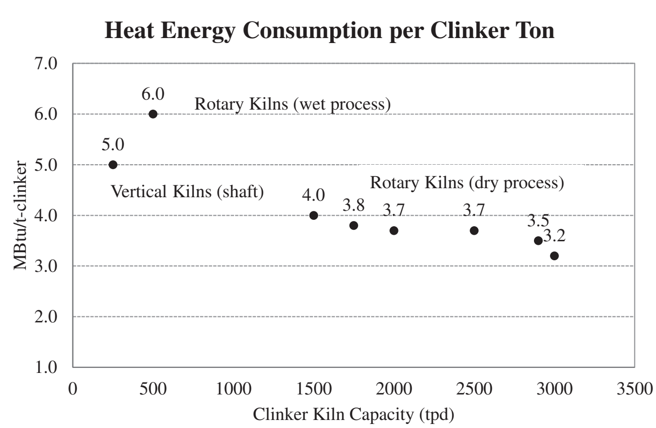

Fig. 1. Heat energy consumption per clinker ton. Source: based on Taylor et al. (2006); and Martin, Worell, & Price (2001).