

# Overview of tata steel pre merger



TATA Steel, earlier known as TISCO, is the iron and steel production company which is the flagship concern of the TATA group, India's largest private corporate group. Tata Steel was established by Indian Parsi Businessman Jamsetji Tata in 1907. As of 2005, TATA Steel was Asia's largest private sector steel company. The company was also recognized as the world's best steel producer by World Steel Dynamics in 2005.

Tata Steel has set an ambitious target to achieve a capacity of 30 million tonne by 2015. To this end it acquired Singapore based NatSteel in 2004 and acquired a 40% stake in Thailand based Millennium steel. Through these two acquisitions, TATA steel added about 3. 2 million tonne to its production capacity. As of 2006, TATA Steel had a production capacity of 5. 3 million tonnes. After the Corus acquisition (18. 2 million tonne), the net acquired capacity was 21. 4 million tonne, and TATA Steel plans to add another 29 million tonne by this route.

Thus we see that TATA Steel seems to have a definite strategy of increasing capacity through acquisition and is acting on it rapidly. At this point we will conduct a resource based analysis of this strategy. A resource based view of strategy emphasizes the internal resources of a company in the formulation of strategy in order to achieve a sustainable competitive advantage. The following model makes this process clear:-

## **Resources**

Resources are the input which an organization uses to carry out its activities. And yet organizations in the same industry might have similar resources but have differing performance, since they may utilize their resources differently.

**For a resource based view, Assets available to a business may be classified in the following form[1](Resources in management TRIZ, Business level):-**

## **TATA Steel**

### **Particulars**

#### **Pre Merger**

#### **Post Merger**

Tangible assets (in Rs. Crore)

Fixed assets

9865

11040

Current assets

2174

2332

Financial assets (in Rs. Crore)

Assets (cash)

288. 39

7681. 35

Net Worth

9755

14096

Intangible

Location

Jamshedpur

Jamshedpur

Size

World 56th largest

World 5th largest

Competition

None domestically

None domestically

Thus we can see that prior to the merger TATA Steel was a very large domestic steel player, in fact the largest in India. The location advantage conferred by the plant being in Jamshedpur was aptly put by Mr. Ratan Tata, who said that ‘ the owners of iron ore will be the rulers of the steel industry’. Its captive raw material resources and state of the art 5 million tonne plant at Jamshedpur gives it a competitive edge. This capacity is slated to go up to 7 million tonne. In addition, TATA steel has extremely good relations with the government in the region by virtue of its long standing developmental <https://assignbuster.com/overview-of-tata-steel-pre-merger/>

efforts in the region. As a result, TATA Steel has acquired a great deal of goodwill among the local population and consequently, the government. This is apparent in the Greenfield projects which the group is setting up in the region:-

6 million tonne plant in Orissa (India)

12 million tonne in Jharkhand (India)

## **Capabilities**

However, the best resources in themselves are of no real value to a company in and of themselves. The organization must have the capability to employ these resources properly. It is these distinctive capabilities of an organization's resources which result in a competitive advantage. But this advantage is sustainable only if this capability comes from some characteristic other firms do not possess.

TATA Steel is one of the lowest cost steel producers in the world. It is also one of the even fewer steel companies which are EVA positive. It has an operating profit margin of nearly 40%<sup>[2]</sup>(avg. = 16%). As an indication, only two manufacturers in USA (and none in India) have higher margins. At the same time, growth rate for sales was 232% and net income was 590%<sup>[3]</sup>.

Adding this information to its captive raw materials resources as explained previously, we can see that TATA Steel had a unique position as an extremely low cost steel producer in an extremely fast developing region of the world.

Tata Steel holds a very vital place in Indian business history, because it has introduced some of the unique concepts like 8-hour working days, leave with pay and pension system for the first time in India and the first player to start rapid industrialization process. In the later part, the concepts invented and implemented by the Tatas became law and compulsory practice for the Indian employees. A direct result of these employee friendly practices is the goodwill which TATA Steel enjoys among its workforce. In consequence, the Jamshedpur plant furnaces have never been closed down due to industrial strife.

Thus we can see the two major capabilities which enable TATA Steel to employ its resources effectively – extreme operating efficiency and employee friendly policy.

Another point of note is the extremely cash rich status of the organization even prior to the acquisition with an interest coverage ratio of 32, and a growth rate of 380% for net cash flow from operations.

## **Competitive advantage**

At this point we can clearly see the sources of competitive advantage for TATA Steel prior to the merger. Therefore let us examine its position in the market prior to the merger, with the Porter's five forces model.

### 1) Threat of entry of new competitors

The steel industry is one which has a very high entry barrier. In addition, established players already enjoy customer loyalty, and hence it will be

difficult for new players to gain market share. On the other hand, the sector promises high returns in future.

## 2) Intensity of competitive rivalry

In terms of price, quality and innovation TATA Steel had no domestic competition as of 2005-06. However, on a global scale, it was just so small in terms of volume that it could not bring into play the economies of scale of the truly major players.

## 3) Threat of substitute products

This threat is well nigh negligible with respect to steel.

## 4) Bargaining power of customers

The steel industry is one of periodic swings in demand. However, with an average growth rate of 7% expected in countries like India, China and Brazil in the foreseeable future, we can safely assume that price of steel will continue to rise. In fact, the price of steel has doubled over 2006-2008[4]. However, it is also accepted that consolidation in the steel industry will lead to stabilisation of world steel prices and higher bargaining power. This is necessary because the buyers are consolidating e. g. auto makers are consolidating with six to seven global majors.

## 5) Bargaining power of suppliers

The three major iron ore suppliers – CVRD, Rio Tinto and BHP Billiton have a 75% market share and 40% margins. Clearly, small players are at a distinct disadvantage.

## **Strategy**

In this context, let us examine the strategy of acquisition as proceeded upon by the TATA Steel management. First, TATA Steel had proximity to low cost iron ore, and the capability to take advantage of it. As a result, TATA Steel had acquired leadership status in the Indian market. In terms of the BCG Matrix, it would be considered a ‘star’. However, if it does not grow into the international it would, sooner rather than later, become a ‘cash cow’. In order to remain a star, it would have to grow its capacity and become a world major. However, before the Corus acquisition, it was only at 56th position in capacity.

In terms of the world market, TATA Steel would find market penetration in Europe or America extremely difficult. In addition, as explained via the Porter’s five forces model, steel producers are on the wrong side of the equation both with respect to the buyers as well as suppliers, who are well consolidated and hence in a position to dictate terms. Hence, it is necessary for global steel players to consolidate as well, and thereby acquire a position of strength. This would decrease price fluctuations and increase earnings multiples.

Hence, considering resources (cash, technology) present with the company, the competitive advantage it enjoyed (low cost, high margin) and the market conditions (consolidation), acquisition of some major manufacturer and jump into the big league was the only choice.



## **Strategic Decision Undertaken**

The strategic decision we will be considering for the purpose of this project is Tata Steels decision to acquire Corus and the how they went about the entire process. The reasons behind the takeover will be viewed in detail along with a resource based view of the resources so collated by the newly formed company now known as Tata Europe.

“ I really believe that the owners of iron ore are going to rule the industry. They will be OPEC of the steel industry.” (Ratan Tata’s interview to McKinsey Quarterly quoted by Wheatley in Financial Times, January 29, 2007). This statement made by Ratan Tata expresses in clear words the true reason behind the adoption of this strategy.

## **Corus- An overview**

Corus headquarter in London, Europe’s second largest producer of steel and the 9th largest in the world was founded in the October 1999 via a merger between two companies British Steel and Koninklijke Hoogovens. This merger was a result of the privatization of Steel producing companies by the U. K government. In the year 2005 its revenues stood at £9. 2 billion. Corus had a divisional structure which comprised the Strip Products division, the Long Products division, Aluminum Division and the Distribution & Building division. Corus’ customer base ranges across countries of the world and its core businesses include the manufacturing, development and allocation of steel & aluminum products as well as services. It has a diversified product & services portfolio which comprise manufacturing of electrical steel, narrow strip, plates, packaging steel, plated steel strip, semi-finished steel, tube products, wire rod and rail products and services and also design, technology

and consultancy services. To support this elaborate array of products & services, Corus employed about 42, 600 employees in sales & services centers across 40 countries. The main strength of the company lay in its international expertise with local customer service and its brand which stood for quality and strength

Through the period of 200 - 2006 Corus grew via a number of acquisitions which did add to its large pool of long term debts, but nevertheless it has a wide range of customer segments ranging from commercial and military aerospace ventures, the automotive, construction, engineering, defense and security, as well as the rail and shipbuilding industry.

Some of the Financial Information available in respect to Corus in the year 2005 has been put in annexure 1.

### **Acquisition Based Dynamic Capabilities**

Tata Steel has often used the Acquisition strategy to expand their products and markets or gain other advantages and have in most cases been good at it. Looking at this strategic decision from ' Acquisition Based Dynamic Capabilities' approach we find that over the years the Tata's have well groomed these capabilities into their system. There are three factors to consider here:

Acquisition Selection Capability- Tata steel was correct in timing the merger as it was due to emerging trends in the world steel industry with the increasing consolidation in the market. With a ' eat or be eaten' mentality it was essential for this strategy to be adopted in order to become the 5th largest producer of steel and give competition to post merger entities like <https://assignbuster.com/overview-of-tata-steel-pre-merger/>

Arcelor-Mittal etc. Also there would be multiple points of contact with their firms existing resources and those of Corus owing to the long list of synergies as listed in the following pages of the report.

**Acquisition Identification Capability-** The most appropriate target for the Tata's was definitely Crus as there was the horizontal integration with respect to the R &D capabilities that the Tata's were keenly interested in adding to their resource base. The Due Diligence was well carried out as though there were certain cultural issues in the way, the top management of the Tata's were fact to act in a manner to resolve the issues. Some of the steps they took involved retention of crucial executives of Corus to help in a smoother integration process and also aid in running the newly formed entity. Also the Tata's did not over pay for the deal as the market value of it exceed the price they paid, and the yearly savings expected from it were substantial. Apart from that they were able to gain access to wider distribution networks and newer markets.

**Acquisition Reconfiguration Capability-** This is one of the most crucial aspects which can determine the success of failure of a merger. It involves the acquirer to be able to merger its resources with the new ones acquired and do so in a productive and efficient manner in order to enhance the functioning of operations etc.

## **Tata Corus Merger**

Tata steel started the acquisition process in the year 2005 but since Corus had been involved in a number of its own acquisition processes the deal was finally closed with the acquisition of Corus on the 2nd April 2007 as per

official records. The price paid or the same was considered to be too high at an overwhelming \$12 billion out of which the Tata's financed the deal with only \$4 billion. This strategic decision undertaken by Tata Steel raised their rank from the 56th to being the 5th largest steel producing company in the world. In all fairness it is necessary to note that this acquisition did not come to the Tata with ease, as though the bidding started at 455pence per share, by the time the deal came to a close it had resulted in gaining a price of 608pence per share. This 33% hike in bidding rate was caused due to the emergence of another bidder, the Brazilian Steel maker Companhia Siderurgica Nacional (CSN).

#### The Counter Bids

The deal so made was a 100% acquisition and the newly formed entity now renamed Tata Europe is being run by one of the subsidiaries of Tata Steel. As Corus had been looking to make an exit, Tata's acquisition proved to be a profitable opportunity. The expected synergies deemed the deal to be beneficial for the Tata's as although some said that the Tata's overpaid, it was clearly communicated by the Tata's that they had paid much less than the replacement cost (market value) of all the assets they were able to acquire via this merger.

### **Reasons For This Merger Strategy- The Global Trends**

The Steel market in the world had been witnessing some very strong trends which called for such a merger. There are a series of mergers which happened in the world steel industry which include some of the following:

In 2004, Mittal bought International Steel Group, an American company which included assets of the previous Bethlehem Steel.

Mittal's merger with Arcelor (\$36.1 billion offer) in 2006 created the largest steel company in the world.

In October, 2006, Russian steelmaker Evraz Group bought Oregon Steel Mills of the U. S. for \$2.3 billion.

Nucor, the second largest US steel producer, acquired Harris Steel Group of Canada for \$1.07 billion in January 2007.

Severstal, the largest Russian steelmaker had invested \$800 million in a new plant in Mississippi and \$900 million in a plant near Detroit.

Essar Group of India has made a \$1.6 billion investment in Algoma Steel of Canada (2007) as well as \$4.65 billion offer to buy Minnesota Steel Industries.

On May 4, 2007, Swedish steelmaker, SSAB, made a \$7.7 billion cash offer to acquire Ipsco of Canada.

#### Global Steel Production in 2005

Hence we see that the environment of the steel industry was amenable to consolidation. There was a strong desire among key players to gain efficiencies resulting from steel production. Some of the reasons for such a trend towards acquisitions were:

Obtaining access to new and growing markets

Enhancing purchasing power with respect to suppliers and buyers

Growing economy of China and India during mid-2000s

Higher degree of price stability & better margins

Attractive to Investors

“ Eat or be eaten” mentality

A desire amongst the key players to gain efficiencies resulting from scale

Steel prices have been on an upward trend as can be seen in the following graph. This phenomenon started in the year 2004 and slowed down due to the economic crisis in 2009. But a great deal of volatility has been witnessed in the market and had been another major reason to consolidate so as to have a greater hold on the market dynamics. There was also lot of speculation in the market about China, the world’s largest producer of steel to increase its capacity resulting in a dip in world prices of steel. Growing economies like China and India did make up for a major demand for steel and to meet this requirement China was even importing steel from outside.

Following is the graph of 2006-2008:

Prior to the beginning of the deal negotiations, both Tata Steel and Corus were interested in entering into an M&A deal due to several reasons. The official press release issued by both the company stated that the combined entity will have a pro forma crude steel production of 27 million tons in 2007, with 84, 000 employees across four continents and a joint presence in 45 countries, which makes it a serious rival to other steel giants.

## **Post- Acquisition Scenario**

### **A Resource Based Perspective**

**Before**

**After**

EBITDA

13%

25%

Capacity

7 MTPA

25 MTPA

Position

56

6

## **Business Resources with sub-categories in Management-TRIZ**

### **Concrete Level**

#### **Business**

#### **Specific Level**

#### **Tangible Assets**

##### **Fixed Assets**

Assets: 23741. 48 cr

Cutting edge technology- providing metal solutions

Low cost upstream Tata facilities with high end downstream processing facilities of Corus

R&D facilities of Corus

#### **Intangible Assets**

##### **Human**

Distribution networks, Research and Development capability of Corus to be leveraged for Tata Steel's green field projects in Orissa, Bihar and Jharkand

#### **Finances**

##### **Capital, Obligations and Savings**

To finance the deal worth \$12 billion the following sources were used:

Equity by Tata Steel: \$ 3. 88 billion

Bank loans: \$ 8. 12 billion by Credit Suisse, ABN Amro and Deutsche Bank



Long term loans obligation to be paid by Corus' cash flows

### **Obligations:**

Total interest obligation: \$ 640 million to the already existing interest obligation of Corus amounting to \$ 400 million

Pension liabilities of Corus \$ 24 billion

### **Cost Synergies:**

Production cost \$ 710/ton which is far less than a green Field project which would cost around \$ 1200-1300 per ton

Savings of \$350 million per year through synergy

## **General Characteristics**

### **Location of Operation**

Main Center India; UK, Netherlands and South East Asia

### **Markets**

Innovative solutions to:

Construction, Packaging, Automotive, Aerospace

Energy, Engineering, Defense and Security, Consumer Products, Ship Building, Rail

Greater access to market and Significant presence in over 25 countries or regions

## **Products**

Bar & billet, Business services, Construction products & services, Electrical steels, Packaging steels, Plates, Plated steel strip, Pre-finished steels, Rail products & services, Sections, Semi finished steel, Specialty, Strip products, Support products, Tube Products, Wire Rod

## **Size**

Post Acquisition Sales Rs 8105. 30 cr

Production Capacity 26 million MTPA

## **Competition Position**

5th largest Steel Maker with a production capacity of about 26 Million Tons Per Annum

Strengthened position in construction, automotive and packaging construction sector

## **Management Resources with sub-categories in Management TRIZ:**

Concrete Level: Management

Specific Level:

Planning and Coordinating;

Strategic Planning- For the growth and globalization the route of acquisitions was taken up and the logic has been explained before. Post acquisition the top management of the acquired company was retained for effective integration of processes

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Operational Planning-. The Tata Steel and Corus operations were being run as one virtual company with performance improvement tasks being undertaken in each location. The aim was cross-fertilization of research, development of capabilities across functionalities and transfer of best practices from Europe to India.

Organization-

Company Operational Structure- 15-18 teams were formed with 3-4 members each with joint representation in teams to look at various synergistic avenues

## **Company Organizational Structure-**

### **Corus**

### **Tata Steel Integration Team- 7 members**

**Several Task Force Teams were also constituted for integration.**

## **Organization and Environment-**

Government and society- The acquisition had a very positive response from India, Indians felt patriotic towards this investment. In fact the Indian Trade and Commerce minister Kamal Nath commented that the global perception of India is now changing. This way the Indian government and society was quite supportive of the deal, in spite of critics commenting that the deal was over-priced. The historical ties between India and UK were also becoming stronger, Trade and Industry were looking up.

Markets- the Tata Steel stock attained a 52 week high of 721 on March 2007, showing positive investor response. S&P's credit rating also improved

## **Informal Organization**

Culture- Both the organizations had similar performance culture with respect to aspirational targets, safety and social responsibility, continuous improvement and openness and transparency. However, there were some cultural issues:

Inherent in the mind of the employees. Resentment of being governed and managed by a former British colony

Insecurity of production centers shifted out of the UK to low-cost centers. The labor unions in Europe raised their concern regarding this.

## **Other Characteristics**

### **Compensation mismatch**

18. 5 % employee expense (Corus)

7. 9 % employee expense (Tata Steel)

### **Recent developments:**

In 2010 Tata Group has announced that the name and logo of TATA Steel will be used use for Corus.

The transition also signifies that Tata Sons, which controls the use of the Tata brand, is satisfied that operations at Corus are now aligned with the characteristics of the Tata brand.

The workers understand this is a name change and also realize that the Tata board has been supportive of the employees.

It implies that synergies are being attained and that cultural integration is on the right path.

## **Leadership:**

Common organization values for Tata Steel and Corus:

Continues improvement program

Integrity, respect for individual and world class governance

Post- Acquisition:

The company had effectively retained the top management of the acquired company to facilitate effective integration and to take care of the above stated cultural issues of the employees. This move coupled with effective communication has instilled confidence amongst the employees

2010 – Current Executive committee which manages day to day operations of Tata Steel Europe (new name for Corus under Tata Steel)

## **Value Chain Perspective**

There were significant effects that were seen on some parts of the value chain post Tata's acquisition of Corus. As already detailed above, Tata saw Corus as a strategic acquisition and took some immediate and long term steps to make the acquisition a success.

**Operations:** This part of the value chain witnessed a saving of a whopping \$103 million in 2008 – 09 post the integration process. Performance Improvement Teams (PITs) in 15 different areas were identified. These teams engaged in various new cost related projects in the wake of the economic recession and reduced volumes. The most important project that the teams worked on was the use of low cost coal for coke production and recycling of steel plant waste.

**Marketing and Sales:** The acquisition of Corus gave Tata access to European markets in a very time efficient and cost efficient manner. Tata got access to the distribution network of Corus which was instrumental for its expansion in Europe. With the help of new capacity new products were introduced to cater to an expanding market in Europe. Post the acquisition, the company added flat products to Corus portfolio and thus strengthened Tata's position in the Automotive and consumer product segments. Tata globally became the 6th biggest player in the steel industry.

**Outbound Logistics:** This function of the integrated company has undergone significant computerization and has led to more efficient supply chain management. The IT teams of Tata Steel Europe (Erstwhile Corus) are working in coordination with the IT teams of Tata Steel India to strengthen the IT support to this vertical. Both are also working to create online visibility of the operational performance of the organization.

**Procurement:** This support function has seen significant cost savings driven by the increase in scale of the combined entity. Post the acquisition, Tata Steel Europe has appointed Lead Buyers for high value items and thus has

streamlined the processes to a large extent. Contracts have been renewed for these suppliers and a resultant savings of over \$40 million have been realized.

**Technology Development:** The acquisition has provided Tata access to the latest technology and state of the art Research and Development setup. Tata has always been known for its technological excellence amongst the Indian peers but Corus took it to international standards. Post this deal, the total R&D strength of the company has gone up to 1000 people. Process improvement teams have been set up leveraging the expertise of Corus for better process technologies. Through this R&D set up TSE (Tata Steel Europe) has been working with various strategic partners one of them being the UK ministry of Defense.

**Human Resource Management:** To increase efficiencies and in the wake of the economic downturn faced by the organization in FY 09, the company decided to cut its manpower costs by 20%. The target departments were IT, Finance and Human Resources. This undercutting was done through leveraging of Tata Steel Group's capabilities.

A Performance Improvement Committee was set up during the integration phase and it still is responsible for knowledge transfer across the organization and adapting of best practices, which has to a great extent to Tata Steel Europe.

**Firm Infrastructure:** Substantial steps have been taken in this regard in various departments such as finance, plants etc. This has been the pivotal point of addition in the value chain of the new company.

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Finance: Substantial expansion in the equity and debt resources was witnessed in order to acquire a big company as Corus. As the acquisition was essentially financed by raising substantial debt (\$7.3 billion), the gross debt of the Tata Steel group stood at \$10.54 billion in 2008 and increased to \$11.78 billion by close of 2009. Restructuring of the debt has been witnessed in the recent past but the debt equity ratio still stood at 1.65 as at the end of FY 2009 from a low of 0.06 in FY 2006.

Asset Restructuring, Integration and Divestment: With the acquisition of Corus, Tata Steel was the owner of an asset base that was thrice the size of the original Tata Steel and therefore was the need for integration of assets, divesting the obsolete assets and pairing down of overlapping assets.

Immediate steps taken included closure of 4 plants and mothballing of 2 plants out of the 15 plants of Corus group. The expansion of the hot strip mill capacity at Port Talbot to 4mt. is on the table; and a decision to restructure the Corus Engineering Steels has been taken. All of this was done under the 'Fit for Future' initiative undertaken at the merged company.

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