# TOP 5 BUSINESS TRENDS TO WATCH OUT FOR

**The growth of the steel industry in India has been marred by various regulatory and environmental hurdles apart from challenges posed by land acquisition delays and social opposition. But steel players are finding ways to expand their capacities as the demand for steel races in India – one of the fastest-growing economies of the world. With steel players implementing global best practices in their new projects, the long-term growth story of the Indian steel industry remains intact.**

As the world economy closely interlinks with businesses, India, as a country, cannot remain decoupled much longer from the global markets. Consequently, the developments in the global steel sector affect the market dynamics of the Indian steel sector. After witnessing the ramifications of the recent downturn in the global economy, Indian steel companies are now looking to become more proactive to counter any such adversity in the sector. The domestic steel industry is now more in sync with global activities prevalent in the sector as players have now formulated business plans after considering domestic as well international issues.

The following are the top five business trends in the steel industry in India:

## FOCUS ON THE DOMESTIC MARKET

**Growth opportunities galore**

India has emerged as the second-largest growing economy after China in 2011 with a GDP growth of 8.5 per cent. Industrialisation and a boom in economic activity have resulted in a robust demand for steel in the country. India emerged as the fourth-largest producer of crude steel in the world in 2010. As per the World Steel Association (WSA), India's finished steel consumption has grown at a compound annual growth rate (CAGR) of 9.4 per cent from 2004 to 2010.

As indicated in Figure 1, the per capita consumption for steel usage in India is low at 51.7kg as compared to the world per capita consumption of 202.7kg in 2010. This indicates that there is scope for significant development of the sector in India.

**End-use demand to remain robust**

The demand drivers for the steel industry in India are predominantly in the construction space, with 61 per cent of the total demand. Investment in infrastructure in the first three years of the 11th Five Year Plan has already surpassed the target of about US$245 bn. The government is aiming to allocate approximately US$1 trillion in infrastructure development in the 12th Five Year Plan (2012-2017).

Foreign auto-makers have set up shop in India to capitalise on the ongoing demand. This is likely to spur demand for automotive steel in India. With demand for the auto and white goods industries witnessing high growth in the recent years, companies have now started expanding capacities in the flat steel segment.

**India as a net importer of steel**

With inadequate supply to meet demand, India, from a net exporter of steel in 2006-07 has turned into a net importer. Realising the demand potential, steel players have set up capacity expansion plans. Foreign players have also entered into India to set up capacities post stagnation in developed markets. The global steel consumption CAGR growth, excluding India and China, has been nil from 2004 to 2010.

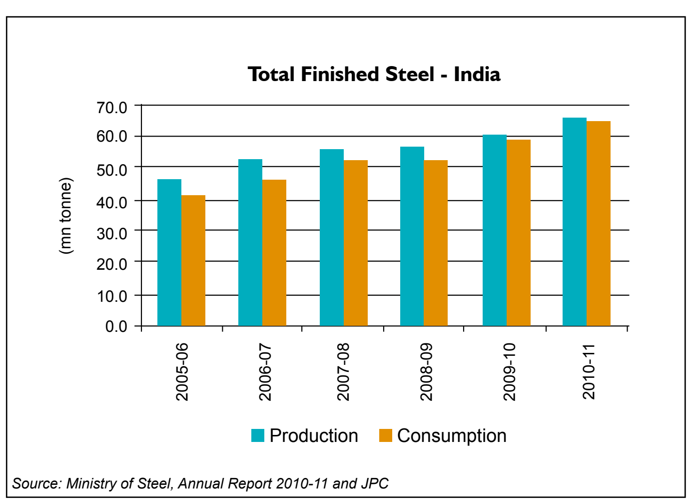


*Figure I: India's Total Finished Steel*

**India with the competitive advantage**

Apart from strong demand conditions acting as inducement to set up capacities in India, the country has abundant mineral resources, which are yet to be fully exploited, as well as young, cheap workforce of skilled and unskilled labour. A case in point is Tata Steel India. Although it is fully captive in iron ore and 50 per cent in coking coal, it remains one of lowest cost producers in the world and also impervious to volatility in commodity prices.

**Increase in rural penetration by expanding distribution network**

In order to push steel consumption in rural areas, a number of companies are expanding their distribution network. Essar Steel, under the brand name Essar Hypermart, has set up one of the largest retail chains for steel. It offers customised services to original equipment manufacturers (OEMs), small and medium enterprises (SMEs) and retailers. SAIL, as on January 2011, had 2,579 dealers in 630 districts against 200 dealers in 2006. JSW Steel, too, in order to make the most of the demand in semi-urban and rural areas has expanded its distribution points. From 50 in 2008-09, JSW Shoppe has 280 outlets as of March 2011.

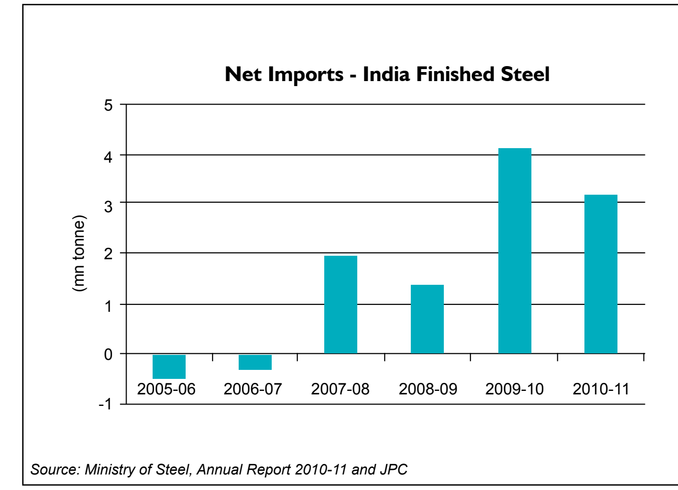


*Figure 2: Net Imports of India's Finished Steel*

## ALLIANCES WITH GLOBAL PEERS

A number of joint ventures (JVs) have been announced between Indian steel players and their global counterparts. Developed markets have stagnated over the years, while emerging markets, such as India and China, have showcased strong growth numbers. As per WSA, India's finished steel consumption has grown at CAGR of 9.4 per cent from 2004 to 2010, while the world consumption growth has been 4.6 per cent for the same period. Global players are optimistic about the domestic consumption story in India and are looking to gain a foothold in India by setting up integrated greenfield plants notwithstanding the current slowdown in the economy, which hopefully is a temporary blip.

With greenfield projects for companies such as POSCO and Arcelor Mittal stuck, other global counterparts have signed strategic alliances with local players and are in talks to jointly set up facilities in India. Arcelor Mittal and JFE Steel have acquired stake in Uttam Steel and JSW Steel, respectively. It is a win-win situation for Indian steel players, as strategic alliances with global peers – Tata Steel India-Nippon, JSW-JFE and Bhushan-Sumitomo – will provide them access to the latest technologies that will enable them to produce high-end value-added steel. A number of global auto majors have set up operations in India, which, in turn, should result in demand for auto-grade steel.

**The goals set by the Indian Government to grow the steel sector are encouraging and are reflected in the number of Memorandum of Understandings (MOUs) the central and state governments have signed for greenfield projects. Steel growth has a direct correlation with the GDP growth of a country and as a basic industry it propels downstream industrialisation as well and hence it is expected to remain the key sector for the Government.**

## STRENGTHENING THE BALANCE SHEET

During the meltdown in the late 2008-09, Indian players were plagued with low volumes, increased interest costs and declining steel prices with costs remaining high, all of which ultimately resulted in low profitability. As economic activity rebounded from its lows in 2010, Indian companies took advantage of strong capital market flows and raised funds through equity dilution. Hence, balance sheets became stronger as leverage was brought down and high-cost debt was refinanced.

Companies have earmarked funds for further expansion in steel as well as to scout for mining assets. PSUs such as MOIL and Coal India have released their initial public offerings (IPOs) as part of the government divestment programme. SAIL is likely to come out with a Follow-on Public Offer (FPO) in this fiscal year. Tata Steel after raising ₹34.7 bn in FPO in January 2011 had raised ₹15 bn in March 2011 through perpetual hybrid securities, perpetual in nature with no maturity or redemption and callable only at the option of the company. Such instruments are common in Europe and the US. We can now expect them to gain prominence in Asia as well.

## BACKWARD INTEGRATION FOR RAW MATERIAL SECURITY

Mine production in India and the world has not kept pace with the rise in steel production. Unlike steel, which is a largely fragmented industry, the mining industry globally is being dominated by select players, who enjoy an upper hand in bargaining for pricing contracts. India is self-reliant in iron ore and is the net exporter of iron ore with at least 80 per cent exported to China, whereas coking coal is imported by most steel players. The sharp volatility in iron ore and coking coal prices has made it difficult for steel players to make their business plans. In the recent past, a sharp increase in inputs has resulted in a severe decline in company margins. The cost of iron ore from captive mine is approximately US$30-40 per tonne, while the prevailing spot price in the market is US$150-160 per tonne. This entails cost savings of approximately US$160 per tonne of steel production for a player fully captive in iron ore. So, while companies are expanding their steel capacities – both greenfield and brownfield – they are also looking to simultaneously increase their backward integration.

Mine allocation in India is long and cumbersome as it is a multi-stage procedure required to avail clearances from both, the state and the Centre. It takes anywhere between three and seven years to complete the entire process and begin mining. Thus, apart from mine acquisitions, companies are employing best practices to increase exploration activities in their existing mines.

Like all countries rich in natural resources, India is also in the midst of coming out with a new mining bill, which is likely to ease procedural delays and facilitate mine development and investment in the country. Local steel players have shown intent in acquiring mineral resource assets abroad given that mining assets are difficult to come by domestically. JSW Steel has purchased mines in Chile, Mozambique and the US, while Tata Steel has mining interests in Mozambique, Canada and Australia. An interesting development is that pure play iron ore mining companies such as Sesa Goa and NMDC have shown intent of diversifying into steel production.

**FACT**

The Indian steel industry is expected to experience robust growth, as long-term positive indicators (such as strong demand from key end-use sectors and iron ore availability) exceed challenges (such as land allotment issues, shortage of coking coal and environmental clearances).

## INVESTMENTS TOWARDS ENVIRONMENT CONSERVATION AND LAND ACQUISITION

As mentioned earlier, new mine allocation is a long-drawn tedious process owing to delays in securing forest and environment clearances. Apart from that, land acquisition has been a critical reason for delays in projects in India. Lack of clarity on land records, deed titles, resistance from locals and opposition from environmental activists are the roadblocks. A case in point is POSCO's US$12-bn proposed investment in Orissa.

The Centre is in the process of drafting a new Land Acquisition Bill that aims to allay all concerns & hindrances and provide realistic compensation to the affected parties. The Environment Ministry, which had earlier put many industrial projects on hold, has now softened its stand. Some projects are likely to be granted conditional clearances with riders. Thus, companies will have to adhere to these norms and amend their investment plans accordingly.

Carbon emission norms are also becoming stringent, thereby forcing companies to invest in technologies that will curtail emissions to acceptance limits. Globally, steel companies are already open to adopt environment-friendly technology as carbon costs are expected to rise. The UK Government has proposed to introduce the carbon floor price for power generation from April 2013. The floor price will start from GB£16 per tonne of carbon dioxide and rise linearly to GB£30 per tonne in 2020. This proposal is aggressively contested by the steel industry as this additional cost will make plants economically unviable in the UK.

## THE NEXT MOVE

Although presently the Indian steel industry is witnessing slow demand, the long-term story remains intact. With steel players implementing global best practices in their new projects, the focus has shifted to manufacture environment-friendly specialised steel products. Further, reforms in land acquisition and the proposed mining bill are likely to remove impediments to development of the steel industry in India. ■

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