



Strategic Management in the Dark Period: Lessons from the Steel Industry

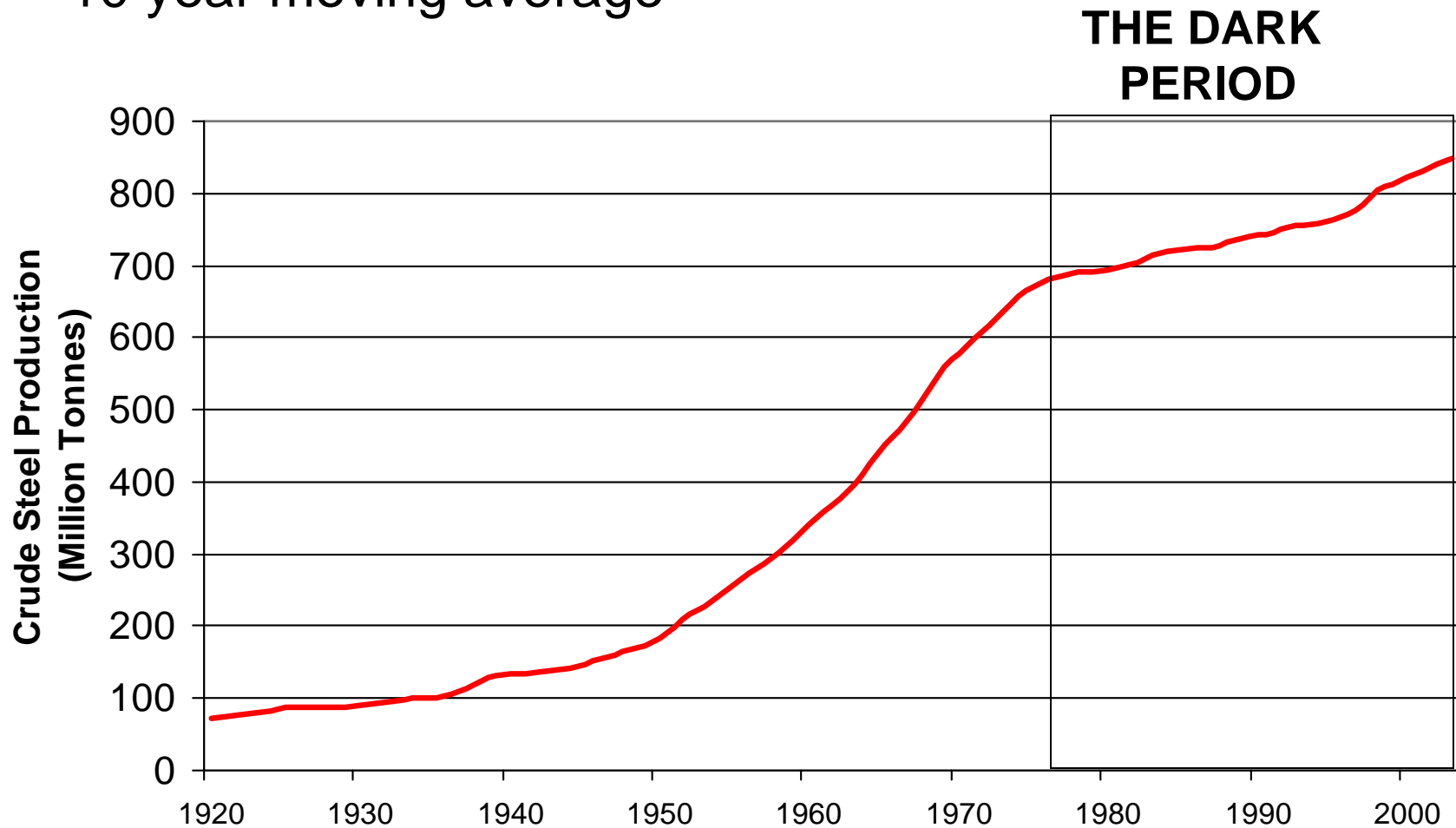
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Joint Leadership Conference

June 29, 2004



Global steel market

10 year moving average





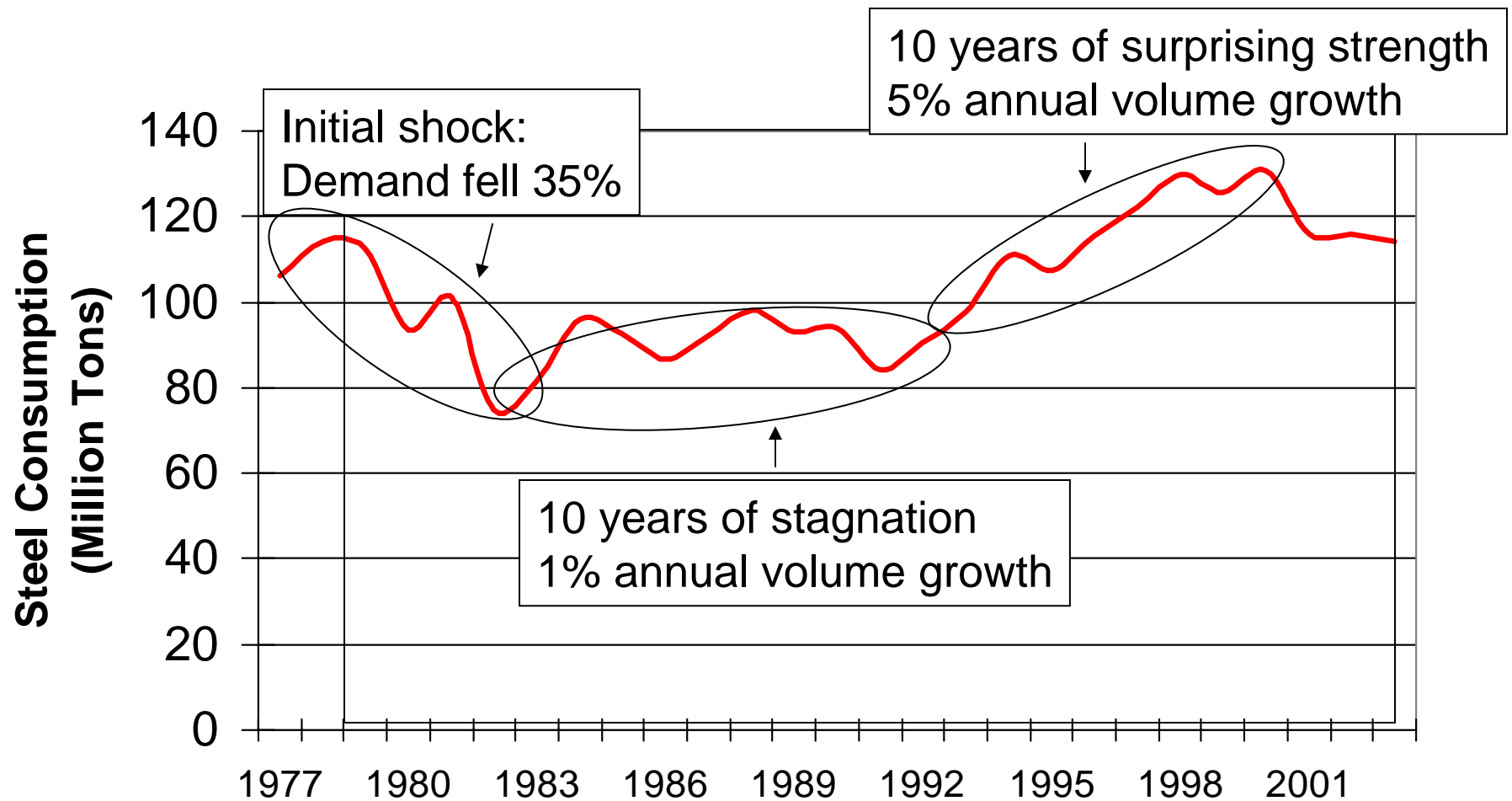
Managing in the dark period

Goal: Survival

- Global stagnation
- Significant capacity closure in developed world
- Global overcapacity (despite closures)
- Significant growth in steel trade
- Declining prices
- Abominable returns on capital
- Multiple periods of bankruptcies & restructurings
- Massive privatization of assets
- Governments attempted to “mitigate social impact”

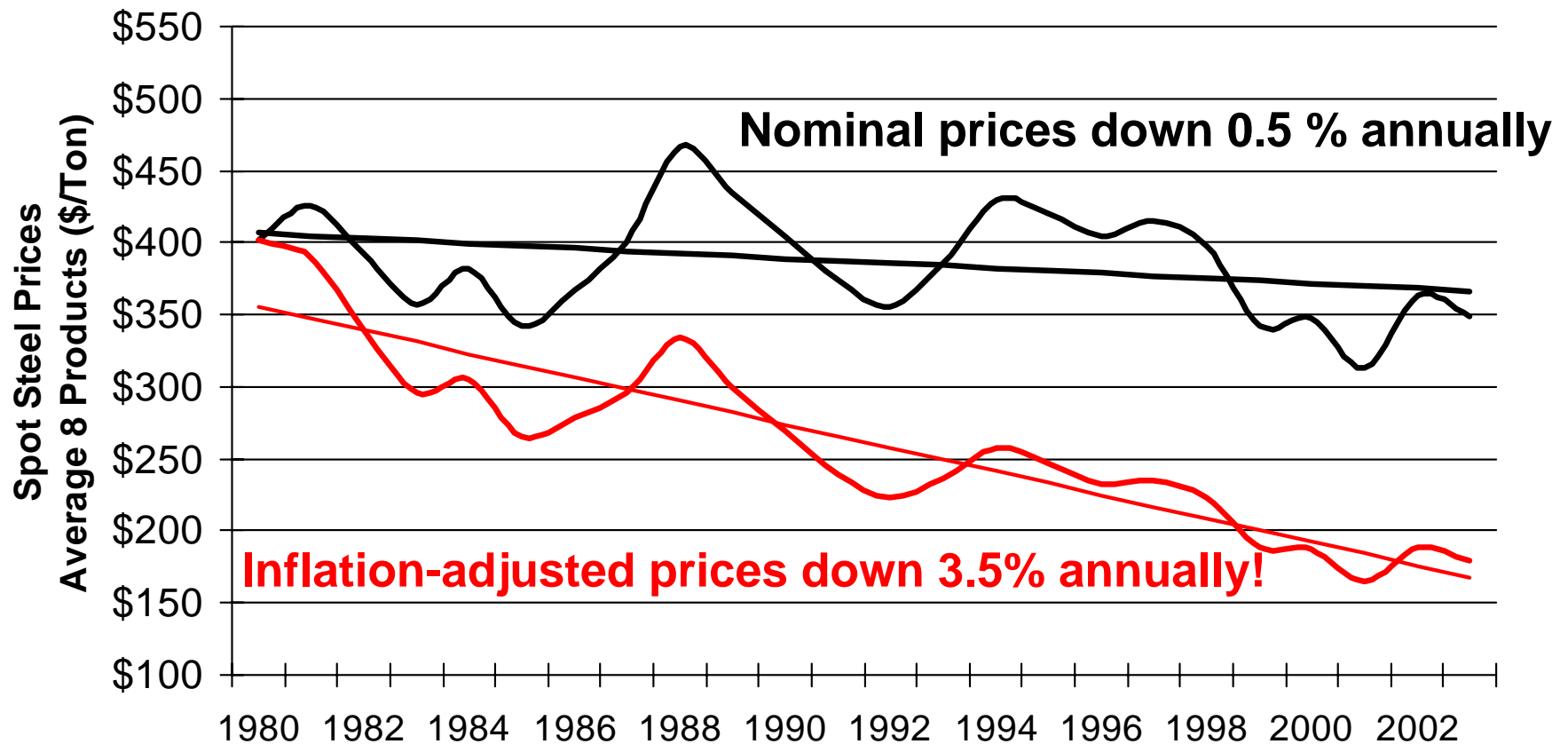


US steel demand – not that bad



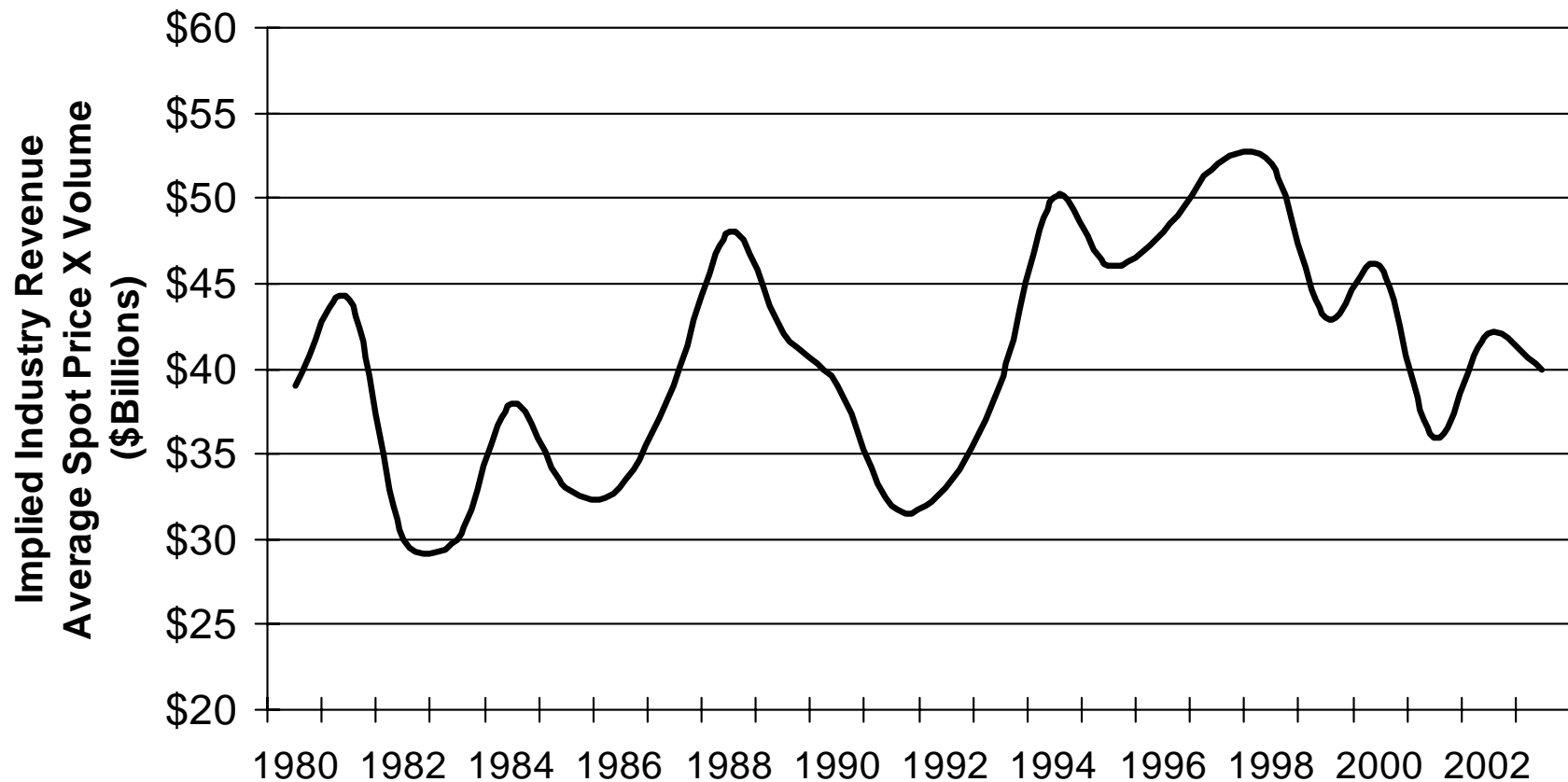


US steel prices – not that good





Aggregate industry revenue – very cyclical





How did the industry fare during the dark period?

Depends on how we define “the industry”:

- Incumbents (integrated, big steel) → Not well
 - Downsized, limped along, ultimately restructured & consolidated
- New players (minimills, processors) → Pretty well
 - Grew, gained market share, ultimately became the industry
- The US industry → Survived
 - Reinvented itself through creative destruction



Managerial Response #1: Reorient

But not pursued very aggressively

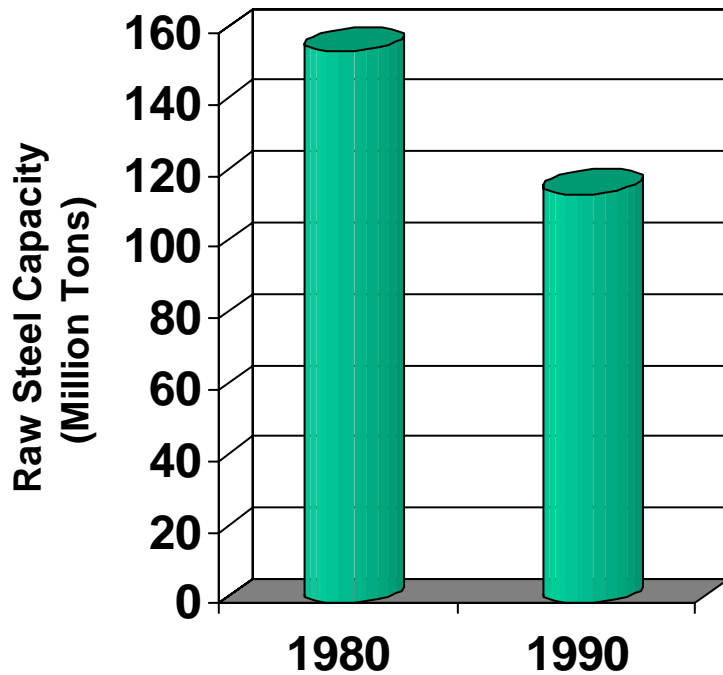
US Steel	Bought Marathon Oil Dramatically downsized steel
Bethlehem Steel	Bought & sold distribution business Downsized steel
LTV	Formed via merger within LTV; twice in Ch. 11 Restructured to focus on steel & steel products
National Steel	Restructured into National Intergroup, then spun-off Sold 50% to NKK (Japan)
Inland	Expanded distribution business JV'd finishing assets with Nippon Steel (Japan)
Armco	Invested in insurance business & a few others JV'd carbon flat roll with Kawasaki (Japan)



Managerial Response #2: Downsize

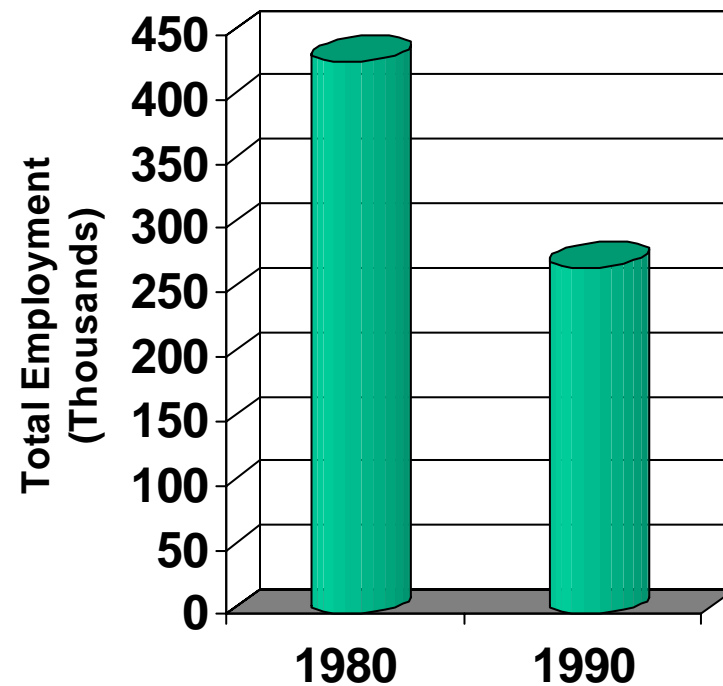
Helped but...

**Capacity Reduction
25% in 10 Years**



Source: AISI

**Employment Reduction
37% in 10 Years**



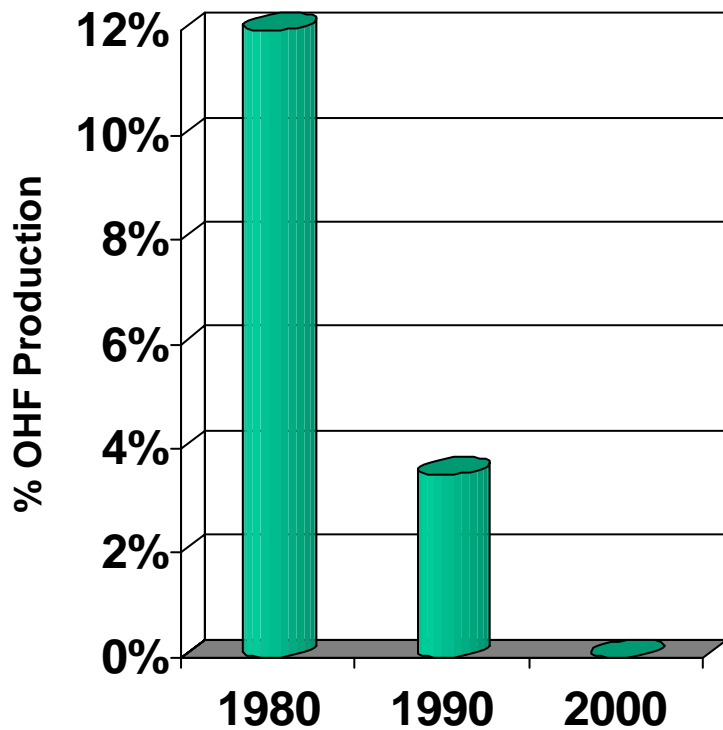
Source: OECD



Managerial Response #3: Efficiency

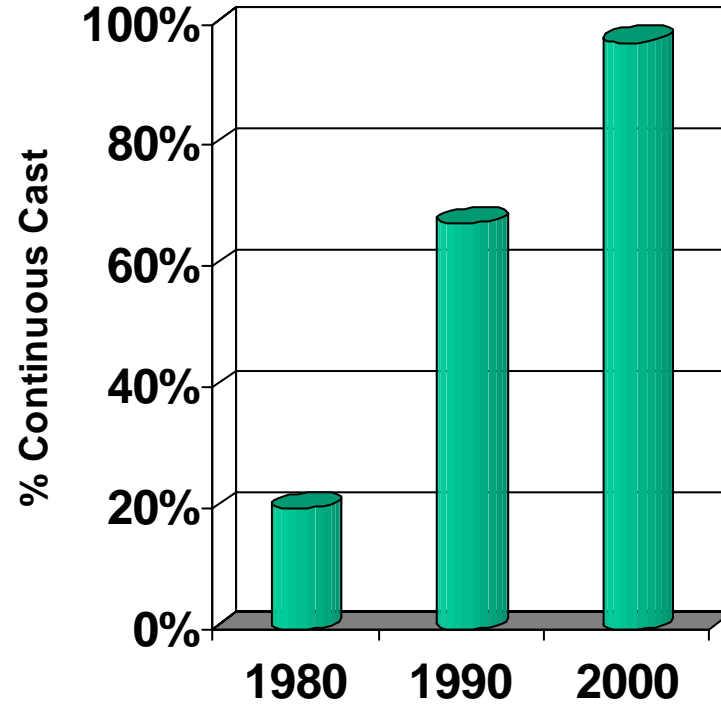
Also helped but...

Open Hearth Production



Source: AISI

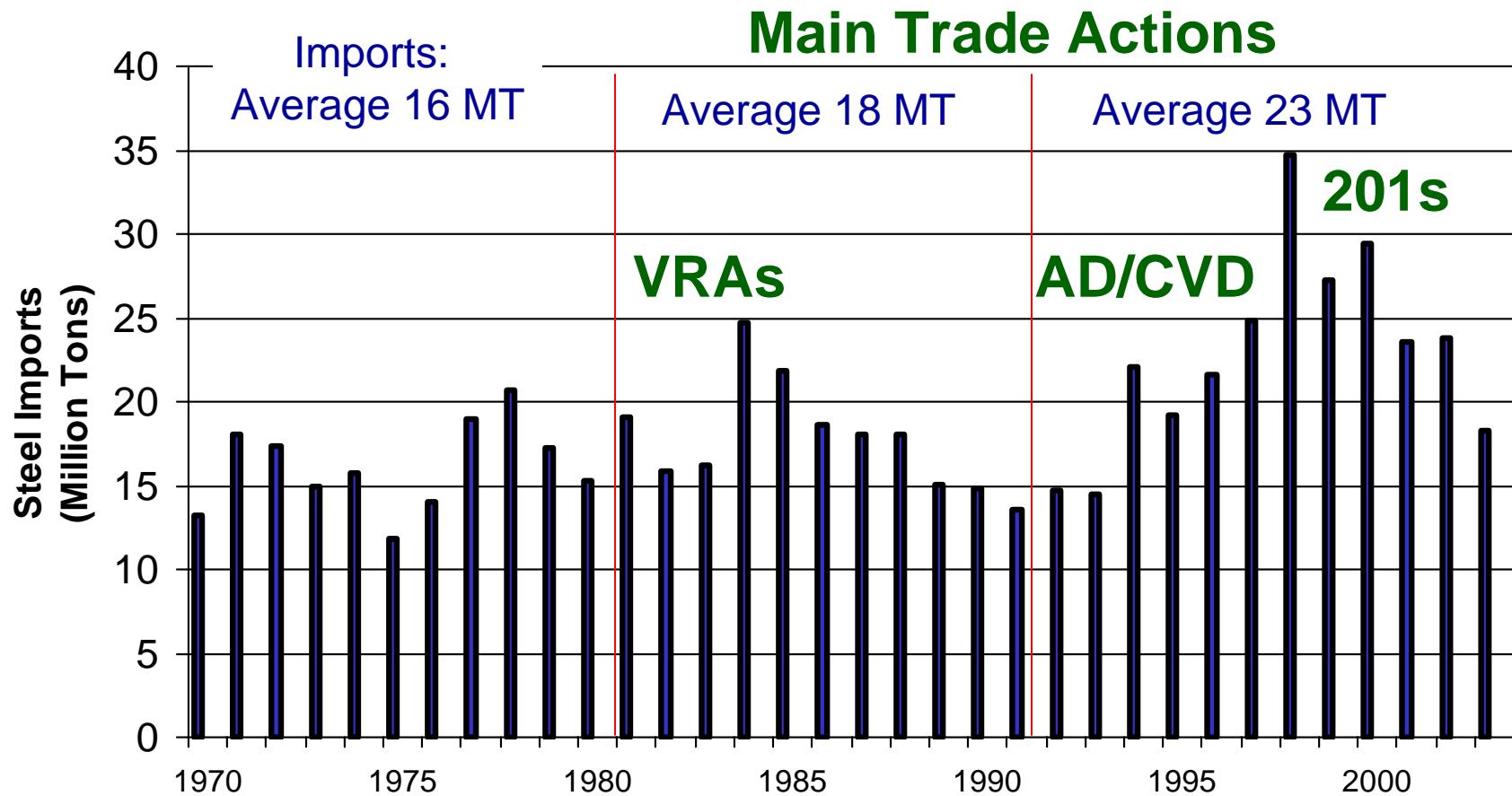
Continuous Cast Ratio



Source: AISI

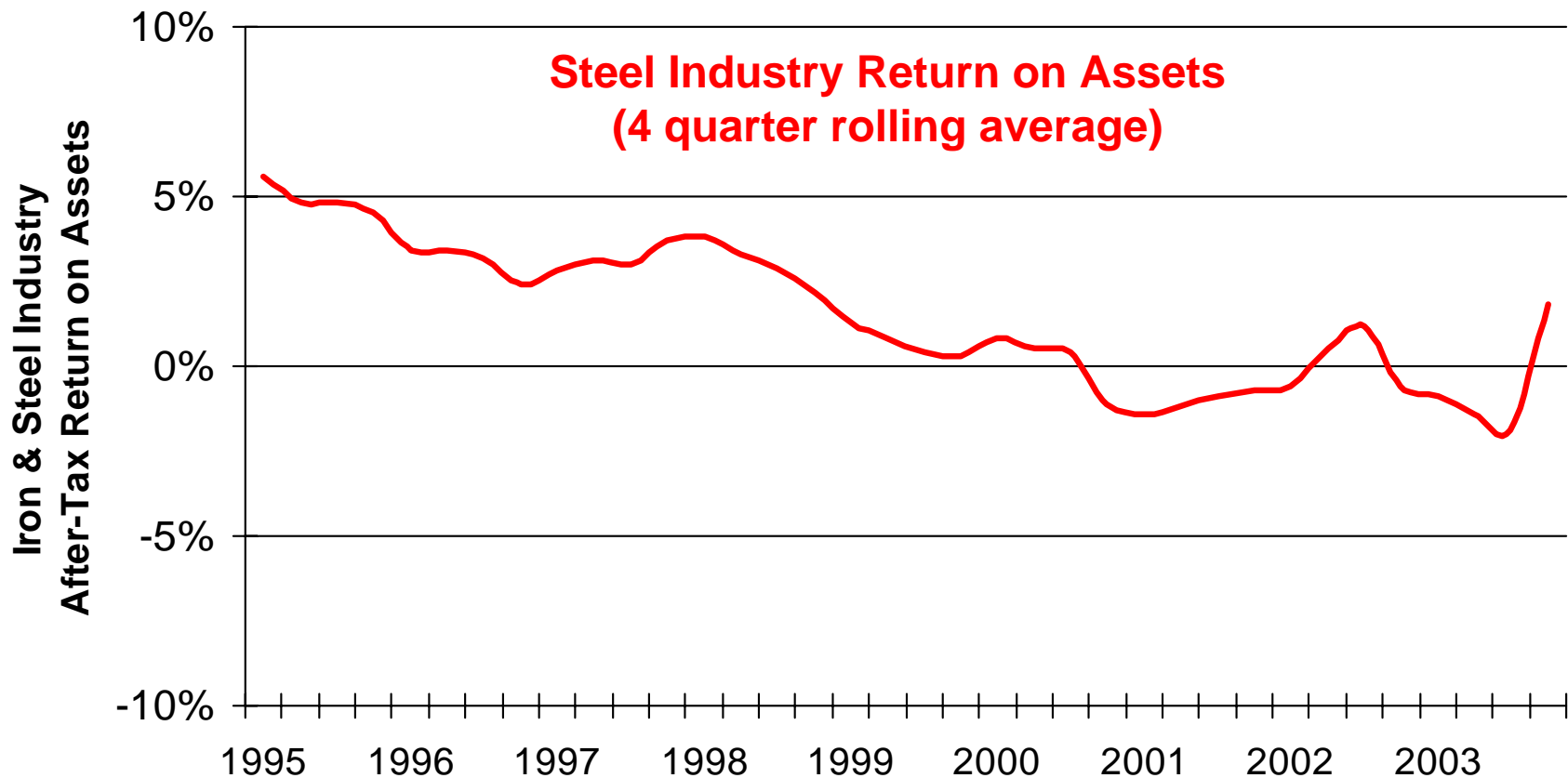


Managerial Response #4: Government





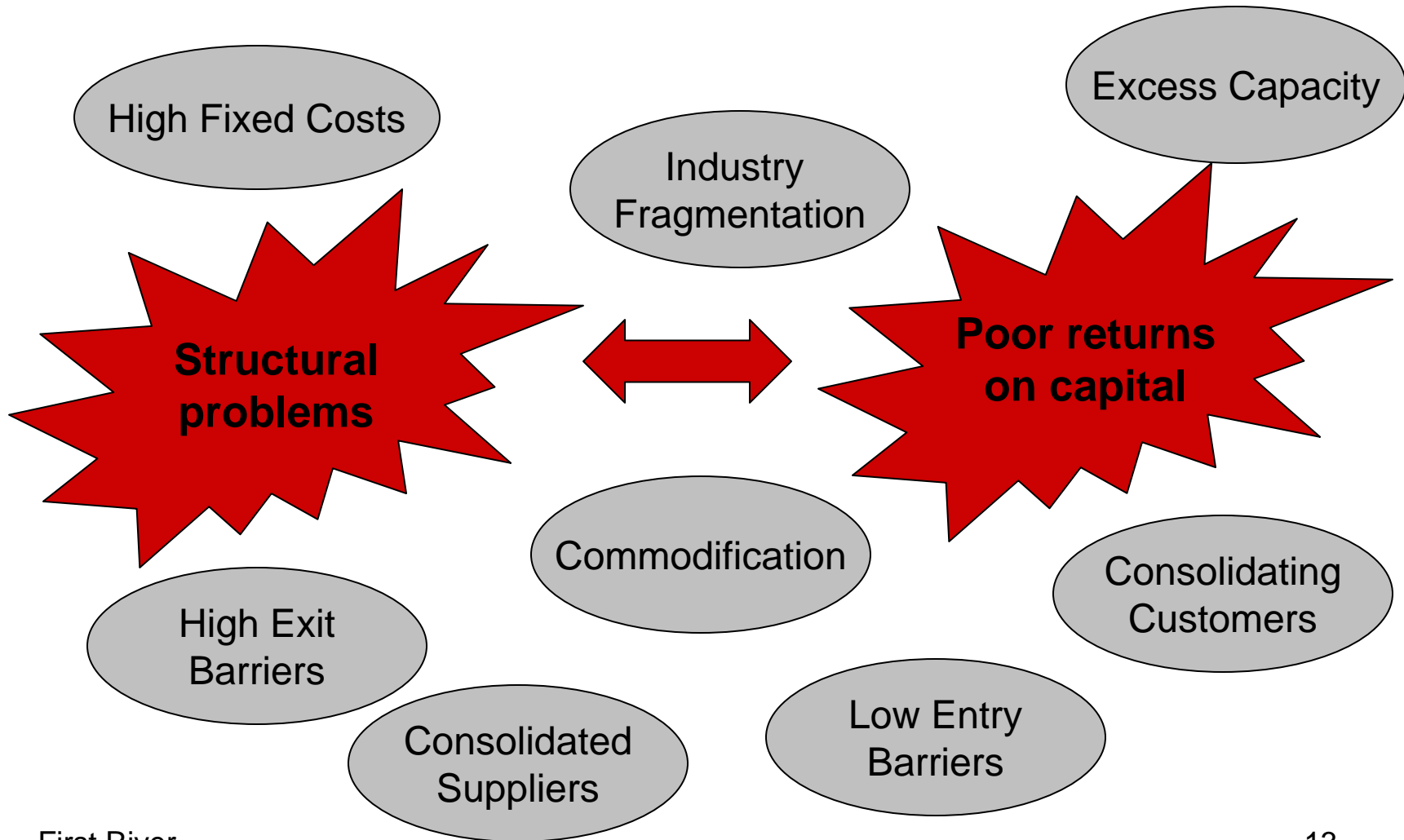
Despite managerial efforts, the industry's plight continued





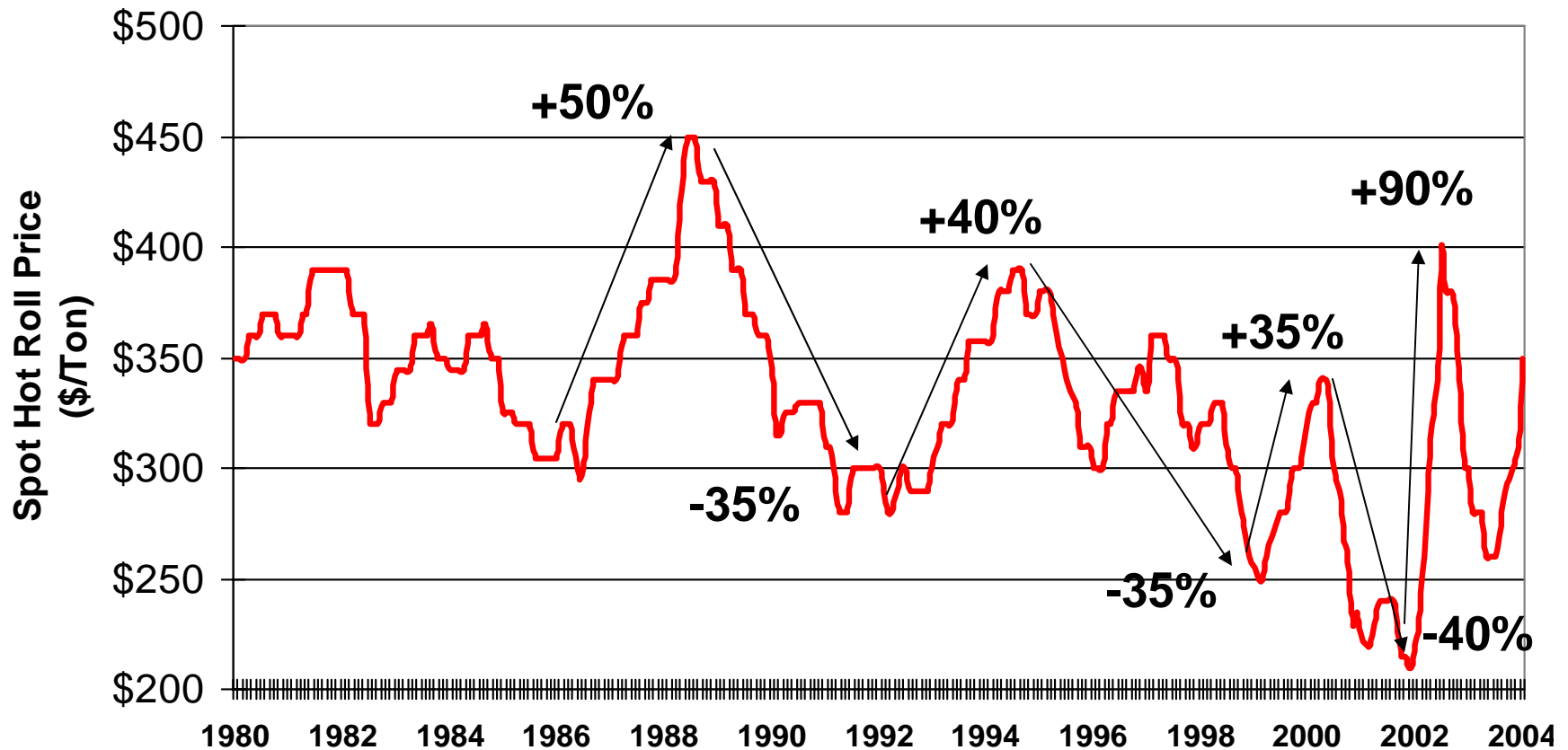
Why?

Because management did not manage strategically!





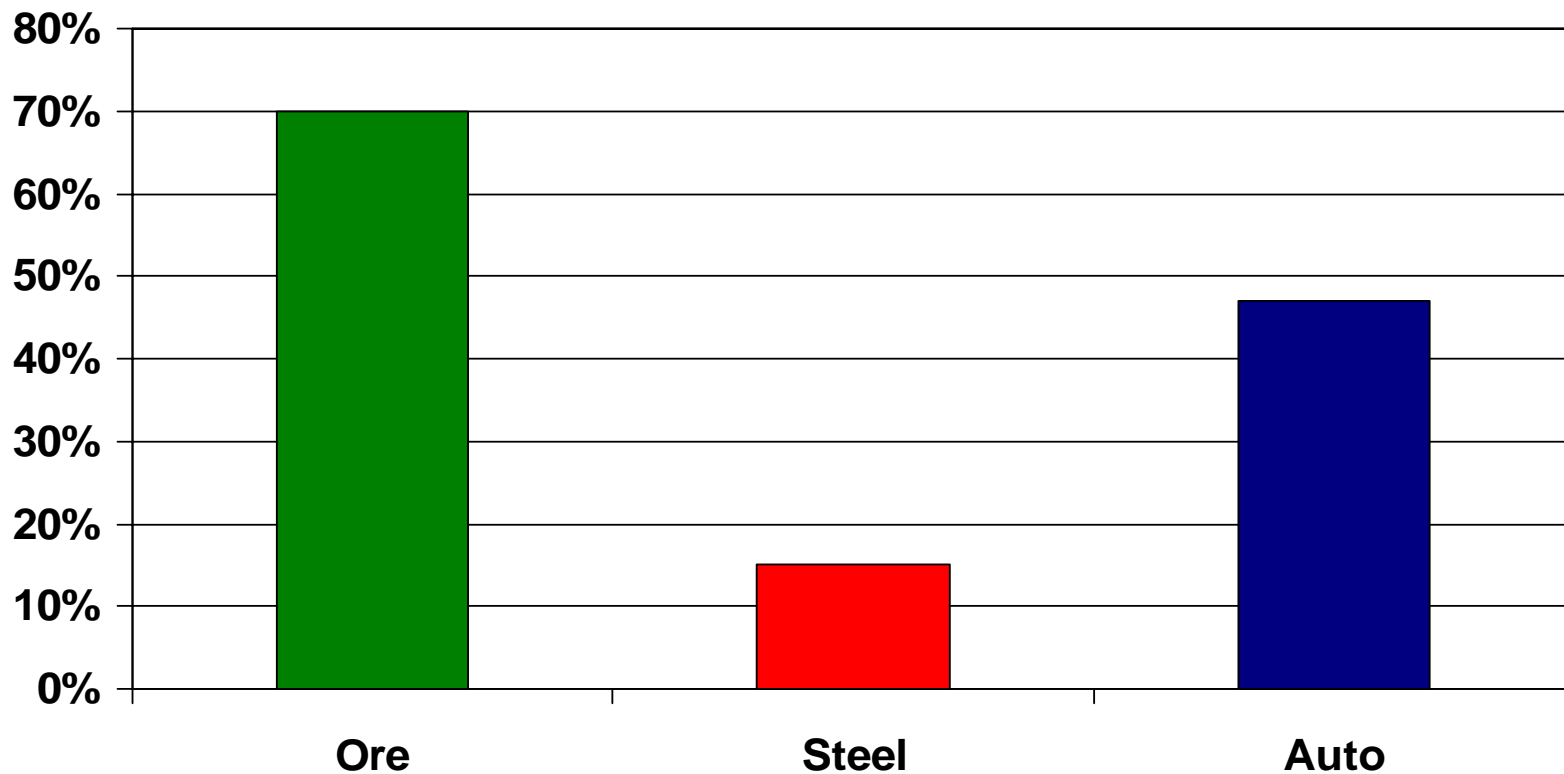
Variable revenues vs high fixed costs





Relative fragmentation...

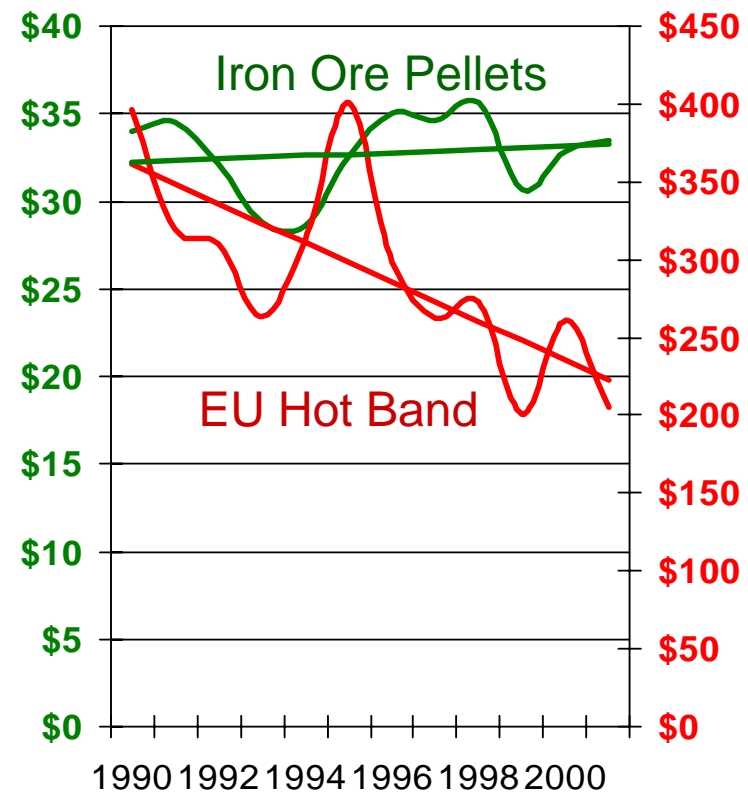
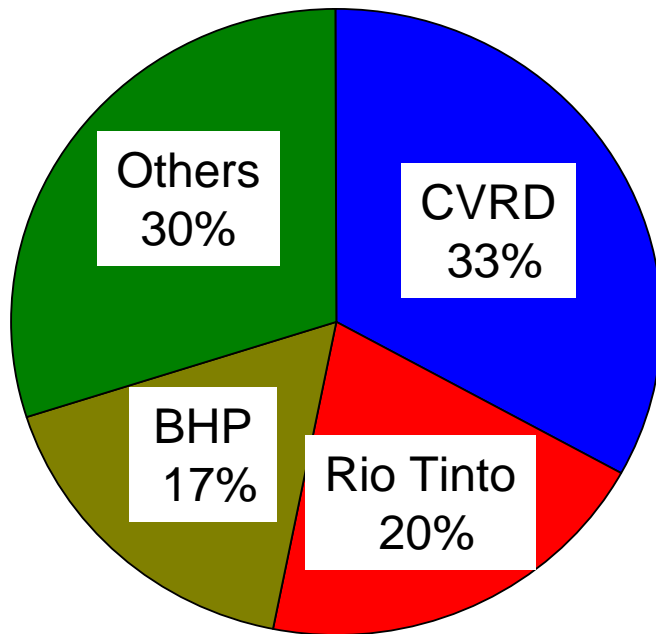
Top 4 Firms Global Market Share





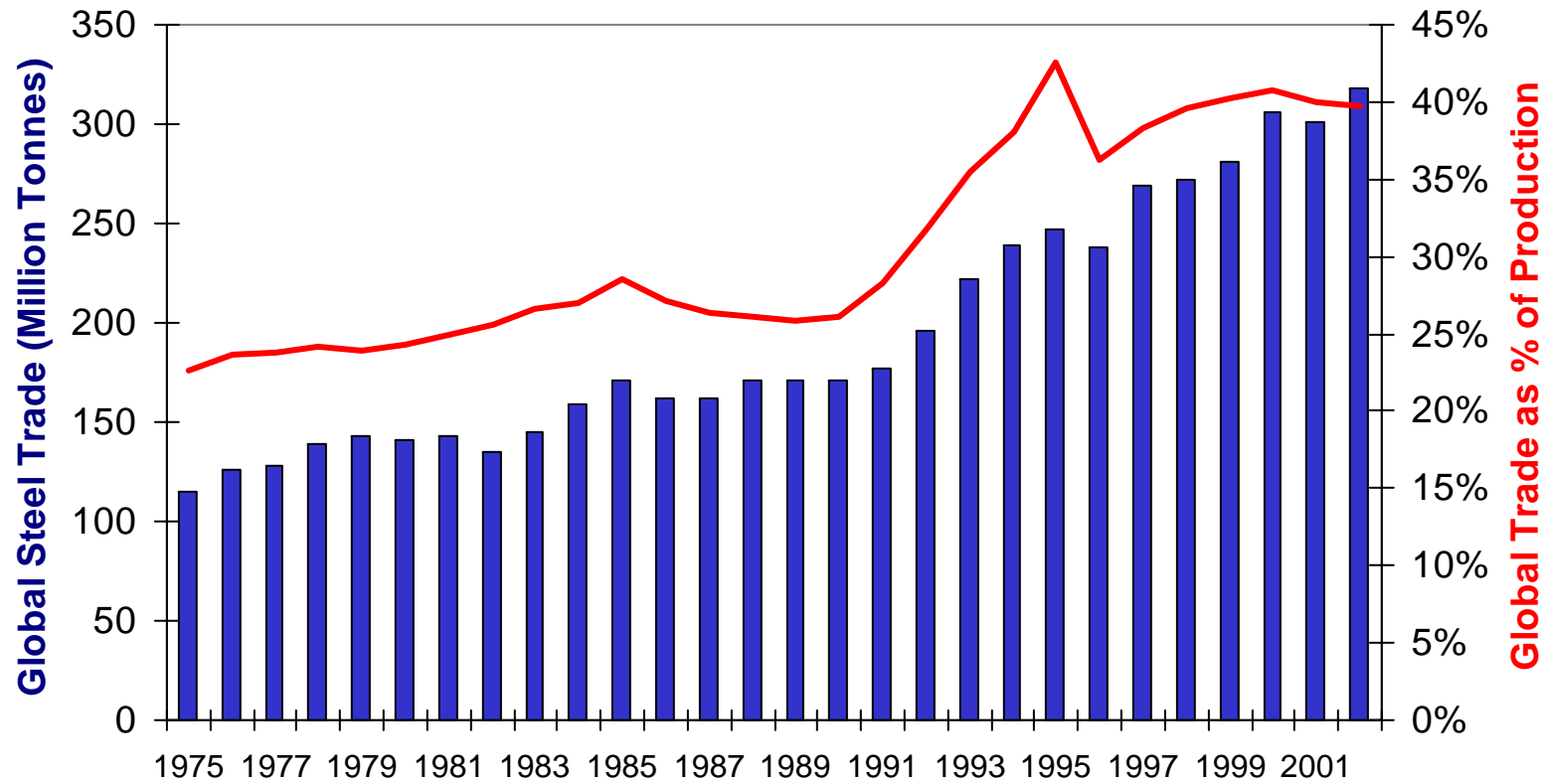
...means no leverage for steel companies

Share of Globally Traded Iron Ore





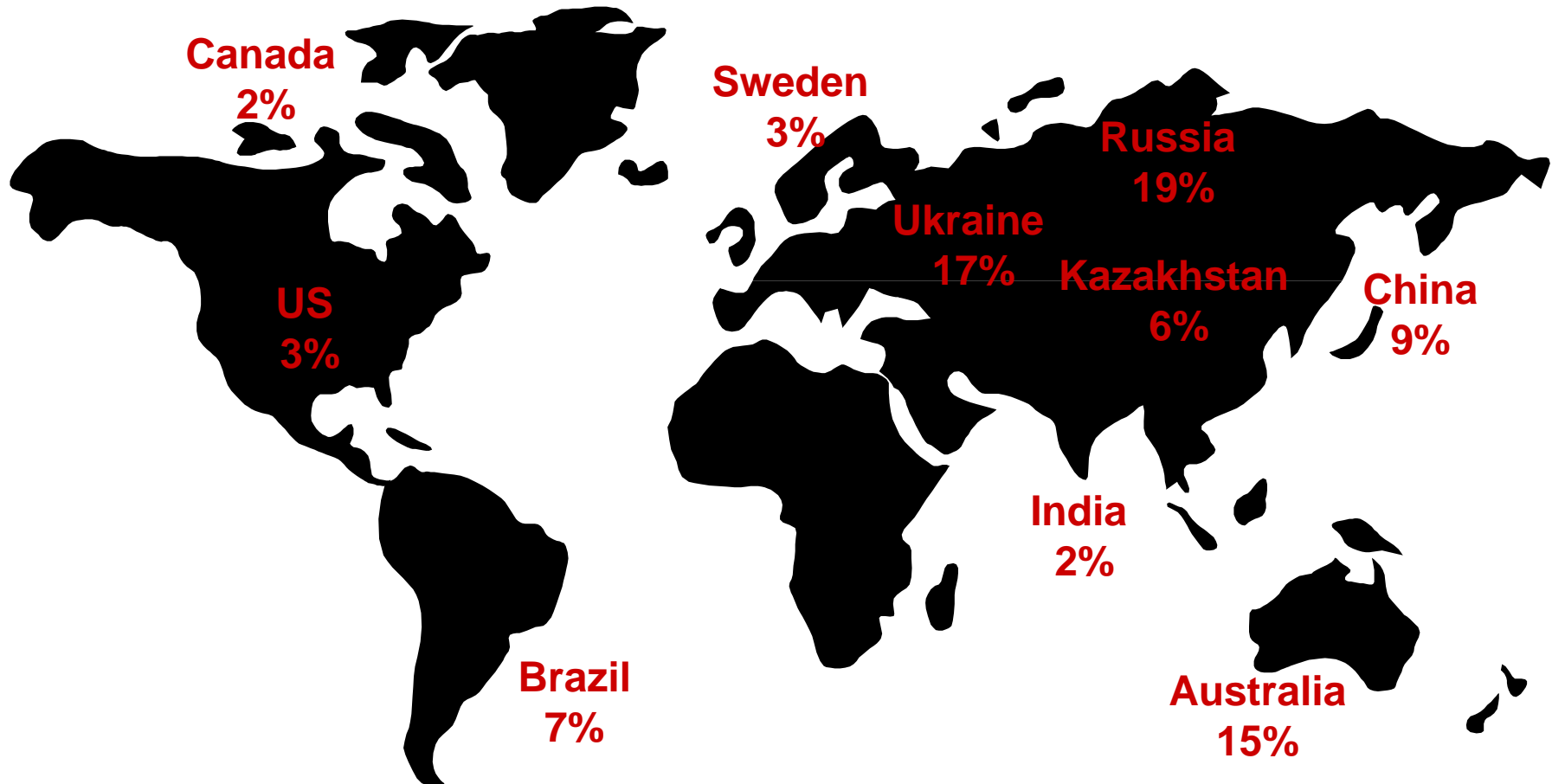
Global trade grew because...





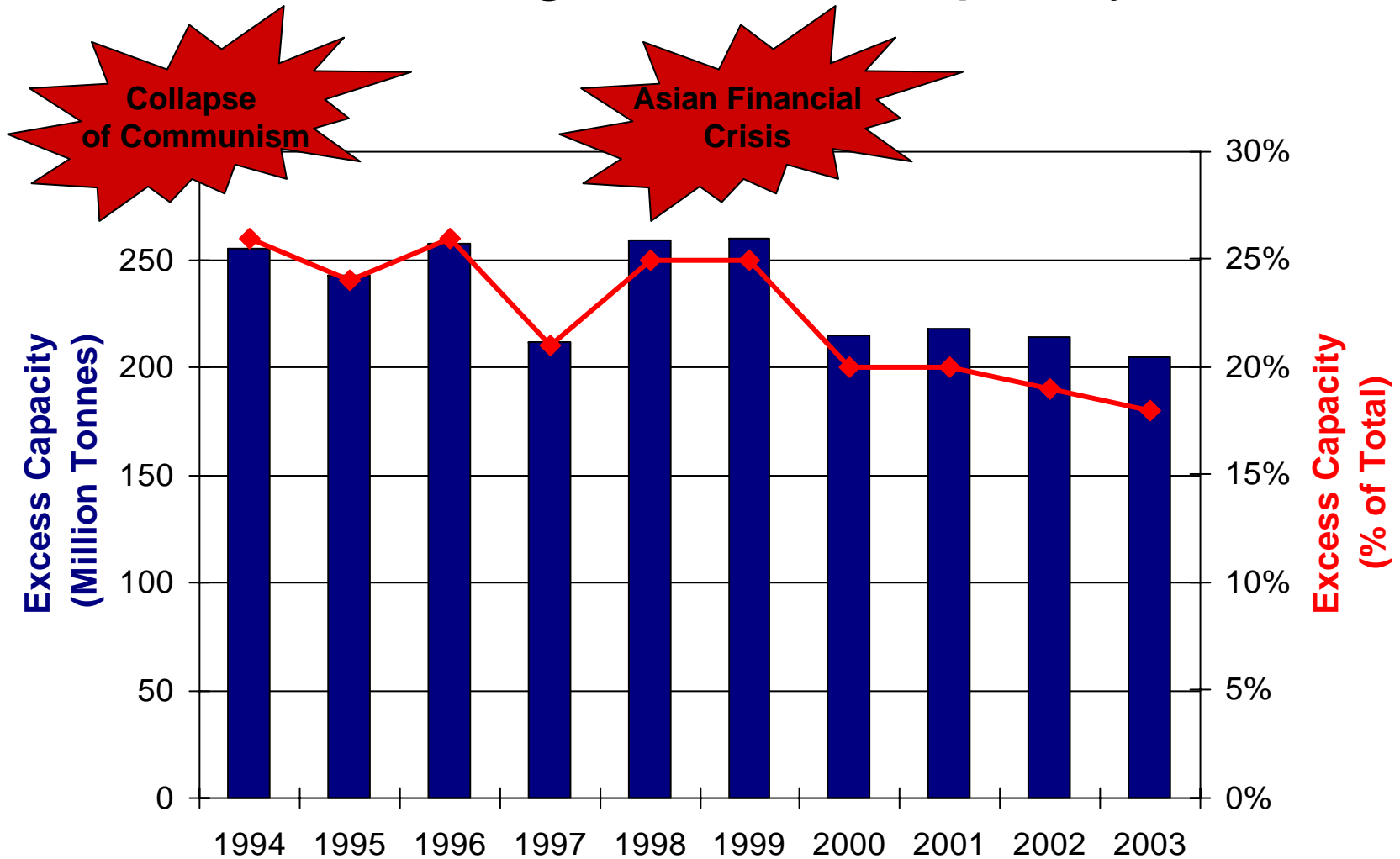
...trade is inevitable

85% of global iron ore reserves are in 10 countries





... and there is global overcapacity





Solving the problem of poor industry returns is not an easy one

“When managers with a reputation for good management, meet an industry with a reputation for bad economics, it is generally the reputation of the industry that emerges intact”

Warren Buffet

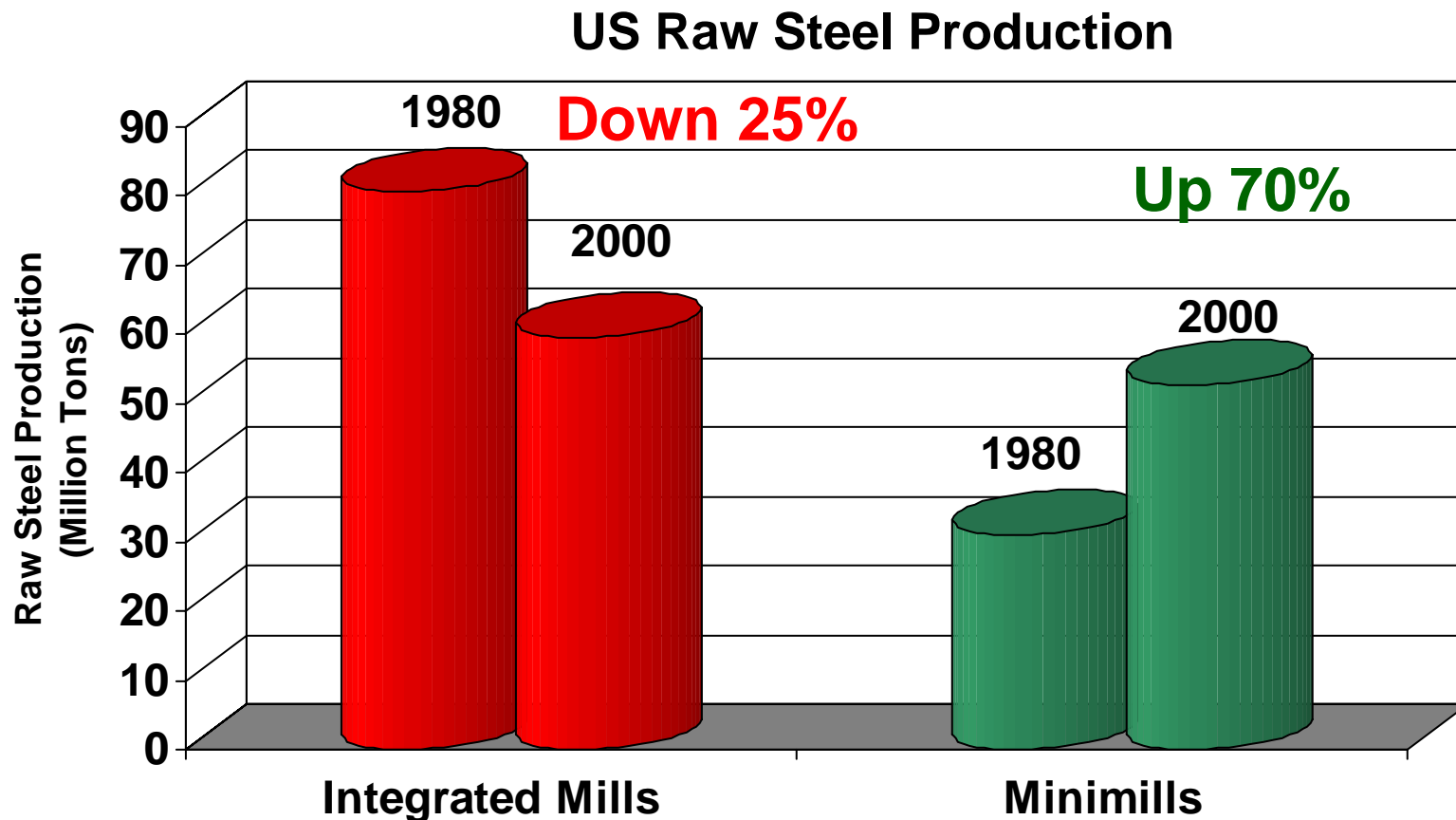


But it's not impossible either

- Adapt the business model
- Confront the structural impediments to poor returns
- Reframe the product/market strategy
- Maintain control of the customers
- Aggressively exploit opportunities

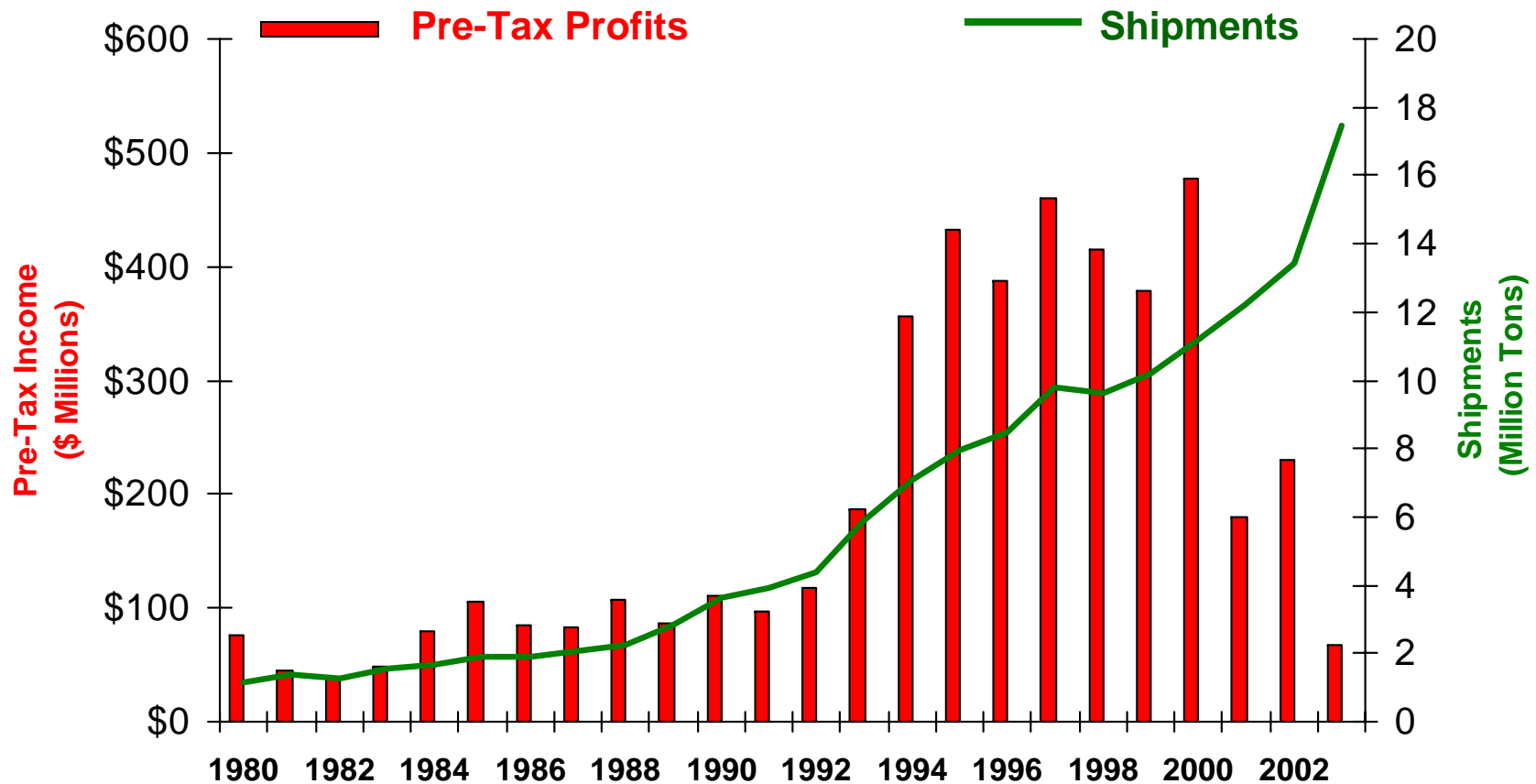


US minimills grew because their business model was better suited to the environment





Nucor- the minimill poster child

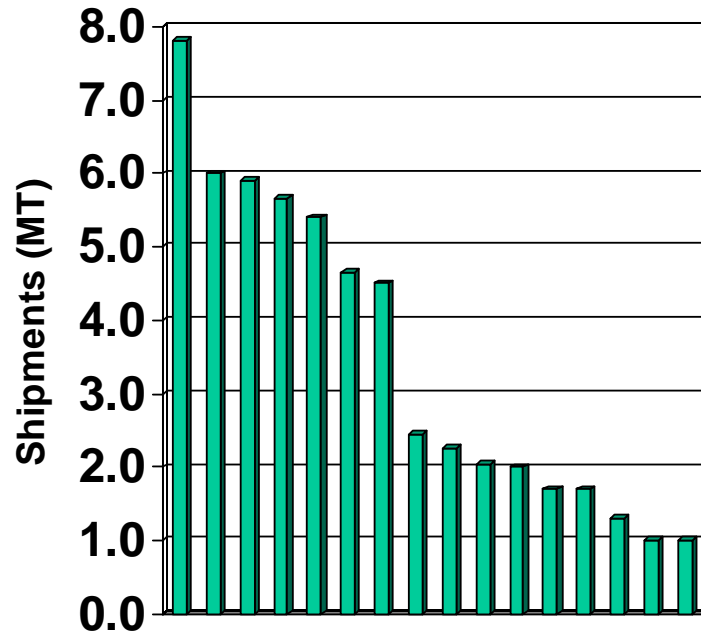




Confront structural impediments

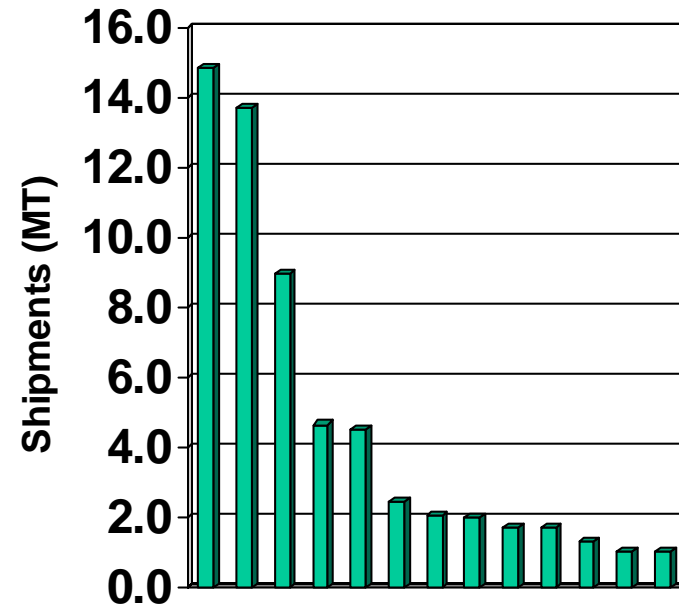
Consolidating US flat roll industry

Top 5 = 50%



Before Consolidation

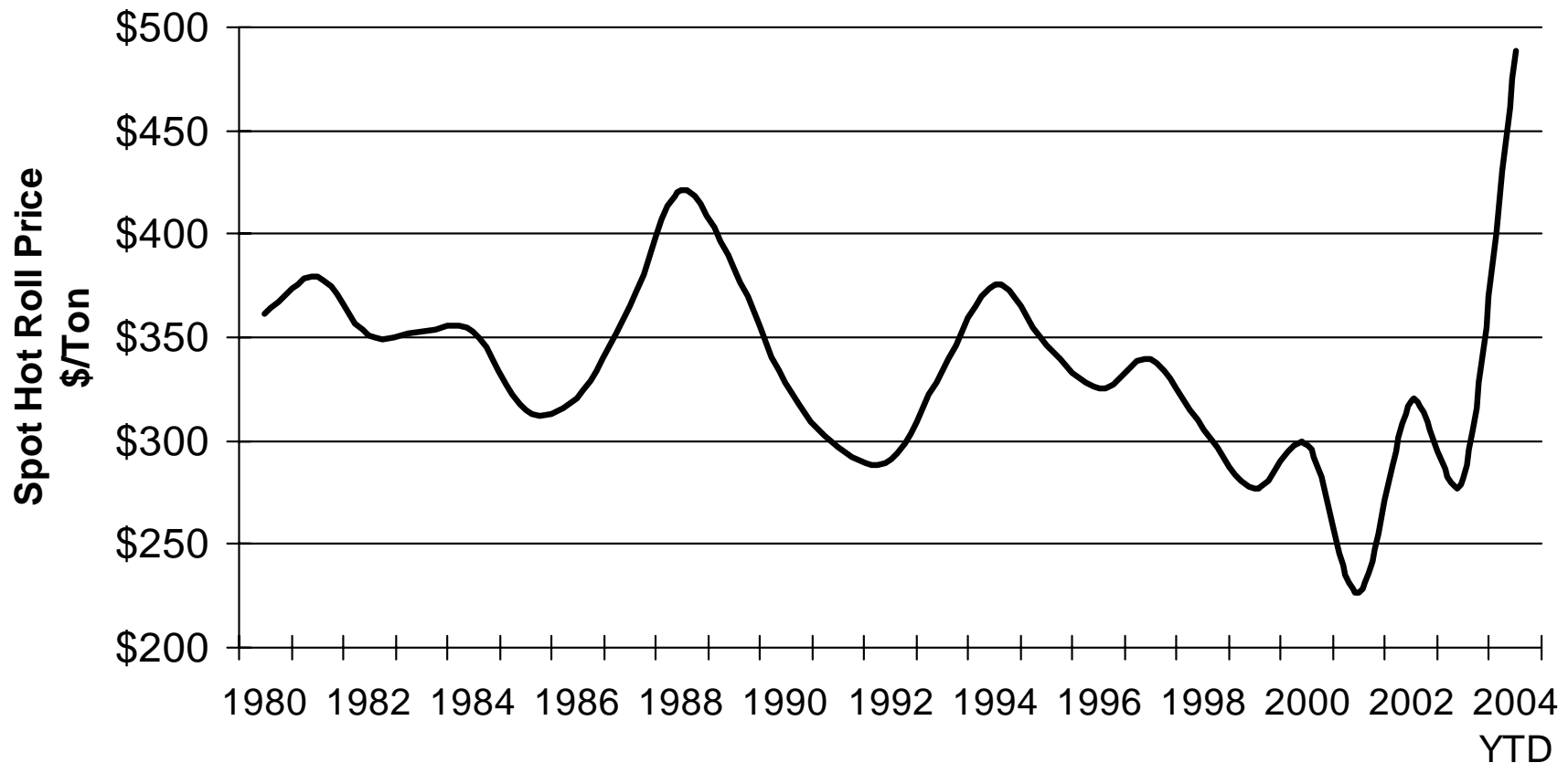
Top 5 = 75%



After Consolidation



Consolidation is partly responsible for current high steel prices





Reframe the product/market strategy

Dofasco
“Solutions in Steel”

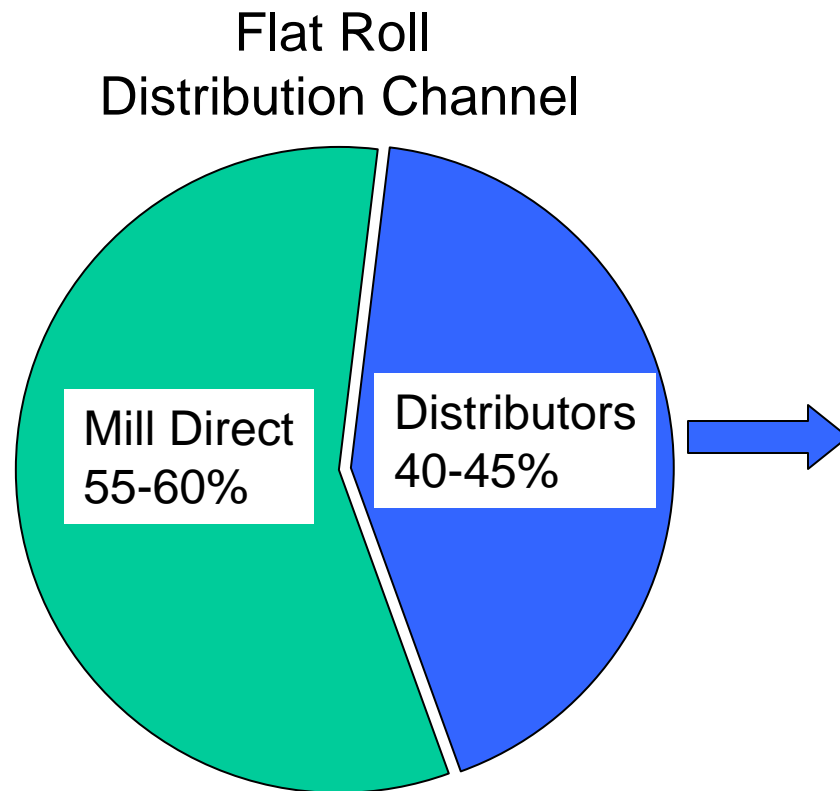
Voest Alpine
“Global market leader in
track systems”
“From rails & switches to
a full systems/service
provider”

JFE Holdings
“Only 1 and No. 1 products
to 30 percent in the next three years”

SSAB
HARDOX & WELDOX
HSLA & HardTech



Maintain control of customers



Distributors – The Theory

- Break bulk & serve small users
- Steel processing
- Warehousing & JIT delivery

Distributors – The Reality

- Below average order size
- Serve large & small customers
- Channel for new entrants & imports



Aggressively exploit opportunities

Think like Wilbur Ross

- Bought LTV out of bankruptcy for \$50 per ton in 2002
 - Handed pension obligations to government
 - Brought in minimill management
 - Renegotiated labor contract with USWA
 - Variable pay, restructured benefits, flexible work rules & fewer job classes
- Did it again in 2003
 - Acquired Bethlehem Steel out of bankruptcy with similar deal
- Created the third largest steel company in the US in two years and totally changed the face of the industry



Aggressively exploit opportunities

Don't fall into the entrepreneurial gap





And remember

- No strategy is right for all circumstances
- Differentiation, while difficult to achieve, is essential
 - “No two species can co-exist that make their living in the identical way”

Gause’s Principle of Competitive Exclusion