RISK OF ECONOMIC ACTIVITY OF METALLURGICAL INDUSTRY ENTERPRISES

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Abstract
Economic activity carried on in times of recession or out of the crisis poses additional challenges of managers. Metallurgical enterprises do not relied of consequences of the current crisis in the industry. Paper presents an attempt to diagnose the business risk of Polish steel industry in the time of economic downturn.

Keywords: metallurgical industry, risk, management, crisis.

1. INTRODUCTION
There is no single and ultimate definition of risk. Risk is universe. There is one reason for it – risk is abstract term because risks are everywhere. Risks have different background, different stakeholders and different impacts. This includes, but is not only limited to, corporate scandals around such companies like Enron, Lehman Brothers, Maxwell group. This is further rendered to risks which impact economies of bigger scale, namely countries, regions, and continents – USA, Japan and EU recessions which started in 2008, did not tranquil until now and still affect life of regular citizens. All in all, risk has different variants and people witness more often man-made disasters, both environmental and economic, around the world. They have direct and indirect effects on people and their lives.[1]

2. RISK IDENTIFICATION
Because risk is such universe term and it takes many forms, there is a need for systematic approach, which would help to categorize risks, so the right people with right knowledge could work with them in order to mitigate their negative effects or identify real business opportunities.[2]

Theoretically, the more all-embracing the categorization and the more detailed sub-division, the higher chance the risk will be captured. In the real business life, process is constrained by many factors, including time, technology, data availability, and resources of people and funds.[2] Risks can be broadly grouped in the following categories: market, credit, liquidity, operational, legal and regulatory, business, strategic, and reputation.

Strategic risk is often referred as a business risk. From the conventional point of view, strategic risk relates to uncertainty about significant investments, the demand for products, their pricing, and cost of production and transportation. Recent studies started presenting strategic risk also in the form of an opportunity for the business. This is because emerging threats and challenging market conditions are an opportunity for the change that can be advantaged by watchful organizations i.e. sudden change of dominant market players, shift of consumer preferences etc. Therefore, strategic risk should be treated with paramount importance by the organization because it affects its strategy.[4]

3. RISK MANAGEMENT
Risk management could be said to originate from the early times when a chieftain pledged to fortify walls or create security alliances to protect local people from the opponents. Part of RM could be also a decision of storing incremental provisions to secure people from famine.[3] As of XX century, the early development of modern risk management started in the United States as a result of non-business oriented practices carried by insurance companies. Risk management became popular among businessmen because of two drivers.
First, insurance in the 1950s was high-priced. Second, the extent of coverage was very limited what did not satisfy the needs of entrepreneurs. Latter reason was even more troubles, especially in the case of inadequate attention to people and property protection. Thus, insurance clients became concerned with the quality of asset protection, the standards of health and safety, product liability claims and other risks affecting business.[5]

Paradigm of risk management was further explored in Europe during 1970s, by making a combined approach to risk financing and risk control. This established a new pinpoint on the concept of total cost of risk. Organizations found out that many risks they face are insurable. In result, businesses were forced to find tools and techniques helping them in the process of risk management. This eventually led to establishing fundamentals of a few specialist areas in risk management, specifically risk management over projects, operations, and energy.

4. RESEARCH AND DISCUSSION

With a population of 38 million, Poland is the largest country in Central-Eastern Europe. In 2008, Poland’s share in the EU gross domestic product (GDP) generated by all new Member States (including Bulgaria and Romania) was more than 40%. Poland’s accession to the European Union in 2004 was an important milestone in the dynamic development of the country. The adjustment of Polish legislation and administration to meet EU standards and the inflow of EU structural funds (some 67 billion Euros by 2013) has provided a major stimulus to economic growth. Poland has taken full advantage of these opportunities and embraced measures to meet the challenges of the common European market. The main sectors of the Polish economy are services (64% of GDP) and industry (32% of GDP). The remaining 4% of GDP is generated by agriculture.

In 2010 State Treasury planned to sell up to 10% of the shares in KGHM Polska Miedź S.A., while retaining ownership control over the company. Also earmarked for sale on the regulated market is the Treasury’s 4.52% stake in Grupa Kęty S.A. In 2010 the Treasury sold through the negotiations procedure 85% out of 100% in Centrozom Wrocław S.A., a company dealing with the collection and sale of scrap metal and waste recycling, and in Zakłady Górnice-Hutnicze Bolesław S.A., Poland’s largest producer of electrolytic zinc. By 2011-2012, 19 more companies from the iron and steel industry as well as the non-ferrous metallurgy sector are to be privatised, including 7 metallurgical plants. For sale in the rock mining industry are, among others, an aggregate producer, 2 mineral mines, marble, dolomite and quartzite mines as well as road material quarries. In order to support the restructuring process an agency (Towarzystwo Finansowe Silesia) has been set up to deal with the financial asset ownership transformation process associated with the sector.

The privatization of metallurgical companies, mainly with the participation of foreign investors (Mittal), has mostly been completed according to the 2006 deadline set in the governmental strategy for the sector. The state still retains control over 11 companies, including the only Polish producers of zinc and lead and several small iron and steel plants as well as a non-ferrous metal smelter. The privatization plan assumes complete sale of the companies except for the copper producer KGHM, the largest Polish industrial firm listed on the Warsaw Stock Exchange, in which the Treasury holds 41.79% of shares. With increased global competition, the EU steel industry faces a number of competitive risks and challenges. For the foundry sector, however, competition from outside the EU is still limited. Below, the most significant risks and challenges for the industry are highlighted.

Challenge 1: The centre of the steel business is moving to the East, and EU producers are faced with new competitors. The global centre of gravity for the steel business is moving to the East. China, Japan, India and South Korea represent more than 50% of world steel output (2007), and when adding Russia and Ukraine these countries represent more than 60% of world steel output. Moreover, the EU’s relatively strong position on quality and high quality product markets is increasingly challenged as these competitors are improving their technological capacities and competencies as well. Consequently, the EU steel producers face the risk of losing control and global market share, even for quality products.
Although certainly not the only competitor, China constitutes the most concrete threat to the EU steel sector. Today, China is a net-exporter of steel and is offering steel products at all levels of quality and at very competitive prices. In this regard, direct and indirect state aid imply that Chinese steel producers are able to reduce prices to artificially low levels compared to the real cost of producing steel – preventing a level playing field for European steel producers. Moreover, Chinese steel capacity is increasing with prospects of even increasing its current excess capacity. And with strong incentives to export excess production, exports from China constitute a formidable competition to the EU steel industry. Already, excess capacity has fuelled Chinese exports into European markets: in 2006-2007, China flooded the EU market with both flat and long products.

In addition, the threat from other countries is likely to increase in the future as well. E.g. steel production capacity is increasing in the C.I.S. and, depending on domestic demand, exports may increase. In case of decreasing demand for steel, this turns into a significant risk as excess-production leads to increased incentives to export and to stronger competition in general. Moreover, technological improvements in the C.I.S. in terms of EAF-technology imply that the volume of scrap exported from the C.I.S will decrease, leading to increasing scrap prices. This poses a threat to the EU being a net-importer of scrap.

Thus, the European steel industry increasingly depends on maintaining and improving its ability to compete with products from China and other new and emerging world steel producers such as India and the C.I.S.

Challenge 2: Imbalances in demand and supply for raw materials and increasing input prices

With China entering the world steel scene and with the huge increases in Chinese steel consumption, capacity and production, patterns and conditions for steel production are changing globally. Among other things, the rapidly increasing Chinese demand for steel leads to imbalances in the supply and demand for iron ore. The increasing demand for steel, driven by China, has led to an increasing demand for raw materials, and the current raw material supply and demand imbalances are affecting the EU industry heavily as it is very dependent on raw material imports. Thus, access to raw materials has become a pressing issue for the EU steel industry. Moreover, countries outside the EU with better access to raw materials and energy have a competitive advantage in this regard related to lower transport costs. In this regard, it should be noted that the foundry industry is not as directly dependent on imported raw materials as other parts of the steel sector.[6]

Access to raw materials is also becoming a key factor in determining future location investments, with some third countries such as Brazil, China, India and Russia offering more attractive production conditions in terms of better access to raw material and cheaper energy. Moreover, Africa may gain greater prominence in the future as an iron or producing region. Consequently, a future scenario could be that primary steel producers will be located outside the EU in locations with good access to raw materials, exporting semi-finished products to the EU. In this scenario the EU will cease to produce semi-finished products.

With the current heavy demand for all steel inputs, both raw material and energy prices have increased substantially. As prices of raw materials are set globally, increases affect all producers. Thus, increased input prices do not per se create a competitive disadvantage vis-à-vis other countries/producers outside the EU. However, in countries where state aid and subsidies are still in place (e.g., Russia, Ukraine and China) pressures on input may be partially alleviated through this kind of support, leading to an indirect disadvantage to the competitiveness of the EU steel sector.

Challenge 3: Trade policies and the need for a level playing field.

The global scope and reach of the EU steel sector implies that international trade regulations, investment conditions, and global competition for markets and resources, are crucial aspects of the institutional framework conditions affecting the sector’s competitiveness. While tariffs are becoming less relevant for the industry in terms of market access, non-tariff barriers have become a more prominent issue on the EU trade agenda. Non-tariff barriers cover a broad range of issues including for instance rules and regulations, standards, restrictions in government procurement, subsidies, export and investment restrictions and conditions, and trade facilitation issues.
Trade defence instruments include anti-dumping and anti-subsidy measures as well as safeguarding mechanisms which are only used very selectively and after a thorough investigation procedure. By way of example, the EU steel industry has filed three anti-dumping cases against China following the recent flood of Chinese steel into the EU market and two anti-dumping cases have been filed by the EU steel tube industry. An uneven playing field presents the EU steel industry with serious competitive disadvantages. Specific issues related to trade for the EU steel industry include safeguard measures and non-tariff barriers concerning import of raw materials from for instance China, India and Russia, e.g. export taxes and barriers to investments in the steel sector proper or in extracting industries, thus limiting possibilities to secure access to raw materials.

The EU’s approach to its relationship with China has taken on a more confrontational stance in recent years. In this regard, the EU-China Steel Industrial Dialogue is intended to help recognise and address problems related to Chinese steel production and exports to the EU, with risk of overproduction and subsequent unbalance in the global markets, before they become prominent.

Challenge 4: Asymmetric environmental regulation. Environmental regulations and sustainable development are main issues in relation to competitiveness. In this regard, particularly the Emission Trading Scheme (ETS) is a hotly debated topic. The EU Commission’s proposal for ETS review of January 2008 is moving more of the responsibility for European climate policies to the European level. It includes an EU ETS Sector Cap, meaning that Member States will no longer have control over the allocation of the emission rights in the ETS sector – in other words, the National Allocation Plans will be abolished.

The crux of the competitiveness issue that the steel sector faces due to the ETS lies in its global nature: while the European steel industry is forced to take on additional costs due to the mandatory nature of the ETS, in many other steel producing countries the reductions are mostly voluntary and thus not comparable. This will put EU producers at a cost disadvantage vis-à-vis their global competitors. Although the EU ETS structural options post-2012 include embedding ETS in a global agreement, the political, legal, and institutional feasibility of doing so is unknown and uncertain.

New regulation in general constitutes a risk for the EU steel industry, as the investment attractiveness of the EU steel industry is diminishing if a long-term stable framework cannot be assumed. Uncertainties in e.g. environmental policies may affect the investment environment negatively and constitute a threat to current investors. However, under the assumption of a well-designed environmental policy approach, production and consumption losses for the EU steel industry are considered to be weak in the long run.

Challenge 5: Scarce supply of skilled labour in the future. The occupational structure of the steel industry’s labour force has changed during the restructuring period, and today it consists of a large proportion of multi-skilled workers, technicians, engineers, and managers. For some time, the industry as a whole has been attempting to attract more people with higher qualifications, but as many other industries the steel industry is faced with skills shortage.

Moreover, skills and knowledge requirements can be expected to continue to rise, and demand for highly skilled labour can be expected to continue. This constitutes a serious challenge to the steel industry with a decreasing workforce in many European countries. In addition, the average age in the sector is rather high and retirement in the coming years may create difficulties for the industry. Workforce recruitment and workforce development will have to be addressed.

The EU steel sector’s demand for skilled labour is another challenge to the performance and competitiveness of the EU steel industry, as skills and knowledge requirements are rising while the labour force is decreasing. Thus, attracting and retaining highly skilled labour is increasingly a topic of concern.[7]

5. CONCLUSIONS

When analyzing the factors underlying the current competitive performance of the European steel industry various elements must be considered. The factors are divided into business conditions; input factors, e.g.,
the cost of labour and raw materials; process factors, such as choice and utilization of technologies; output factors such as access to markets and overall performance measured in profitability; and performance in international markets; and last, but not least, demand for steel product, including market prospects. In addition, the individual companies’ overall strategies towards ensuring their competitive advantages are of course integrated parts of the industry’s competitiveness.

As a result of consolidation in the European steel industry relatively few companies account for a large share of the steel production. This indicates the presence of entry barriers for new companies - most likely caused by high capital requirements and economies of scale. Apart from foundries and the casting industry, large, multinational companies dominate the steel industry, albeit to a lesser extent than in other sectors.

LITERATURE


