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Delivering results

Key findings in the Metals industry

15th Annual Global CEO Survey

Sector summary

Commitments to doing more business globally are accelerating in 2012 despite economic, regulatory and other uncertainties. CEOs see the fundamentals for future growth still squarely in place.

To understand how businesses are preparing for growth in their priority markets, we surveyed 1,258 CEOs based in 60 different countries and talked to a further 38 CEOs face-to-face for our 15th Annual Global CEO Survey. *Delivering results: Growth and value in a volatile world* explores CEOs' confidence in prospects, and how they are building local capabilities and creating new networks for new markets.

CEOs are adapting how they go to market, reconfiguring processes and at times entire operating models. They are also addressing risks that greater integration can amplify and are focused on making talent more strategic to pursue market opportunities.

This report looks at the key findings in the metals sector, based on interviews with 40 metals business leaders in 20 countries. CEOs running companies headquartered in China and Hong Kong account for 20% of our sample, which reflects China's growing importance in the global metals industry. We have also drawn on an in-depth interview with Mr. Baba Kalyani, Chairman and Managing Director of India's Bharat Forge Ltd. To explore the full results of the 15th Annual Global CEO Survey, please visit www.pwc.com/ceosurvey.

Confidence disrupted

As 2012 starts, the outlook is more uncertain than ever, with little prospect of a coordinated turnaround. Metals CEOs are especially worried: 58% expect the global economy to decline over the next 12 months, compared to 48% of the overall sample.

They're also more pessimistic about the outlook for their own companies – which isn't surprising, since the metals industry is highly cyclical; demand is intimately tied to the overall economic situation. As Figure 1 shows, 30% of metals CEOs are *not* very confident of being able to generate higher revenues over the next 12 months, which is markedly more than the overall average of 12%.

This explains why two-thirds of the metals CEOs we surveyed plan to make strategic changes over the coming year. They want to make sure their companies are well-placed to cope with tough economic conditions and greater competition – two of the main reasons they cite for changing course. More than half are concerned about the impact of new market entrants. CEOs heading metals companies further down the value chain may also be worried about losing their independence, if the industry continues to consolidate.

"For us, every market is attractive: opportunities fall with a downturn and rise with an upswing. And sometimes markets can be strong irrespective of the GDP growth. For instance, North America has been going through the financial crisis but for us, it is a very strong market."

Mr. Baba Kalyani
Chairman and Managing Director
Bharat Forge Ltd

Improving efficiency

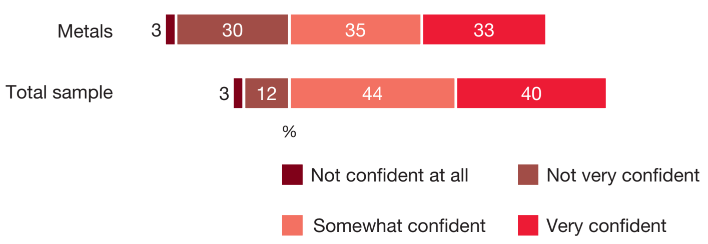
Cost-cutting remains a top priority. Three-quarters of the metals CEOs in our sample trimmed costs in 2011 and even more plan to do so this year – though the measures they're introducing vary substantially. Mr. Baba Kalyani, Chairman and Managing Director of Bharat Forge Ltd, is focusing on lean operations, for example. "This plant [in Mundhwa, Pune] is the world's largest forging facility and operates at a WIP [work in progress, or in-process inventory] of 11 days. In 2008, the WIP was 40 days. When you are lean, you are able to respond to market changes faster, without incurring heavy costs," he explains.

He's not alone in concentrating on organisational efficiency. In fact, metals CEOs regard it as so critical that nearly three-quarters of them would like to devote more time to making their organisations more efficient.

Other research we've done suggests the efforts they're making are beginning to pay off. Many metals companies have seen their liquidity improve.[1] And some are clearly considering where to spend the extra cash: 70% of metals CEOs expect to revise their capital spending this year, although that doesn't necessarily mean they'll increase it. Nearly half of all metals CEOs still worry about whether their companies will be able to finance growth.

Figure 1: Metals CEOs are much less optimistic about the near term

Q: How confident are you about your company's prospects for revenue growth over the next 12 months?



Base: All respondents (Total sample, 1258; Metals 40)
Source: PwC 15th Annual Global CEO Survey

1 PwC 'Forging ahead: Third quarter 2011 global metals mergers and acquisitions analysis' (2011).

Making it happen

CEOs in every sector are now focusing on the upside more than the downside. They're restructuring their companies to cope with a world where the risks and opportunities are increasingly interconnected but the sources of growth are often local. It's even more important for CEOs in the metals industry – where the picture looks gloomier – to develop new ways of doing business in this changed environment. That presents three related challenges:

- **Reconfiguring operations to meet local market needs:** Building the right portfolio mix – the right infrastructure, operating model, strategic alliances, products and services for the right markets.
- **Defending against micro risks and macro disruptions:** Managing the consequences of local risks that may become global disruptions – such as the political upheavals, nuclear disaster, massive floods and sovereign debt crisis that featured in 2011.
- **Getting and keeping the right talent:** Putting the right employees in the right places; managing serious short-term problems like the shortage of technically skilled people in mature markets and trained managers in emerging markets; coping with an ageing workforce; and attracting the millennial generation.

Balancing global capabilities and local opportunities

Historically, the metals industry – and the steel sector, in particular – has been closely linked with national interests. That's been changing over the past decade, with the continued growth of the global aluminium players and the emergence of some genuinely global steelmakers.

Yet tariffs still have a big impact on overall demand for some metals. Trade disputes are common, too; witness the recent accusations by Eurofer (the European Steel Association) that China is selling organic coated sheet steel at prices so heavily subsidised as to be less than production costs.[2] So it's not surprising that metals CEOs are more worried about protectionism than their peers in other industries (60% versus 44% of the total sample).

They're not concerned about regulation in general, though; only 40% see cause for anxiety on this score. In fact, regulation is one issue about which metals CEOs are more optimistic than CEOs in other industries. Nearly half of them think more cooperation among governments will eventually translate into more consistent rules. And, remarkably, given their fears about protectionism, they're also more convinced than their fellow CEOs that the world will be more open to free international trade.

The CEOs of many heavy manufacturing companies are moving into emerging markets like China and India partly to keep an eye on future competitors. In the metals sector, by contrast, the competition from the emerging economies has already arrived. Russia's RUSAL is the world's biggest aluminium company, while Hebei Iron and Steel, and Baosteel – both headquartered in China – are the second and third largest steel producers, respectively.

The emerging markets are now driving metals production and demand, with China leading the way. The World Steel Association forecasts that, in 2012, the emerging and developing economies will account for 73% of world steel demand, up from 61% just five years earlier.[3] Chinese demand for aluminium is also going up sharply.[4]

2 Eurofer, 'Massively subsidized Chinese steel products target the EU market: Eurofer files anti-subsidy complaint at the European Commission' (9 January 2012), http://www.eurofer.org/index.php/eng/content/download/12633/65313/file/Massively%20subsidized%20Chinese%20steel%20products%20target%20the%20EU%20market.pdf

3 'Worldsteel Short Range Outlook' (12 October 2011), http://www.worldsteel.org/media-centre/press-releases/2011/october-sro.html

4 Glenys Sim, 'Aluminium Demand in China Set to Double Over Decade, XinRen says', Bloomberg (15 August 2011), http://www.bloomberg.com/news/2011-08-15/aluminum-demand-in-china-set-to-double-over-decade-xinren-says.html

Metals CEOs look to the US and Germany, China and India

In our survey as a whole, we found that many CEOs are pinning their hopes on the emerging markets. The response we got from metals CEOs was rather different. The US and Germany top the list of countries they regard as most important for their companies' future growth, although China and India come close behind. That may reflect the composition of this year's sample – with a strong showing from Chinese companies, some of which are already sizing up the opportunities in the US and Germany.

M&A outlook staying subdued

But metals CEOs are generally cautious about using mergers and acquisitions (M&A) to expand. Only 13% of metals CEOs have completed a cross-border deal in the past 12 months, and only 18% plan to do so in the coming 12 months, less than the overall average. Similarly, only 40% of metals CEOs intend to form joint ventures, which is also lower than the norm.

Growth markets are a C-suite priority

It's critical to get growth markets right, wherever they are, and the commitment needs to come from the top. When asked how they'd prefer to spend their time, 63% of metals CEOs told us they'd like to devote more hours to developing operations outside their home markets (versus the overall average of 49%).

"In every business, you have to periodically evaluate the new technologies and the margins. It's more to do with products than markets. In our business, some products become commodities while others become technology. And our focus is on products that require high technology."

Mr. Baba Kalyani
Chairman and Managing Director
Bharat Forge Ltd

Process innovation, new products and business models key

Innovation is taking place all over the world – and that includes the emerging markets. "You can't change an approach to innovation in one year. To build innovation capabilities you need a minimum of about 15 years. It will take us another five to seven years to become as innovative as companies in the West. But we will get there for sure," says Mr. Kalyani.

Becoming more innovative continues to be a major strategic priority. Nearly three out of four metals CEOs plan to change their company's R&D and innovation capacity in 2012, and 23% intend to make 'major' changes. That doesn't necessarily mean they want to alter the products or services they offer – though developing stronger, lighter and more durable products certainly helps companies maintain a competitive edge. New, more efficient processes can be equally valuable, as metals CEOs recognise. Better waste heat and gas recovery processes can cut costs and emissions alike. In fact, metals CEOs regard such improvements as so important that four-fifths of them are investing more heavily in this area (see Figure 2).

A growing number of metals companies are also forming research alliances. One such instance is the Ultra-Low CO2 Steelmaking consortium – better known as ULCOS – a group of 48 European organisations that have banded together to research ways of radically reducing the emissions from steel production. And some companies – Bharat Forge – among them – are linking up with academic institutions. "We encourage innovation. We have four to five programmes going on with universities in Europe. Mostly, innovations take place through joint efforts. For instance, our aluminium forging plant in Germany has created a new game-changing technology. While it was developed in Europe, the idea came from company headquarters in Pune," Mr. Kalyani notes.

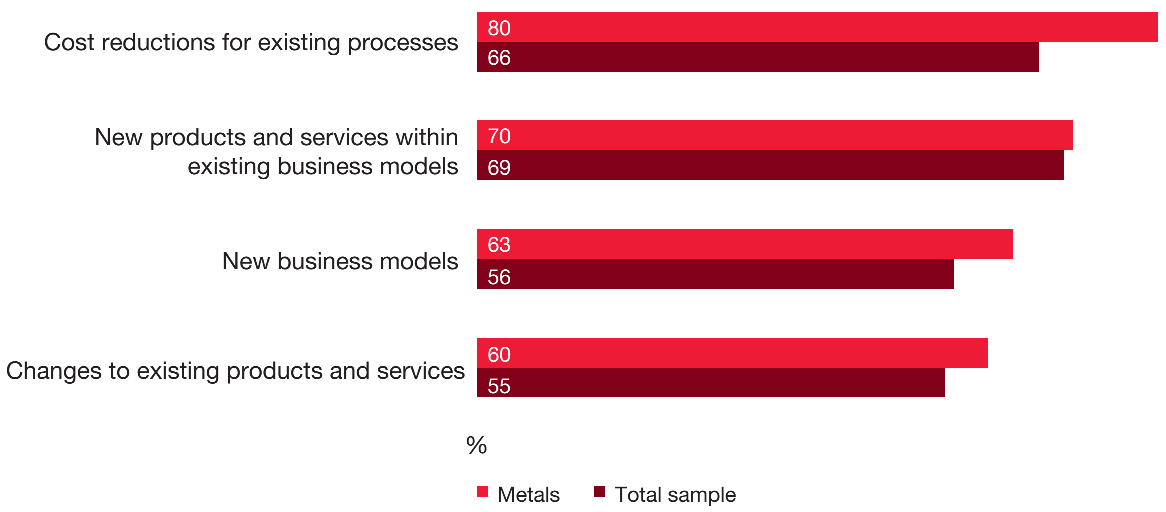
Resilience to global disruptions and regional risks

In 2011, global businesses had to confront a variety of unrelated high-impact global risks – from political upheaval and a nuclear disaster to massive flooding and a sovereign debt crisis. Through it all, CEOs have learned that prudent risk management focuses less on the probabilities, and more on the consequences, of such diverse events.

Most CEOs expect to focus less on risk management than on other key areas in 2012, but metals CEOs differ on this point. They plan to put even more effort into changing their risk management and technology investments than they do into increasing innovation. Indeed, a third of all metals CEOs expect to make 'major' alterations to the way they manage risk in the coming 12 months (see Figure 3).

Figure 2: Innovation remains a priority for metals CEOs

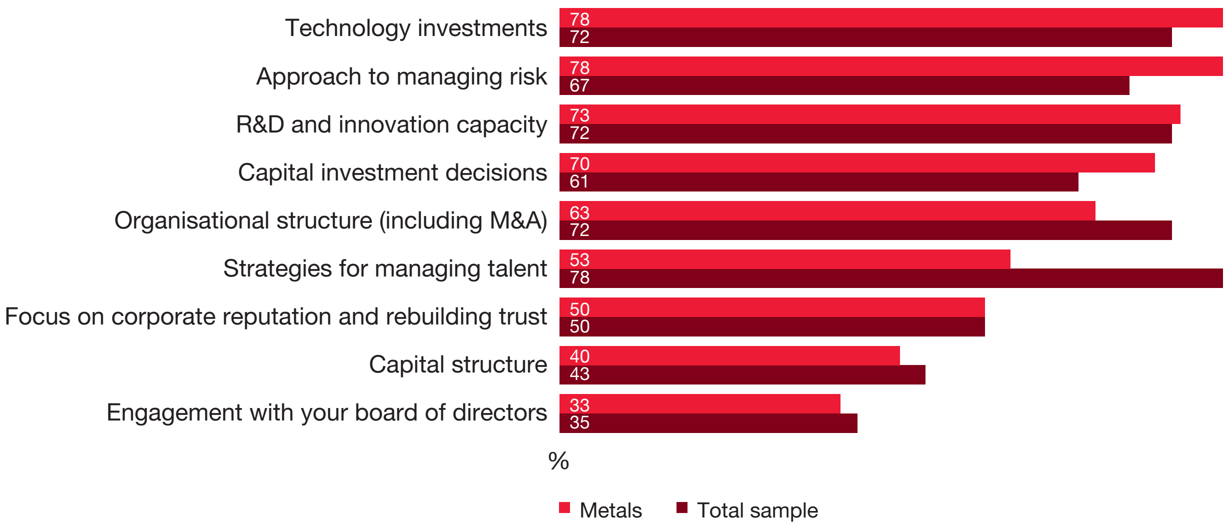
Q: To what degree are you changing the emphasis of your company's overall innovation portfolio in the following areas?



Base: All respondents (Total sample, 1258; Metals 40)
Source: PwC 15th Annual Global CEO Survey
Note: Respondents who stated the emphasis increased 'somewhat' or 'significantly'

Figure 3: Metals CEOs are emphasising changes to risk approaches more and changes to talent management less

Q: To what extent do you anticipate changes at your company in any of the following areas over the next 12 months?



Base: All respondents (Total sample, 1258; Metals 40)
Source: PwC 15th Annual Global CEO Survey
Note: respondents who stated 'some change' or 'a major change'

Why? Probably because they're much more worried about a whole host of economic and business threats than their peers in many other industries.

Economic threats loom large

Take inflation, for example: that concerns 53% of metals CEOs, which is significantly more than the overall average of 42%. Exchange rate volatility rings even bigger alarm bells. An astounding 70% of metals CEOs are nervous about major currency fluctuations, and 45% of them are extremely worried. Some of this anxiety may be linked to concerns about Europe's sovereign debt crisis, which nearly two-thirds of metals CEOs say has directly affected their companies.

Energy costs still a major worry

Metals CEOs are also much more worried about energy costs than other CEOs (75% versus 46%). That was true last year, too – and it makes sense, given the industry's steep energy bill.

Energy and raw materials typically account for about 60-65% of sales in integrated steelmakers. Downstream processing and aluminium refining are very energy-intensive as well.

That's why many metals companies are targeting energy in their cost-cutting efforts. ArcelorMittal is a case in point. The company has replaced equipment at its Burns Harbor plant in the US Midwest; added weekend shifts to take advantage of lower electricity costs; and refitted its blast furnaces to use cheaper natural gas instead of coke.[5] These steps have significantly reduced the energy bill at Burns Harbor.

Investing in raw materials, responses to climate change

Another area in which metals CEOs are investing more heavily is natural resources. More than half of respondents think they'll have to spend more to secure critical natural resources over the next three years – and a quarter of them think the increase will be 'significant'.

China's particularly important in this regard. According to the British Geological Survey, China is the leading producer of 27 of the 52 critical minerals and metals.[6] While some of these metals are produced in other countries, there are a few strategically important metals – such as rare earth elements – which are mined almost exclusively in China.

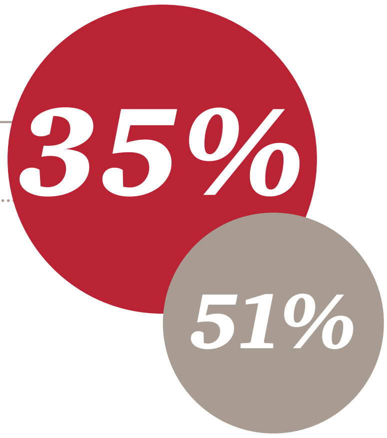
Our research suggests that the shortage of key minerals and metals could have a substantial impact on the manufacturing industry as a whole. It will certainly mean that metals companies have to work more closely with their customers.[7]

5 Bowdeya Twey, 'ArcelorMittal Burns Harbor execs make investments to retain competitive edge', nwi.com (8 January 2012), http://www.nwitimes.com/business/local/arcelormittal-burns-harbor-execs-make-investments-to-retain-competitive-edge/article_aa64d022-7bce-5318-a949-55cbecec955f.html

6 British Geological Survey, 'Risk List 2011'.

7 PwC, 'Minerals and metals scarcity in manufacturing: the ticking time bomb' (2011).

Fewer metals CEO expect to expand headcount this year, compared to the total sample



Taking climate change seriously

Metals CEOs are also showing a real commitment to corporate sustainability. Nearly half plan to boost the amount they invest in addressing climate change and protecting the planet's biodiversity. That's 9 percentage points more than the overall average and a reflection of the industry's success in developing products with a better carbon footprint.

Increasing the resilience of the supply chain

Economic and business threats aren't the only risks metals CEOs need to address. High-impact external events are important as well. More than a quarter of metals CEOs (28%) told us the earthquake and nuclear crisis in Japan had directly affected their companies. That's probably because the disaster had a serious impact on the automotive sector, which is a key customer for many metals products companies. But, whatever the explanation, metals CEOs certainly took note: 25% have responded by changing their company's strategy, risk management or operational planning.

They'll also need to work more closely with their customers to build more resilient supply chains – and the automotive sector should be particularly receptive to this idea. Nearly half the automotive CEOs we surveyed are worried about supply-chain security. There are other good reasons for creating more flexible and robust supply chains, though. Research conducted by PwC's PRTM Management Consulting shows that integrating five key 'flexibility levers' in a company's supply chain can increase its revenues by 12-15% annually.[8]

The talent challenge

In most sectors, CEOs report that finding and keeping the right talent in the right markets is probably the biggest challenge they face. But here, too, the picture is different for metals CEOs. Talent management is much lower on the list of areas metals CEOs want to change this year, coming in at number six, rather than in the top spot. Only 43% are concerned that a shortage of key skills could jeopardise their company's growth (versus 53% of the total sample). And only 53% want to spend more time developing the leadership and talent pipeline (versus 68%).

Why isn't talent management higher on metals CEOs' agenda? Here's one possible explanation: they're so concerned about the gloomy economic outlook that it's edged out other issues. Slower headcount growth could be another factor. Only 33% of metals CEOs have hired more people in the past 12 months, which is 20 percentage points less than the overall average. And though 35% of metals CEOs plan to increase staffing levels in the coming 12 months, that's also far less than the 51% of CEOs who intend to do so in our sample as a whole. With fewer companies hiring, the need for new approaches to talent management may seem less urgent.

8 PRTM Management Consulting, '2011 Global Supply Chain Trends: Achieving flexibility in a volatile world' (2011).

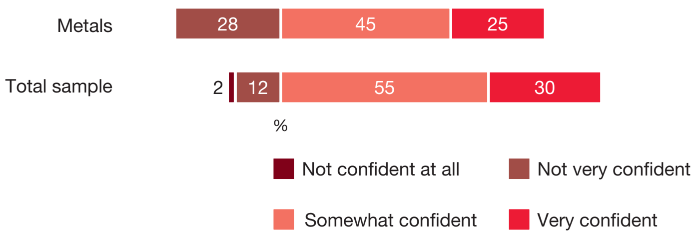
Keeping up the focus on talent

But there are clear signs that metals CEOs need to look past the immediate future and keep the pressure on, when it comes to managing talent. Skills shortages have a direct effect on the bottom line, as some metals CEOs have already discovered: 40% told us their labour costs have risen more than expected in the past 12 months. And the opportunity costs may be even higher. More than a third of metals CEOs say talent constraints have already affected their company's performance in overseas markets and impaired its ability to innovate.

The situation could be even worse in future: 33% of metals CEOs believing it's getting harder to hire good workers – and that's while many boomers are still too young to retire. In fact, metals CEOs are actually less confident than their fellow CEOs that they'll have access to the talent they need to execute their company's strategy over the next three years (see Figure 4).

Figure 4: Only a quarter of metals CEOs are very confident of their company's talent pipeline

Q: How confident are you that you will have access to the talent needed to execute your company's strategy over the next 3 years?



Base: All respondents (Total sample, 1258; Metals 40.)
Source: PwC 15th Annual Global CEO Survey

Getting the full picture

How can metals CEOs make sure they have a competitive people strategy? The first step may be getting more of the critical information that's needed to make the right decisions. Almost all metals companies see traditional indicators like staff productivity (93%) and labour costs (85%) as important. Employees' views and needs are also right at the top of the list with 93%.

In fact, staff productivity is one measure metals companies track more rigorously than most: 38% of metals CEOs believe they get comprehensive information on this benchmark, compared to just 25% of the total sample. The percentage who are completely satisfied with the data they get on internal advancement is the same – and that's a good guide to employee satisfaction

When it comes to other important data that can help companies make talent more strategic, though, metals CEOs are falling behind. The percentage who see return on investment in human capital as important drops to 70%, and only 58% rate costs of employee turnover as a critical measure. This suggests that metals CEOs may not have a full view of how much benefit they get from their investments – or how much turnover could be costing them.

Skills on the line can be hard to find

While for CEOs in general high-potential middle managers are the biggest talent challenge, metals CEOs say it's just as difficult to find and keep skilled production workers (see Figure 5). In many mature markets, that's because the workforce is ageing. "Europe has the best universities and technical institutes but it has an ageing population. By 2020, it will be very short of talent," says Mr. Kalyani.

The situation's similar on the other side of the Atlantic. The average age of employees at one steelmaker in Cleveland, Ohio, is 57, for example – and the competition for younger workers is rising as the regional steelmaking industry revives. The company has responded by developing a work-study programme in conjunction with the local community college to train future workers.[9]

9 'Ohio Mill, Union and College Collaborate on Training the Next Generation of Steel Workers' The Republic (20 November 2011), http://www.steel.org/sitecore/content/Global/Document%20Types/News/2011/Ohio%20Mill%20Union%20and%20College%20Collaborate%20on%20Training%20the%20Next%20Generation%20of%20Steel%20Workers.aspx

Sending the right talent overseas

Another big concern for metals CEOs is filling key spots abroad. At present, 35% transfer senior managers from their headquarters country to newer markets when the need arises. But in an ideal world only 23% would do so. The flow is still mainly one way. While 55% of metals CEOs plan to use experienced employees from their home countries to beef up the workforce in newer markets, only 15% plan to do the reverse.

Targeting millennials and keeping boomers

Increasing the number of employees working overseas could actually be good news when it comes to attracting younger employees. Other research shows that millennials are more interested in overseas postings than their predecessors: 71% want to work abroad at some point in their careers.[10] The strong commitment to corporate sustainability that we've highlighted may also help attract younger workers.

But the industry will need to adopt more flexible working patterns to encourage diversity and retain people at the other end of the age spectrum as well. Demographic changes are already influencing how metals companies in developed economies manage their workforces. ThyssenKrupp is one such instance; it's introduced flexible working hours, part-time work and regular retreats for children to help employees find the right work/life balance. Its trainee programmes also feature job rotations at locations around the world as a core part of professional development.[11] And, in Korea, the Pohang Iron and Steel Company runs an educational foundation that operates kindergartens and schools for employees' children.[12]

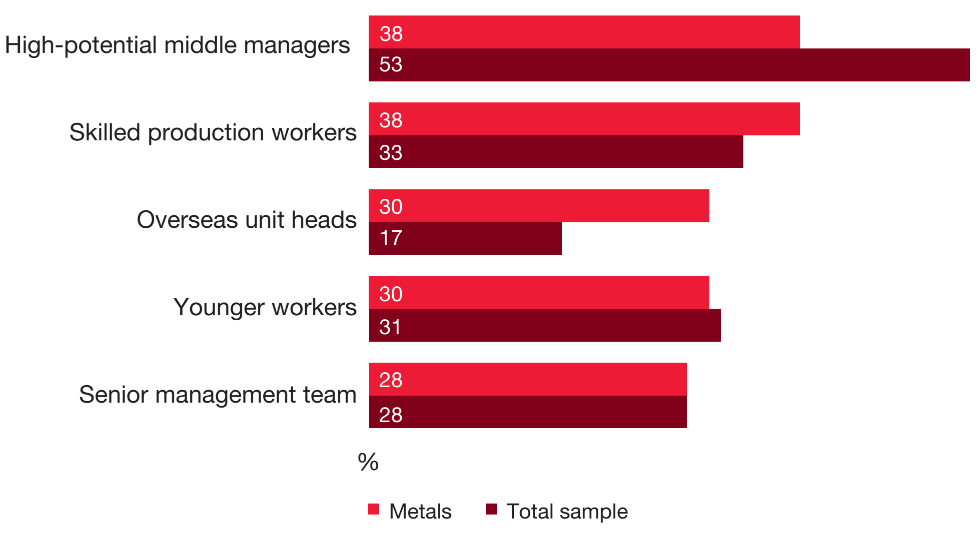
Metals CEOs are committed to workforce development

Metals CEOs are convinced that the private sector needs to play a major role in creating and fostering a skilled workforce. Just 38% think it should be a top priority for the government, while 80% believe that business in general has a role to play in developing a skilled workforce above and beyond their own employees.

They're taking that responsibility seriously. Four-fifths of metals CEOs are already making direct investments in this area in at least some of the markets where they do business. But while most CEOs in other sectors make such investments primarily to ensure a future supply of potential employees, metals CEOs are more likely to do so because they want to improve living and working conditions in the countries where they operate.

Figure 5: Skilled production workers are as big a talent challenge as high potential middle managers for metals CEOs.

Q: With which of the following groups do you currently face the greatest challenges with regard to recruitment and retention?



Base: All respondents (Total sample, 1258; Metals 40)
Source: PwC 15th Annual Global CEO Survey

10 PwC, 'Millennials at Work: Shaping the workplace', (December 2011).

11 ThyssenKrupp, 'Work-Life balance', http://karriere.thyssenkrupp.com/en/career/your-future-with-thyssenkrupp/employer-performances/work-life-balance.htm and 'International Operations', http://karriere.thyssenkrupp.com/en/career/your-future-with-thyssenkrupp/employer-performances/international-operations.html

12 POSCO Educational Foundation, http://www.posef.or.kr/posefen/rationale.asp

What's next?

Deciding which processes and capabilities need to be global, regional and local isn't just about taking advantage of growth opportunities; it's also about developing the flexibility to survive disruptions, wherever they may surface. That involves getting the right people into the right roles in the right places. It's not an easy balance to strike. We've distilled eight key questions from the feedback CEOs have given us in this year's CEO Survey:

1. **How local is your global growth strategy?**
2. **How are you balancing global capabilities with local opportunities?**
3. **Is your talent strategy fit for growth?**
4. **Are your innovations creating value for your customers – or just novelty?**
5. **Are you prepared to deal with the consequences of risk?**
6. **Are you responding to the needs and constraints of the communities in which you operate?**
7. **Where are the biggest opportunities for business and government to coordinate better?**
8. **Are you adapting your governance model to changing stakeholder expectations?**

If you'd like to discuss any of these questions, please contact us.

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