ITEM 11:
MERGERS AND ACQUISITIONS, CONSOLIDATION AND STEELMAKING CAPACITY

87th session of the Steel Committee
Paris, September 26th, 2019

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Background

- Firms in dynamic markets are continuously under pressure to adjust and restructure

- Industries may therefore need to undergo process of structural adjustment i.e. reorganising and/or reducing factors of production

- Mergers and acquisitions (M&As) can be an important mechanism to facilitate structural change across firms and within sectors
  - M&A refers to change of ownership and “control”

- Growing firms can acquire and integrate existing firms rather than increasing the scale of current plants or opening up new ones
  - Consolidating or closing other parts of the firm that are less productive
Why steel firms may want to consolidate?

- Lower raw material costs due to greater bargaining power
- Lower costs of distribution and logistics via an expanded and integrated distribution network
- Greater economies of scale possibly reducing unit costs and enabling higher profits
- Steel firms may seek to also consolidate through cross-border mergers to further achieve greater pricing power
How M&As in steel sector alleviate excess capacity

• M&As can function as a mechanism of inter-firm adjustment and exit

• If firms find synergies, close and consolidate operations and transfer resources away from less productive to more productive plants, leading to potential exits
  – Knowledge spillover and capital diffusion
  – Scant empirical evidence on M&As and steel excess capacity

• After acquisition targeted firms employ capital more efficiently and obtain enhanced productivity gains

• M&As can also facilitate financial restructuring which may also help streamline production and any future expansion plans
How M&As in steel sector alleviate excess capacity (cont’d)

• The expansion and enhanced performance from M&As may increase competitive pressure in market inducing other less efficient businesses to scale back inefficient activities and/or exit

• Extent to which M&As may facilitate closure and scale back will depend upon market and regulatory conditions
  – Barriers to entry and exit, labour market conditions, access to finance, judiciary efficiencies
Why M&As in the steel sector may not improve excess capacity

- If firms with considerable cash reserves use acquisitions to obtain low performing plants during economic downturns
  - An anticipation of a market uptick in the near future

- If firms use M&As as a means of improving its access to finance

- Firms looking to acquire new plants may be cherry picking top performers

- M&As may escalate financial challenges because extremely large companies are more prone to moral hazard problems
Why M&As in the steel sector may not improve excess capacity (cont’d)

• Horizontal M&A activities may lead to sectoral concentration overtime

• Increased concentration may result in decline in competition
  – slower productivity growth, less innovation and oligopolistic behaviour

• Lobbying activities are also more likely to be undertaken by firms when benefits are concentrated, which is usually the case in more concentrated markets
Data

• Dealogic specialised data on M&A deals
  – One of the most comprehensive databases on ownership changes and “control”

• An M&A deal involves different types of transactions
  – Acquisitions, pure mergers, divestments, share buybacks, etc…

• Moreover, each deal involves at least two of the following types of parties:
  – Acquiror: investor/company that is buying shares in a target company
  – Target: company that is being invested or divested in
  – Divestor: investor/company that is divesting in the target

• Time period: 01/01/95 to 31/12/18

• Coverage steel industry, as well as a selected number of industries, which may also be affected by excess capacity
Evolution of M&A deals in selected industries
Evolution on number of horizontal M&As

M&A deals targeting steel businesses, 1995-2018
Evolution on number of cross-border M&As

M&A deals targeting steel businesses, 1995-2018
Geographical distribution of M&As


- China: 14%
- United States: 13%
- Japan: 11%
- Russian Federation: 10%
- Germany: 5%
- India: 5%
- South Korea: 4%
- United Kingdom: 3%
- Brazil: 2%
- Luxembourg: 2%
- Netherlands: 1%
- Other: 29%
Evolution of M&As in selected economies

Output 1: Prevalence M&As in Steel

• Assess the nature of M&A activities within the steel sector over time

• Methodology
  – descriptive statistics and simple correlations

• Answer the following questions:
  – What are the trends of M&As over time and how are they concentrating across geography (target and acquirer)?
  – Are M&As incremental or sudden? How often does a steelmaking asset change ownership?
  – What are the characteristics of investors that acquire steelmaking production units?
Output 2: M&As and capacity consolidation

- Examine the statistical relationship between M&As and capacity

- Methodology:
  - Econometric analysis at the micro-level

- Answer the following questions:
  - What is the relationship between M&As and capacity?
  - Does the relationship between M&As and capacity (if any) evolve over time?
  - If M&As result in changes in steelmaking capacity, how are these achieved?
  - Is there a homogenous relationship between M&A and steelmaking capacity change?
Thank you for your attention

Questions?

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