Another Setback for the Tatas*

C.P. Chandrasekhar

At the end of March, Indian private sector steel major Tata Steel, flagship firm of the Tata group, announced that it was closing its steel operations in the UK that are reportedly bleeding losses at the rate of one million pounds (approximately Rs. 9.5 crore) a day. Its board meeting in Mumbai, had rejected a plan to turn the UK company around, on the grounds that it was unaffordable and did not make sense, preferring sale of the business. However, with no suitors coming forward to buy out the assets, expectations are that it would soon just close its British plants. This is a second major failure of investment decisions taken by the Tatas in recent times, the other being the launch of Nano, the cheap, small car.

In Britain the likely closure, as expected, has raised a series of questions: the fate of the 15,000 steel workers (more than 4,000 of whom are concentrated in Port Talbot in the South and 3,000 in Scunthorpe in the North) likely to be affected by the decision; the future of the British Steel industry given global overcapacity; and the role of competition from and limited protection against cheap Chinese imports in influencing the current situation. In particular, it is being argued that British industry is being wiped out because Europe and the UK protect their industrial sector (against Chinese competition) less than the Americans do. The crisis has also led to a call from Labour leader, Jeremy Corbyn, that the UK government should nationalise the company and not treat workers as expendable, which would require the Conservative Party under Cameron to rethink its market oriented industrial policy.

Corbyn's call makes sense to many because the fate of Tata Steel is widely seen as the result of neglected investment in the plants of the company as it moved from state ownership under British Steel to private owner Corus Steel, before being acquired by Tata Steel in a bidding war against Brazil's Companhia Siderurgica Nacional (CSN) in 2006. That war took the price paid by Tata for Corus to 608 pence a share as compared to the original offer of 455 pence a share. Analysts at that time had held that the final price was clearly over the top, especially for capacities that were not the most competitive, and driven more by 'nationalist fervour' rather than business logic. Reflecting that 'nationalism', Ratan Tata was reported as saying at the time: "I believe this will be the first step in showing that Indian industry can in fact step outside the shores of India in an international marketplace and acquit itself as a global player."

The sceptical analysts are now proving to be right. The claim that in 2006 nobody anticipated the 2008 global crisis or the slowdown in China is to miss the point. It is not just that not anticipating is in itself a failure. It is also that if original acquisition costs were a third lower, Tata Steel may have been in a position to weather these difficulties much better and even stay afloat till when (and if) global capitalism experiences a revival. The Tata's claim then was that its decision to stay in the acquisition battle for Corus and acquire it at the high price it paid was because, while its original offer was valid as a price for Corus as a standalone facility, the potential synergies embedded in an acquisition by Tata Steel of Corus warranted the much higher price offered. The claim was that Tata India could ship iron ore and/or low-cost crude steel to Corus' plants in Europe, which would use their technological know-how to turn this low-cost raw steel into finished products for European markets. Clearly that did not work. At that time expectations were that steel demand would rise sharply because of the finance-led construction boom in the region and China's breath-taking growth. But there were at least some who saw the construction boom as speculative and China's growth as led by too much investment creating unutilised and unusable infrastructural and industrial capacity. They were right—the boom went bust and Tata Steel UK, among the less competitive, faced a crisis.

On the Indian side this experience raises a different set of questions. It challenges the much-lauded Indian investment thrust overseas that has been backed by governments unable to ensure adequate demand growth at home. It also raises questions on the ripple effects the Tata crisis in the UK can have within India.

For some time now, Indian firms that had built up adequate capability in certain areas to identify, acquire and run production facilities have been viewing external expansion as a means of addressing the problem of inadequate growth opportunities at home. On the other hand, large inflows of foreign capital after liberalization, which were well in excess of the sums required to finance the current account deficit in India’s balance of payments, had encouraged the government to liberalize the cap on the investment that domestic firms could make in operations abroad. The government had also incentivized such investment with a concessional rate of tax at 15 per cent on dividends received by Indian companies from their foreign subsidiaries. As a result, the annual increase in commitments abroad by Indian firms in the form of equity, loan and guarantees issued, which stood at more than $10 billion in 2007-08, touched an annual figure of about $17-18 billion during 2008-10 and then registered a spike to $40-44 billion during 2009-11 and $35-37 billion during 2012-14.

This did give rise to a new sentiment in government and outside. That the share of manufacturing in GDP at home was distressingly low when compared to India’s erstwhile peers when they were at similar levels of per capita income was increasingly ignored. Focus was on the success of Indian firms abroad, not as exporters from India but as investors in foreign lands. Besides Tata Steel there were other examples that were often quoted, without reference to the possible correctness or otherwise of the investment decision. The Tata acquisition of JLR Land Rover, Hindalco’s acquisition of Novelis and Bharti Airtel’s acquisition of Zain Telecom’s African operations are typical instances. What the Tata Steel experience reflects is that this kind of a strategy, where the focus is on the fortunes of individual Indian (or Indian origin, as in the case of Arcelor Mittal) companies abroad, has rarely been successful. It has not generated much by way of foreign exchange through profits that are partially repatriated to India with the benefit of lower rates of taxation. It has also been a total failure as an alternative to growth based on investment at home geared to domestic or export markets.

However, the difficulty is that the ‘nationalist’ celebration of the foreign forays of ‘Indian’ firms has encouraged the government to support this strategy. This came into focus in November 2014 when during a visit of Prime Minister Narendra Modi to Australia, industrialist Gautam Adani signed a memorandum of understanding with the public sector State Bank of India for a loan of up to $1 billion. The loan was to part finance the currently-shelved Carmichael project to mine the huge coal reserves in the untapped Galilee Basin. With the federal Australian and the Queensland state governments desperate for the investment to address the problem of collapsing employment in the coal industry, the Adani project too was seen as an instance of India’s emerging role as a favoured international investor that needs government backing.

This, however, is not a new tendency. Even in 2006, when Tata Steel acquired Corus, the Indian government was expected to back the buy-out materially, with credit from the public banking system. Reports at the time of the acquisition suggested that the company planned to fund the acquisition on a 53:47 debt-equity basis, with the exposure of Tata Steel likely to be in the region of $4.1 billion, which too will be a mix of debt and equity. This was expected to take Tata Steel's debt-to-equity ratio to above 100 per cent from its pre-acquisition level of about 15 per cent. So, besides the question as to how the company would bear the interest burden given the high capital costs associated with the competitive bidding, there was the question as to where the required credit would come from. When the deal was announced, the then Finance Minister P. Chidambaram had declared that the government "will be ready to help the Tatas, if they have any request, to complete the Corus

transaction", though he qualified his statement by saying that it would only be "general help" in the nature of facilitating "clearances or approvals or permissions" within the country. But there may have been more to this support.

Tata was to finance its approximately $13 billion acquisition of Corus, with around $4.1 billion in equity, $16.14 billion in long-term debt and $2.66 billion in short-term debt. Whatever the final proportions, there can be no doubt that the debt incurred must have been huge (upwards of Rs. 12,500 crore at today's exchange rate). While a consortium of foreign banks led by Credit Suisse, and including Deutsche Bank and ABN AMRO, had helped put together the package, a number of Indian banks— Export Import (Exim) Bank of India, Bank of Baroda, ICICI Bank (UK) and Bank of India—had expressed an interest in being a part of the consortium. Given the secrecy surrounding these matters the exact exposure of these banks is not known.

The debt had been incurred against Corus' future cash flows that were clearly overestimated. In fact,Tata's decision to retrench its UK assets is seen as a way of paying down the company's net debt placed at close to $10 billion (or around Rs. 65,000 crore) at the end of last year. But with selling the UK assets proving a difficult proposition in today's market, that debt would not be easy to drop. This does increase the vulnerability of the Tata's, since debt of the kind incurred for the Corus acquisition has to be serviced in foreign currency at a time when the rupee is depreciating. It also increases the vulnerability of an already beleaguered banking system. That has been the result of seeking success abroad rather than fixing problems at home.

* This article was originally published in the Frontline, Print edition: April 29, 2016.