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Thailand's Steel Dreams Turn to Rust --- Inexperience and Mismanagement Stymie Effort to Build New Industries

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BANG SAPHAN, Thailand -- Outside the \$600 million state-of-the-art **steel** mill, it is clear that something is wrong.

Unsold **steel** coils are stacked everywhere, rusting in the dirt around the factory and in nearby fields. Sahaviriya **Steel** Industries PCL is choking on its inventory: more than a quarter-million tons of finished product, almost three months' production. The company earlier this month reported a 1.12 billion baht (\$44.3 million) loss for the first half of this year; the shares it sold for 50 baht in its initial public offering two years ago are now trading in the low teens.

With Thailand rapidly losing competitiveness in labor-intensive industries such as textiles and footwear to low-wage rivals such as Indonesia and China, the country's new heavy industries are under pressure to quickly become competitive. A successful **steel** industry would help Thailand narrow its trade and current account deficits, which are among the world's widest and serve as a red flag for economists worried about a Mexico-style economic meltdown.

But what if companies invest billions of dollars building a **steel** industry and still can't produce **steel** competitively? That's exactly what has happened so far.

Thailand's industrial novices are bleeding money after a punishing combination of tough global market conditions, startup troubles and their own inexperience. Along with Sahaviriya **Steel**, other industrial companies reporting first-half losses this month included NTS **Steel** Group PLC (262.6 million baht) and petrochemical maker Vinythai PLC (135.3 million baht). Since the beginning of last August, foreign and local investors have lost \$1.4 billion in market capitalization in the withered shares of those three companies alone.

The disappointment in the performance of Thailand's **steel** industry is characteristic of the current hangover from Asia's decade-long investment party. For years, Southeast Asia seemed to have a recipe that couldn't lose: cheap labor, rapid industrialization, big markets and strong economic growth. But worries have grown in recent months -- notably in Thailand but to varying degrees across much of Asia -- amid slowing economic expansion, dramatically lower export growth, and surprisingly weak earnings performance.

The broad economic slowdown may prove to be nothing more than a quick breather before full-speed growth resumes. But Thailand's struggling **steel** industry shows how the can't-fail assurances that lured billions of dollars in local and foreign investment can look, in hindsight, like top-of-the-market froth. In many cases, the business assumptions proved extremely optimistic, management skill wasn't up to the task and the expected profits haven't been delivered.

"We don't have the experience," says Sawasdi Horrungruang, chairman of NTS **Steel** Group, whose electric arc furnace melted a 263.4 million baht hole in its income statement during the second quarter. "It's not old technology. You can buy a Porsche or Ferrari that can drive 300 kilometers an hour. But not everyone can drive that fast. Only a champion can."

Steel plays a central role in the vision of Thailand's economic planners. In the 1980s, the government decided it would make sense for the country to produce its own high-quality **steel** rather than import it, despite worldwide overcapacity that made low-cost supplies easily obtainable. The process is often described as climbing the value-added ladder, moving from the simple assembly of imported parts to capital and technology-intensive production.

So in 1989, after more than a decade of feasibility studies of flat-**steel** manufacturing, the government granted investment incentives to the Sahaviriya Group to build Thailand's first mills for making hot-rolled, cold-rolled and electro-galvanized **steel**. These flat-**steel** products are used for everything from pipes to auto bodies. The incentives included duty-free imports of equipment, eight-year exemptions from corporate income tax, and permission to bring foreign skilled workers into the country. Sahaviriya began producing hot-rolled coil in February 1994.

NTS **Steel**, meanwhile, built a \$230 million minimill for producing **steel** rods and bars that incorporated an advanced European electric arc furnace.

The results in both cases have been disastrous for investors. In its 1992 IPO prospectus, NTS projected it would make 550,000 tons of **steel** in 1995 and earn a profit of 1.6 billion baht. Instead it made only 360,000 tons and lost 68 million baht. Similarly, Sahaviriya's 1994 prospectus said it would make 1.3 million tons of **steel** in 1995 (it didn't make a profit projection); instead it made 1.1 million tons and lost 189 million baht. A significant chunk of what the two companies did produce remains unsold.

What went wrong?

The steelmakers blame much of their troubles on what they label as dumping from the former Soviet Union and Eastern Europe. But the Thai companies have also been hurt by startup troubles and their own inexperience.

Using the same equipment as NTS, U.S. companies have been able to produce 30 to 32 melts, or batches, a day. NTS has achieved only 16 to 17 a day. NTS officials concede that the problem is one of management.

"Today, everywhere in Europe, in Japan, and the United States, they talk about tap-to-tap (batch) times of under 50 minutes; but here in Thailand almost every minimill is over 65 minutes, sometimes 70 or even more," says Wikrom Vajragupta, project manager and deputy managing director at NTS subsidiary Nakornthai Strip Mill PCL. "This is a tremendous difference in cost. But to reduce the operating time isn't easy. It depends on how people react in the mill. If people aren't trained, if they can't work as a team, then they have a difficult time trying to squeeze down the time."

It is not that Thai workers can't be trained to perform. But with one of the lowest rates of secondary and higher education among Asia's fast-developing economies, Thailand has a severe shortage of engineers and experienced managers, compounded by rapid job-hopping and wage escalation.

Sahaviriya's money-losing subsidiary Thai Coated **Steel** Sheet Co. in 1994 sent eight engineers to Japan for training. Two years later, only one remains on staff. "If they move to a new company, they get a 20% salary increase," says Thai Coated's vice president Masaru Nabatame. "Some get 50% by moving to management."

Compounding the shortage of skilled staff are cultural factors that reduce efficiency. Thais are accustomed to deferring authority upward to their seniors; low-level employees are often afraid to make tough decisions themselves.

"Our culture itself comes from a very feudal system," says NTS's Mr. Wikrom, a former professor of metallurgical engineering. "There's a lot of belief that you have to respect people who are more senior, and there should be a rank, and many lines of command. That gets us into trouble. I would say the inefficiency is in the management, not in the people. If you compare workers, they can work as hard as Americans."

NTS is moving to revamp its operations with expertise imported from the U.S., whose **steel** industry is now considered the world's most competitive. Last month it brought in a team of a half-dozen U.S. **steel**-industry veterans on longterm contracts to run its operations.

And NTS subsidiary Nakornthai Strip Mill, which is building a \$600-million mill for making hot-rolled coil, this year signed a letter of intent for a management assistance agreement with Nucor Corp. The U.S. steelmaker also has an option to take an equity stake in the Thai firm, and will be paid in part according to how Nakornthai's performance compares with Nucor's.

The next generation of **steel** startups may be better placed to avoid such technical difficulties. Large shareholders of some of the planned plants include Japanese **steel** companies, which will presumably bring along their well-honed management systems. Japanese auto makers say their existing plants in Thailand are highly efficient.

For Thailand's **steel** and petrochemical startups, the steep part of the learning curve has coincided with tough global market conditions.

Thailand's fledgling industries are particularly vulnerable to cyclical market downturns. Most Western and north-Asian **steel** and petrochemical facilities are integrated, producing several stages of the product cycle from raw material to finished goods. Thailand's startups generally produce only one or two products and lack control over their raw materials, leaving themselves vulnerable to the wide swings common in commodity prices.

Vinythai PCL watched the average spread between the market prices of its finished product PVC (poly vinyl chloride) and its raw material VCM (vinyl chloride monomer) fall from \$210 a ton in 1994 to \$50 in 1995; during last August and September, the raw material actually cost more than the finished product.

Sahaviriya has also been hurt by supply and price swings. For part of the spring of 1995, its **steel** slab raw material was almost unavailable. Large, established producers secured their supplies first, leaving smaller players such as Sahaviriya out of luck. Sahaviriya was forced to shut down production for about 20 days that spring, an official says; others in the industry believe the plant was shut down for longer.

Once **steel** slab became available in the second half of 1995, Sahaviriya stocked up. Unfortunately, prices for its finished product soon collapsed. After it paid a steep \$280 to \$290 a ton for a quarter-million tons of slab, Western-grade hot-rolled coil prices fell from a peak of about \$430 a ton in the middle of 1995 to just more than \$300 now.

Thai industrials are moving toward integration. Vinythai began making its raw material VCM in July, but only after a six-month delay. The next generation of Thai **steel** and petrochemical plants scheduled to be on-line by the end of the decade will be fully integrated.

But massive expansion throughout Southeast Asia leaves the region's **steel** and petrochemical industries threatened by oversupply, some analysts and industry executives believe. Three planned ethylene plants in Thailand alone will bring the country's production to about 2.5 million tons a year, though Thailand's current annual demand is only 700,000 tons. Since the beginning of last year, Thailand's Board of Investment has approved \$8.8 billion in investment in 40 petrochemical projects due to be completed within three years.

With its population of 59 million, Thailand has the advantage of a large domestic market, unlike Singapore and Malaysia. And much of the future ethylene supply will be taken up by other petrochemical plants that use ethylene as their raw material.

Still, there is likely to be a substantial excess supply being exported at cut-rate prices in a few years. "Export competition should be very tough," says Senior Vice President Aditheb Bisalbutr of money-losing Thai Olefins Co., which has weathered substantial startup troubles. In order to survive, he says, the new industries will need the backing of powerful industrial groups willing to fund their losses.

Thai steelmakers say their biggest problem has been imports of low-cost **steel** from the former Soviet Union and Eastern Europe. They have been demanding more government protection in the form of surcharges on imported **steel** (on top of the 4-10% duties already levied), plus a new anti-dumping law that would impose punitive taxes and countervailing duties on foreign competitors regarded as dumping.

The former-East bloc producers have been selling their low-grade **steel** in Thailand for \$260 to \$270 a ton, says Sahaviriya **Steel** President Adisak Lowjun, forcing Sahaviriya to sell its higher-grade product at \$290 to \$300. At that rate, Sahaviriya loses about \$40 on every ton it sells.

"We can compete with South Korea, Japan, the U.S. and Europe, but not with communist producers," says Mr. Adisak. "This has become a very critical period for us. We are all in trouble."

Last week Thailand's steelmakers got some relief. The Ministry of Commerce and Board of Investment increased the surcharges on several types of **steel**. The measure will last for one year, but could be renewed. Total duties and surcharges on the type of **steel** Sahaviriya makes have been increased from 10% to 20%.

"We're like a two-year child fighting with 30-year-old men," Mr. Adisak says. "Is it fair? It's not, of course. We need some protection first. Then when we're 10 years old, we'd like to fight, with our bare hands."

But when tariff protection is due to expire, 10-year-old and older companies around the world often plead that they're still not ready to compete. Raising tariffs often has side effects, moreover. One of them could be inflation; Thailand has endured more than a year of high interest rates aimed at curbing the rapidly rising prices seen in 1995 and early this year. And because finished **steel** is a raw material for many other industries -- including Thailand's booming auto industry -- pricier **steel** could damage their competitiveness.

"With any measure, there will be people complaining," says an investmentboard official. "Somebody is always affected if you change the tax."

Before the government increased the surcharges, local **steel** executives were bleak about their prospects if they didn't get more protection. "Without the import duties to help us out, we haven't got a prayer," says Hank Herin, a 42-year U.S. steelmaking veteran brought in last month to serve as NTS acting managing director and general manager. "We really can't compete unless we get them to charge a reasonable price."

Asked after the government action whether the new surcharges will give NTS what it needs, Mr. Herin points out that tariffs in some other Asian countries are 30-40%. "While this is a step in the right direction, I'm not sure if it's far enough."

Stuck with 150,000 tons of finished product in inventory -- nearly five months of production -- NTS shut down its furnace in early July and turned off its rolling mill a month later. It expects to resume operations next month.

Though the losses have been punishing for Sahaviriya and NTS, both say they have adequate cash available to continue operations for now.

"We already have our working capital," says Sahaviriya's Mr. Adisak. "That's what we're running by. But if we continue to lose another one billion in the next 12 months, that will be a different story."

The tough times are weakening Thai heavy industries to the point where it has become hard for them to fund their expansion. Sahaviriya Group's plans had called for it to build a \$1.4 billion mill for making **steel** slab and billet by 1998. It has now put those plans on hold, Mr. Adisak says. "The funds aren't available."

Bleak as things may look now, however, today's troubles don't necessarily mean that Thailand's heavy industries won't be competitive in the long run. Startups must often struggle with inexperience, bad luck and growing pains. And after all, Thailand has graduated from rice growing to building silicon wafer fabrication plants in a few short years.

The rush of global economic change probably forced the country to climb up the value-added ladder before it was ready, but in any case, Mr. Adisak says, Thailand doesn't have a choice.

The Japanese "used to be beginners also," he says. "If we don't start now, how about 20 years from now? We'll be industrial slaves. You have to be a beginner first to become an experienced person."

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