Can Poland ever be like the West of us?

To fully appreciate the transformation made in Poland and the subsequent changes in its society, economy and steel industry, it is essential to look back at what there was before and contrast this with what is happening now and where the country is heading. As issues arising from overcapacity are solved, supply dips closer to demand and the price of finished products approaches market value, helping to make Polish producers profitable. 2005 and 2006 witnessed production of the Polish steel industry creep ever-closer to a market-based rather than volume-based philosophy.

BY ELOUISA DALLI & OLIVER CAMPBELL*

Hindsight is seldom forgiving when it scrutinises communism, but to fully appreciate the transformation made in Poland and the subsequent changes in its society, economy and steel industry today, looking back is essential. Ernesto 'Che' Guevara is now a T-shirt design, Chairman Mao is now officially 30% wrong, and the wall that would never fall, fell. Those 'recovering' from communism tend to avoid looking back. Would McCarthy have ever feared 'the Red menace' had he known Eastern Europe's particular brand of communism would be as inherently suicidal as it was sadistic?

From the alleys and squares in picturesque cities such as Krakow, to the Lego-like structures in the planned industrial zones of Nowa Huta, it is clear that today's (unemployed or underemployed) Polish youth has more in common with its American, British or even Japanese counterparts than with its own parents: Poland is suffering from social schizophrenia. Before Google, MTV or 'just doing it' were fashionable in Eastern Europe, a wall divided an already divided German city, students were cut down in Beijing's 'Gate of Heavenly Peace' and an iron curtain provided Poland with shade from many of the activities, information and choices that its youth now takes for granted: it is hard to remember the merits of communism in Poland.

POLAND TODAY

The success of today's steel industry is therefore despite rather than because of the communist era. By looking at the situation within each sector of Poland's steel industry today, we can get a better idea of where it is headed. After good results in 2004, 2005 was more a year of good intentions. Several issues arising from overcapacity were solved through rigorous structural changes and further international consolidation, allowing international supply to dip closer to demand. The prices of finished products began to correspond to market value, helping to make Polish producers profitable for another year. 2005 and 2006 are witnessing the production output of the Polish steel industry creep ever closer to a market-based orientation rather than volume-based. Romuald Talarek, chairman of the Polish steel association Hutnicza Izba Przemyslowo-Handlowa (HIPH) believes that, "owing to investment, improvements and the closure of certain projects over recent years, we are not diverging from international standards, practices or environmental controls."

Poland's domestic supply today is dominated (over 60%) by long products. Talarek believes that "thin flats supplies coming from captive manufacturing processes are not sufficient" and that "domestic consumers have a complete product range to offer". In terms of Poland's trading partners, EU steel imports account for 85% of total imports; exports to EU countries account for over 67% of the total figure. The trade balance, as Talarek notes "is not alas positive for Poland".

In terms of the sustainability of an industry that, as recently as six years ago, looked as if it might have breathed its last, Poland is now looking at the creation of longer term value, with new steel mill owners continuing investments into downstream processes. Mittal Steel Poland's construction of a new hot strip mill in Krakow suggests that the country's strip range will drastically improve.

Productivity rates across the steel industry, while still below those in Western European countries, are rapidly improving. The arrival of new, private, foreign owners means that the operations and philosophies of the Polish mills have changed for good – 'now economics come first' as Talarek explains.

Poland's recent steel consumption floats between 7.5-8.5Mt/y. Talarek acknowledges that this figure is expected to increase substantially as public and private sector investments into construction and infrastructure projects, particularly as predicted by Poland's government, will 'substantially boost steel consumption in Poland."

One part of restructuring, which was essential if the Polish steel industry was to truly shed its communist skin, has been cuts in employment. Consequently productivity levels have increased whilst relative labour costs are falling; the net effect on Polish society has been a drop in employment. This, coupled with the increased flow of labour towards Western Europe (specifically the UK) after 2004's EU accession has left some or the older, die-hard industry members telling the younger Polish generation: "Will the last one to leave turn out the lights!"

Foreign owners, working with EU directives and the Polish government, have provided not so much a 'stay of execution' but rather have taken Poland's steel industry off Death Row and transformed it into a productive, efficient, attractive and responsible member of the international steel community.

	1990	2005	Remarks
Supply/demand	S ≤ D	S ≈ D	Strong capacity reduction – more than 50%
Ownership	State	Private owners	
Main end-users	Military industry + infrastructure	Like in the EU	
Production structure	Long 70% Flat 30	Long 60 Flat 40	Objective: Flat 60% total
Steelworks	Majority: open hearth furnaces	Only BOF + EAF	

Table 1 Carbon steel – main differences in 1990-2005 Source HIPH

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AN IRONIC TURN – IRON CURTAIN RESTRUCTURED

What westerners call ‘steelworks’, the Czechs call ‘hut’, the Germans call ‘hütte’, the Poles call ‘huta’. The construction of Nowa Huta (New Steelworks), showed that Poland could add some much needed carbon to its iron curtain. Nowa Huta today, can only be described as a city that would bring George Orwell to tears. The concept of Nowa Huta began in 1949 as a separate town near Kraków on terrain repossessed by the Communist Government from the former villages of Mogila, Pleszów and Krzeslawice. It was planned as a huge centre of heavy industry. The town itself was to become an ideal town for the communist authorities, populated mainly with industry workers. In 1951 it was joined with Kraków as a separate district and the following year tramway communication was started. World War II presented a particularly busy period for Polish steel production. The establishment of the People’s Republic of Poland (as it became known after 1952) and the emergence of Krakow as a city relatively unscathed by the war (excluding the fact that Auschwitz is a stone’s throw away) was a cause of certain jealousy from other areas of the Republic. The Communist authorities decided that the substantial resistance presented to its regime from middle-class Krakovians could be ‘corrected’. To "correct the class imbalance", the authorities commenced the building of this satellite industrial town to attract people from lower socio-economic backgrounds to the region, such as peasants and the working classes.

Thanks to a series of political and economic changes made from the end of the 1980’s until now; streets formerly named after Lenin and the Cuban Revolution have been renamed to honour Pope John Paul II and exiled leader Wladys Law Anders. In 2004 Plac Centralny, Nowa Huta's central square which once was home to a giant statue of Lenin, was renamed Ronald Reagan Square (Plac Reagana). Today Nowa Huta is seen as much as a tourist destination to see the ‘novelty’ of steel production and manufacturing under Communism as much as anything else. STI

Krakow's old town

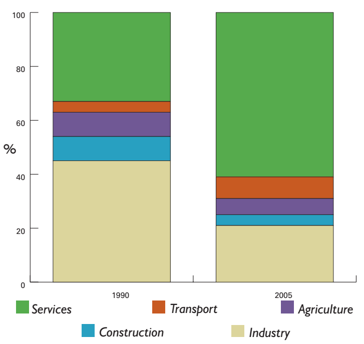
POLAND

Steel's making progress

To merely say that Poland today is a different country to the place it was 20 years ago would be to do its economic and social progress an immense disservice. If we look at several indicators of economic transformation over the past 16 years we can see almost polar changes.

In considering the recent developments that management and ownership changes have forced on the Polish iron and steel making industries, we see that 2004 was actually a very good year for Poland. 2005 saw Polish iron and steel turn out 21.2% less steel compared with the same time the previous year. Output figures dropped in all steel ranges except pipes and tubes – the major attributable reasons being the overall domestic cooling of the Polish economy combined with a drop in the quantity of steel consumed. The effects of both of these factors were compounded by changes in foreign exchange rates which began to favour imports, making life that bit harder for Polish steel producers. According to HIPH, 2005 saw, as in 2004, positive after-tax profits; which were however five times lower than those in 2004.

All of these actions count for nothing without results. So what are the signs that Poland's steel industry is progressing and is having positive effects on the economy, society and environment without draining funds from elsewhere? As Romuald Talarek of HIPH explained, "Poland is no longer a polluter. Steel in Poland is no longer the unwanted industry. Of course employment is down, but the awareness has changed: the role of the manufacturer is not just to provide jobs, but to produce." This reflects some of the harder actions and decisions that the mills had to make and take. Huta Krolweska and its GM Marian Banach explain; "We halted production of a small section mill last year, mainly due to the fact that the competition in Poland increased. This mill was not as productive or effective as our competitors', so we decided to close it down. These specific structural changes were made due to the fact that economically, the small section mill was not competitive on the market and was closed. We had to reduce (our labour force) by some 120 people in order to save the whole outfit and to make it economically stronger." This 'cruel to be kind' attitude is understood across Poland as a necessary measure that will secure the long-term future of the industry. As such, relations with the government and unions has actually become stronger, "The cooperation between us and the Unions is very good due to the fact that they understand that this is an old mill, and that we have to make some cuts in order to lower costs. We meet with the Unions once a week. We have a very good relationship and as far back as I can remember there has never been a conflict that could not be resolved."It is easy for Talarek to be optimistic about the current and future situation of Poland's industry when he compares it with where it was as recently as six years ago, "Given what has happened, we now have investors who have enabled the restructuring of the sector and averted the bankruptcy of the industry, which was a real threat at the beginning of the century." He elaborated on the shift in focus throughout the industry: "The problem with logistics was cured by consolidation as there was no duplication or overlapping of production. Everyone is now aware that they produce for the sake of the market and not for the sake of production." This is certainly reflected in recent figures: in 2005 the steel mills – as beneficiaries of such state aid as is permitted under the restructuring programmes – turned out 62.7% of total crude steel made in Poland. Those mills specifically contributed volumes to overall sector shipments which were down from 62.2% in 2004 to 57.9% in 2005. Shipments themselves were lower by 21.2% in value terms when compared to 2004.



1 Structure of Poland's GDP Source: HIPH

IMAGE PROBLEM?

To merely say that Poland today is a different country to the place it was 20 years ago would be to do its economic and social progress an immense disservice. If we look at several indicators of economic transfor-mation over the past 16 years we can see almost polar changes, but these figures alone do not demonstrate suffi-ciently the effects of this progress on day to day life in Poland, let alone the extent and rate of change that its steel industry has had to undergo.

Poland's population has barely changed during this period and remains at around 38.5M. Poland's GDP however has increased from US$59bn in 1990 to $286bn today.

Through consolidation and responsible planning, crude steel production has dropped from 18.6Mt/y to 9.6Mt/y while apparent consumption (AC) has risen from 7.3Mt/y to 8.6Mt/y in 2006. Steel consumption per capita has increased from 190kg in 1990 to 210kg in 2006; some optimistic estimates suggest that, given another 15 years and pending the success of various proposed infrastructure plans, this could climb as high as 300-400kg.

Between 1990 and 2004, a future for the steel industry was by no means guaranteed. Looking back as recently as 2001, Poland's steel industry was described by the *Warsaw Voice* as, "fragmented, ineptly restructured, burdened with depreciated assets and [with] its debt snowballing." Deputy Economy Minister at the time, Edward Nowak explained that, "The financial liquidity of Poland's steel mills is deteriorating, and they are rapidly losing their markets". He prophetically elaborated, "Privatisation and consolidation may be the last chance for Poland's steel mills."

Back at the turn of the century, Poland was itself trying to consolidate its fragmented industry and bundle it into packages that would entice the foreign investor. Czeslaw Zabinski of Huta Katowice Walcownia Blach, looking back explains, "From a general point of view what happened was a crisis in the Polish steel working and metallurgical industries. The ownership of the mills had to undergo some changes. Back then most of the steel producing mills used to belong to the government, who at that time didn't have the means to invest sufficiently in the sector."Tearing off the band-aid of communism has caused some pain in a transformation that is mainly attributable to this turbo-charged 'healing' process. STI

	1990	2005	Remarks
Steel distribution (SSC+SSH)	Organised by state entreprise	Direct sale to end users and via distributors	
Ecology/Environment	Secondary	Became important	Strong emission reduction
Economy	Volumes over profits	Profit and cash flow	

Table 1 Poland – Main differences in 1990 and 2005 Source HIPH

Foreign owners – saviours of Polish steel?

Transition, transformation, restructuring or 'perestroika' as the Soviet's called it represented the end of what had been a dark period, not just for its steel industry, but for Poland as a whole. The Polish steel industry can be best seen as a jigsaw puzzle that was hastily assembled under a Communist regime; the sweeping reforms of the early 1990s split this puzzle into hundreds of pieces and now foreign investors have been reassembling this complex picture into something much more manageable, with far fewer pieces.

Steel in Poland today is still considered to be very much an important sector within the country; a fact that is reflected and emphasised by the degree of employment in the sector as well as the added value created by Poland's steel producers. The past ten years have seen a significant restructuring of the Polish steel industry, perhaps better described as an 'overhaul'. During this period a large number of fatally under-invested and consequently non-viable facilities were permanently closed, whilst those that showed even the faintest glimmer of life were modernised and upgraded so as to enable the production of steel to the grades and quality expected by international markets.

The ownership structure of the mills would also witness a radical change: "It was clear that the public and the government were not the best owners" – Czeslaw Zabinski of Huta Katowice Walcownia Blach

The changes in the management structures, encouraged by the arrival of foreign investors and owners, have taken place simultaneously with continuing privatisation and the concentration process. By looking at the improvements in the financial and output statistics of Poland's steel producers, the shift from a product-orientated to a market-orientated industry is clear to see.

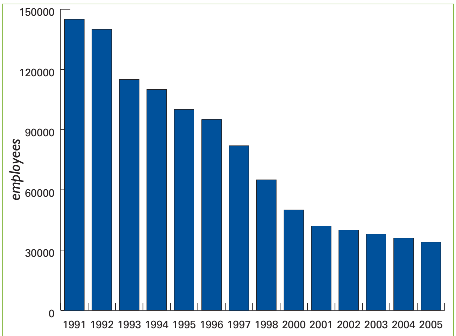
Certainly one of the universal characteristics of this restructuring period was a notable reduction in manpower (**Fig 1**); this gave rise to a significant increase in the levels of productivity (**Fig 2**). The drop in employment in this sector has forced the industry to look towards the implementation of strong social measures in order to reduce the impact of this restructuring on Polish society.

Other technical restructuring measures have helped the sclerotic mills in Poland to not only reduce the input costs but also to cut emissions otherwise detrimental to the environment (**Fig 3**).

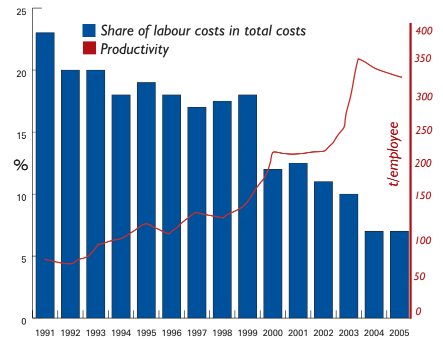
FOREIGN OWNERS TO THE RESCUE?

Despite these specific initiatives to revitalise Poland's steel production, some argue that there is still further scope for improvement and consolidation. Certainly Mittal Steel Poland, which rode into town with the acquisition of Polskie Huta Stali (PHS), has grand ambitions for its operations here, operations which already constitute some 70% of Polish steel output. Today, it is clear that the mills, a majority of which are now under foreign ownership and control, have for the most part reached levels of viability and efficiency which allow them to remain competitive under normal market conditions. 'Viability', until fairly recently, required large amounts of money from the state; a scenario by no means unique to Poland and mirrored amongst its neighbours. This state aid was heavily questioned at several stages and regulating it became essential as a part of Poland's EU accession.

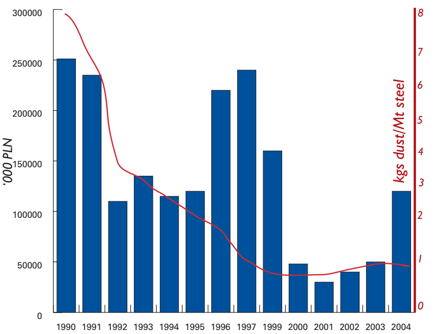
As Adam Zolnowski, CEO of PAIiIZ explains, "The EU was forcing us to stop supporting the steel industry with state money; yet at that time the steel industry was not profitable at all. It was a real bone of contention in terms of the negotiation process with the EU." The state-aid was regulated by the financial projections of the National Restructuring Programmes which were adopted by the governments of the EU applicants (including Poland) and verified by the Commission during 2002 and 2003. Exemption from these EU rules was laid out during the accession talk negotiations between Poland and the EU and are governed by a series of protocols relevant to the accession of the new members of 2004.



1 Employment in 1991-2005



2 Share of labour costs in total cost and productivity in 1991-2005



3 Environmental expenditures in 1990-2004

Protocols 2 and 8 are specific to Poland and the restructuring of its steel industry began in 1993 when it entered into the Europe Agreement with the EC. Protocol 2 contained a framework of bi-lateral agreements for a steady relationship until accession and related directly to the elimination of trade restrictions and to competition. These provided a transition period for the restructuring of the sector. The Polish National Restructuring Programme was adopted in March 2003. Protocol 8 of the Accession Treaty also outlined specific conditions for steel restructuring up to 2006. Outside of these protocols, it became clear that any additional state aid to the steel sector would be in breach of EU accession regulations. The call for a change in the state-owned PHS was answered by Mittal.

BUYING OUT STATE OWNERSHIP

Something had to be done to turn around a centrally-planned industry and rapidly develop its ageing mills and the osteoporosis of its distribution network. It was obvious that the Polish government was always going to be limited in the support that it could offer its geriatric steel industry, given the stiff regulations issued in its EU accession bid. As Novak had said, "Privatisation and consolidation may be the last chance for Poland's steel mills." Talarek, even today shares this view, "Consolidation is very important to us. We have consolidated in terms of the ownership structure, then we began to sub-consolidate for investors. This further consolidation was to some extent forced by the market, insofar as the investors are responsible and they themselves have to respond to the markets."

Time has shown that this solution has been the most clinical yet organic answer in terms of saving Poland's steel industry. Whether or not such a strategic resource as steel is best left in the hands of private foreign owners, has not gone unquestioned, however (**Fig 4**).

Vijay Bhatnagar, CEO of Mittal Steel Poland, explains Mittal's interest and experiences since arriving in Poland and what it means to be a foreign investor in the Polish steel industry. "I think that this was a very tough acquisition. [It] included 13 entities who took up the first bid, as offered by the Polish government for PHS (Polskie Huty Stali) as it was then known; of those 13, only three responded – Mittal Steel, US Steel and Arcelor. Out of these, only two ultimately came to the contest – US Steel and Mittal. Obviously Mittal's offer was the better value for money."

Bhatnagar explains Mittal's initial interest in Poland, "Mittal's interest goes back to a Central and Eastern European strategy, that began sometime in the year 2000." It is more than just fortuitous timing that, whilst Novak was calling for privatisation and foreign investors, companies such as Arcelor, US Steel and Mittal in its current guise, truly foresaw the potential in Poland, both in terms of its facilities, its market and its economy.

Bhatnagar placed Mittal's interest in Poland and its plans for Central and Eastern Europe in context: "The first target of that strategy was Romania, then the Czech Republic and then Poland, all part of that Central and Eastern Europe strategy. Central and Eastern Europe was identified quite early on to be given high priority because these countries were on the cusp of joining the European Union".

Thanks to two successive baby booms, which many attribute to successive periods of martial law and curfews in the second half of the 20th Century, Poland has an unusual demographic that provides an excellent, sustainable platform for economic and industrial growth. Poland itself, with an educated workforce of which over 50% are under 35 years old, stands out amongst these Central and Eastern European republics as a country with a huge economic potential as well as a geography and demography to reinforce the sustainability of that potential.

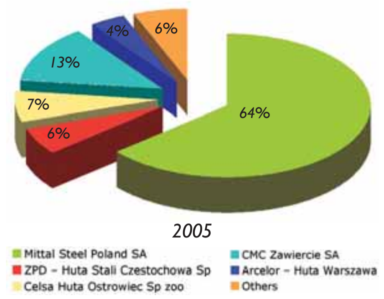
Bhatnagar adds, "So a confluence of factors (represented our interest): a good, skilled labour force that is competitive with costs and proximity to some of the upstream ores, either coal or iron ore. These countries also had high potential in themselves because countries like Poland have a comparatively large population, which needs a lot of potential to grow."

Talarek explains how market forces provide sufficient controls and barriers within which foreign investors are obliged to operate. In this way, the privatisation of Poland's steel cannot be seen as a negative activity but rather as a necessary activity.

"It's a hygienic solution which prevents the steel producers from setting prices as they like. 85% of products on sale in Poland originate in EU countries. Its exports to other EU countries are 66% of all of its exports. Prior to the transformation, industry contributed around 60% of GDP – today, the situation is very different as services now make up a higher proportion. When we tried to downsize our capacity, we had to bear in mind that similar things had happened in many other sectors too – that's why industry in Poland today is responsible for a much smaller part of GDP. The Polish economy is adapting to the general situation, which means it is changing the orientation of the industry of a whole; therefore it is continually adapting, so consequently is playing a lesser role than previously."

SHEETS, BARS, RODS BUT NO POLES

Given the conditions and obligations placed upon Mittal as part of its acquisition of PHS, its success and ambitions in Poland are to be commended. While some Poles feel that steel is far too important a sector to be left entirely in the hands of foreign



4 Current ownership in Polish steel industry

entities, the argument is entirely academic. Talarek notes, "We have lost some of the national character of the industry; because we now have global companies, some nationalism is lost. We have to develop mentally, domestically, regionally and internationally. We have to find our path."

Bhatnagar himself when asked the extent to which he thought foreign investors were seen as the 'saviours of Polish steel' is as diplomatic as he is pragmatic: "I suppose it depends on who you ask. Different people have different ideas. Generally a layman will think privatisation is bad – that these sectors are national assets; that person would obviously respond in light of that view. Those involved more closely in the industry will believe that privatisation and globalisation bring a different kind of perspective to the industry that ultimately benefits the countries." This much is clearly true; Mittal's hopes for Poland, whether born out of a genuine desire to catalyse the development of its host nation, or whether to capitalise on a large, new EU member who is still squinting its eyes in the harsh light of capitalism, is entirely immaterial. The consequences of the acquisition of PHS by Mittal can only be seen as benevolent and the motives irrelevant. Bhatnagar explains that, given time, people will come to appreciate the role of the foreign investor in Poland: "Employers start to realise that a loss-making company is not good for anybody; it won't pay its employees on time, it won't generate any tax revenue for the country, it can't protect the environment and it is no good for the community at large as it can not help anybody. But it takes time for people to realise that."

Explaining that Mittal has provided a future where before there was only uncertainty, Bhatnagar says: "PHS was making an immense loss and had no money to invest; this created uncertainty about its future. Today, with a new investor, people know it has a future: Mittal has the will and the wherewithal to provide investment, secure the future of the company and the future of the people is secure."

One Polish individual heavily involved in upstream steel production shows strong nationalistic feeling, despite all that foreign investors have done for the Polish industry. Maintaining that keeping some Polish aspects will be essential, he says: "I believe it is very important for Polish steel to maintain some Polish characteristics and ownership. Polish owners have a better understanding of the Polish mentality." In a globalised world where the international steel industry is, in a very real sense, getting smaller and more familiar by the minute, these sentiments may very well be irrelevant.

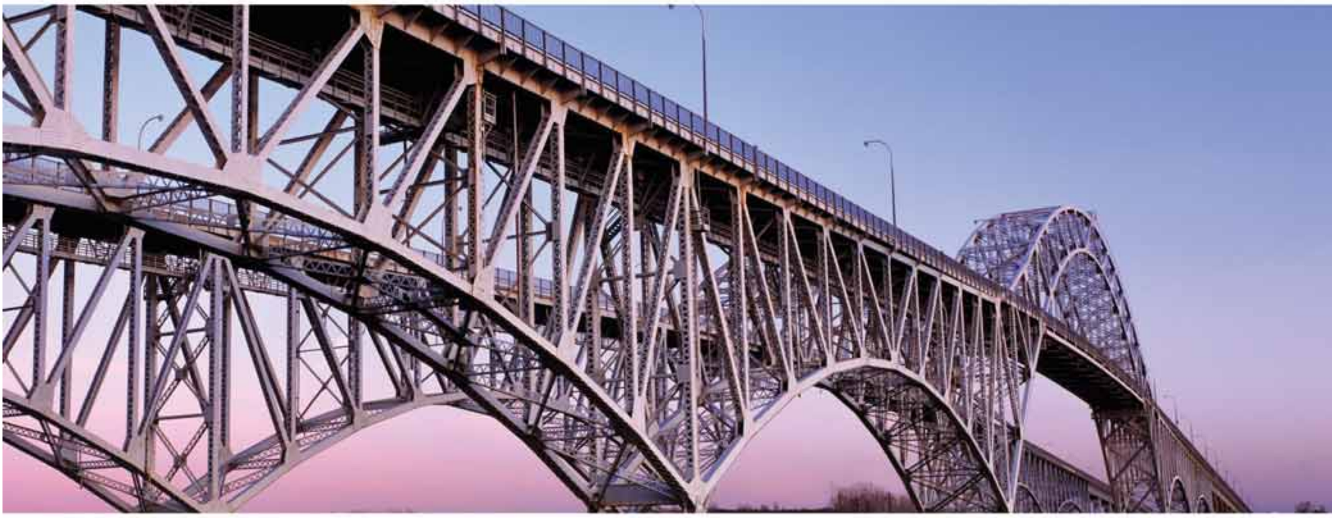
The drop in upstream output has certainly made some of those servicing the industry think about their operations. Zaklady Ropcyze, a manufacturer of refractory products explains what happened when the successful consolidation took place; "The high demand for overseas refractory material) was due to the fact that steel production in Poland was almost twice what it is today. When Polish steel output was cut, it represented a difficult time for us. On top of that, consumption of refractory material per one tonne of steel produced dropped." Mr Józef Siwiec President of the Management board and Mr Marek Tymkiewicz, VP of management board at Ropczyce explain how their focus has shifted, "It is a competitive global market; consumption for refractory materials is much lower. This, of course is all connected with much higher efficiencies and in Poland certainly the 50% drop in steel output (has affected us)." They both see themselves in Poland as having a much more international perspective now, "We think that the exports will increase relatively over the next year because although the Polish market is a big one, the Ukrainian for instance just over the border is massive! We can help steelworks in Ukraine update from older technology to a newer one." Ropczyce are just one example of a Polish company who are not letting this paradigm shift stand in their way and are adamant that despite the arrival of foreign owners and a decrease in output, their future and that of Poland is to be assured, "If you look at Polish business and society we are very open, we have been travelling and trading for ages. We, in terms of location are right in the centre of Europe at the cross roads of any trading. After joining Europe, these characteristics can now be exploited very easily."

Within Poland, Zlomrex is a good example of a company that is maintaining a very Polish feel. Established in 1990, Zlomrex's initial activity included only small-scale trade with scrap metals. As the firm systematically developed, the range and scale of its activities were extended. Nowadays it operates as a joint stock company and is the leader of a group of production facilities and distribution centres. Having been more recently established, the company has not been part of the heavy-handed way in which the steel industry was controlled in the second half of the 20th century; perhaps this has given it more ambition and clear-sightedness than its colleagues. Certainly its investment plans reflect a true belief both in Poland and the industry: "Our main investment will be in the steel melting shop. We have just completed investment into production intensification. By using the hyper-oxy burners, these changes should increase our capacity by 15%" explains Henri Odoj, president of Ferrostal, part of Zlomrex Group.

"We are now thinking about improving billet quality and adding further liquid steel degassing stations; we are also thinking about what we can do with the rolling mill - this should go in the direction of changing product, not just improving the line, which is a relatively small line compared to CMC, Celsa or Mittal."

Mr Walarowski of Zlomrex puts Zlomrex's investment plans into context of its general strategy: "2006 will witness further development and investment. Over the next three years, we have planned a US$400M investment. It consists of three segments: scrap collecting; modernisation and acquisition in steel production; and acquisitions within the distribution network.

"We have a new slogan: 'Three times a million' – representing targets of 1Mt of scrap, 1Mt of steel production and 1Mt of distribution." STI



The appeal of Poland on the international stage

Above: Landscape of steel plant in Dabrowa Gornicza, Mittal Steel Poland

Industry figures explain why Poland is an attractive target to external investors and the impact of inward investment on the Polish steel industry.

The first stage of continuous casting in Dabrowa Gornicza steel plant, Mittal Steel Poland

Vijay Kumar Bhatnagar – chairman, CEO of Mittal Steel Poland

There is a widespread belief within Poland that the future holds great promise for the country – a hope shared by Polish suppliers, distributor organisations as well as the new foreign owners who have forged a place for themselves in this country's fast moving market.

MITTAL'S PERSPECTIVE

Vijay Bhatnagar and Mittal Steel Poland share these hopes from a mill perspective: "Polish consumption per capita is probably close to 230/240kg/y and this could definitely move to around 400kg/y.

"It is at that part of the development cycle where steel consumption growth is very directly linked to the GDP. With Poland's GDP growth at around 5% it depends on how the economy is managed. It is a good market with good potential."

Bhatnagar is clear that his goals for Poland will remain the same despite Mittel's merger with Arcelor, "On a micro level in Poland, it's about the investments and what we are supposed to deliver in terms of capacity, introducing value-added products into the market and developing a new customer base. We need to improve significantly on how we really look after the customer in terms of: delivery, quality and cost. This will be a significant challenge.

"On a micro level, in Poland we have a very different IT platform. There were four differently owned and run companies that were simply put together. Obviously these systems do not 'talk' to each other. Therefore, right now we have just completed the implantation of phase 1 of SAP across all units. We shall be completing phase 2 sometime by the middle of next year. We have spent close to €10M to put this one unit on a common platform.

"A third challenge is that we need to improve our productivity to the levels in the European business plan, which is roughly a 60% improvement over the current level of production." In Poland this represents not a case of 'never being satisfied' but more a case of always being challenged. Mittal's plans for this country show that it is doing more than merely riding the crest of a wave, it is in fact making the waves in this industry.

BENEFITS TO HOME GROWN COMPANIES

Mittal's plans will benefit many others in Poland too, from downstream producers, to those servicing the industry and the retail market itself. Pedmo, for example, which was founded more than 50 years ago has noticed the changes in this rapidly expanding environment. The company supplies components for the metallurgical, cast steel and cast iron, non-ferrous metals founding and metal industries. Pedmo's president Edward Aponiuk puts in plain words how privatisation has affected Pedmo: "After the process of privatising the steel industry in Poland, relationships between companies such as Pedmo and the big steel companies are much better. They are now based upon economic terms." He went on to explain how consolidation and privatisation in Poland had helped Pedmo stretch itself across other parts of Europe, "Now after privatisation we have very simple and open rules: money comes in on time, deliveries are made on time. We cooperate with Mittal steel all over Eastern Europe." One aspect where Pedmo has reacted slightly differently from many Polish industry colleagues has been its lack of focus on organisational change after EU accession and privatisation. "The structure of the company did not change much since privatisation; one focus that was shifted was onto research. We are much more focused on this and as a result, we can offer very new products for our customers." This is from a company that has truly experienced some of the most varied times in Poland's business history, and is coming to terms quickly with what it means to operate in a free market. "We are producing auxiliary materials for the steel industry, foundry industry, aluminium and copper industry also refining and insulation. We have partners and customers all over Europe but at the time of privatisation Pedmo was only operating in Poland." Pedmo must surely be evidence of how the privatisation of the upstream industries has helped provide a future for those who service this industry and has also helped, in a short space of time, to explain the possibilities for export into this global-town and European-village.

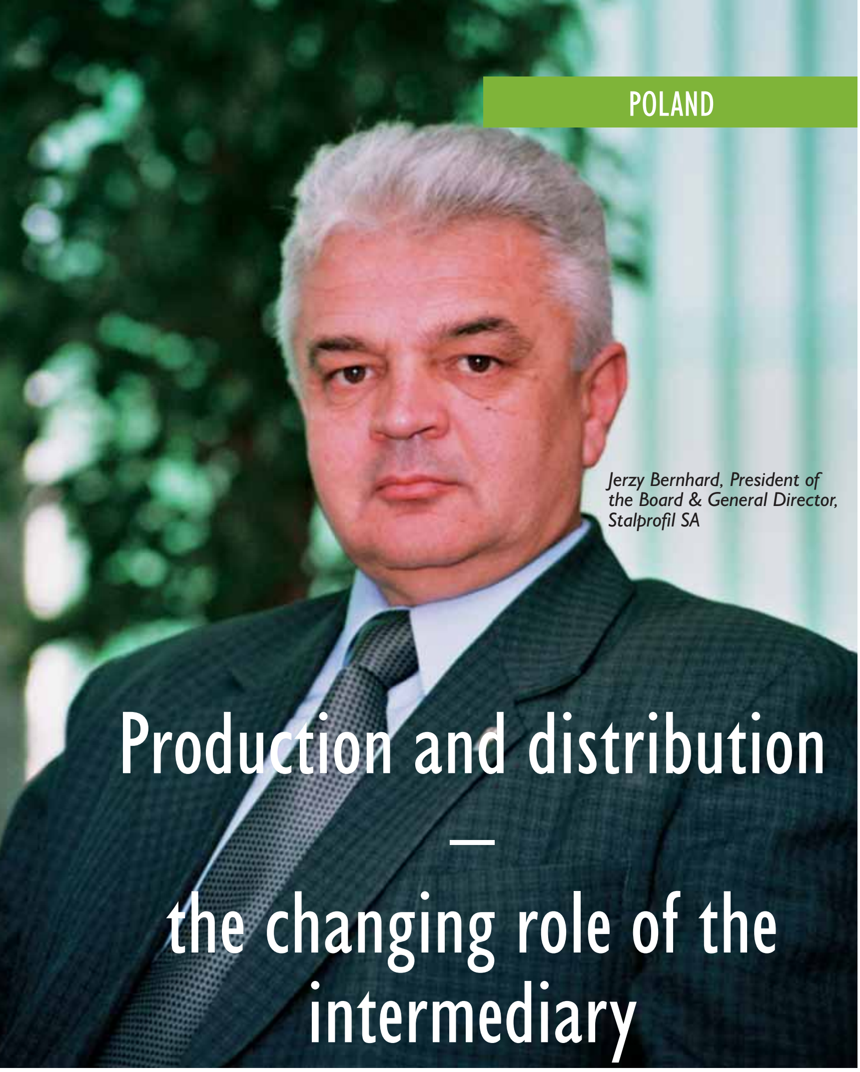
COMING TO TERMS WITH COMPETITION

Bipromet is another organisation, like Pedmo, which has a long and intertwined history with Poland's steel industry. Bipromet has seen decades of central planning and has had to very quickly come to terms with competition, an ailing industry and the necessity for marketing. Tadeusz Baj explains, "The first 40 years Bipromet was a state owned design office, employing up to 1300 people designing the whole Polish non ferrous metal industry. I think it is no exaggeration to say that all Polish copper, zinc, lead, aluminium smelters and processing plants were designed by Bipromet specialists."

Baj is another industry individual who acknowledges the benefits of privatisation and EU accession and elaborates as to how it has obliged a change of focus on organisational change and reliance on markets: "The accession of Poland to EU just made it easier for Bipromet to offer its services abroad. Mainly electro filters and fabrics filters are designed, delivered and assembled in many countries of the EU, the most recent filters being installed at a coke plant in Belgium. Some of the export activities worth mentioning were carried out in Thailand where converters were designed and delivered to Rayong Copper Smelter. We also approach Scandinavian and French markets; so undoubtedly, (EU accession) presented an opportunity and not a threat."

He is clear that Polish companies such as Bipromet will have the edge on competition for many years yet, thanks to lower prices, due to lower costs. "Polish engineering services are far less expensive then in western European or American markets. I think many years will pass before they reach parity. Many foreign engineering companies realise the difference, so some mergers and acquisitions have occurred by some well known corporations such as Lurgi, Fluor Daniel and many others."

Baj goes on to add, "The most competitive services that we offer are most probably electro-filters and fabric-filters-due to these European directives limiting the air polluting tolerance." He is hopeful that EU emissions directives will focus on the services offered by the likes of Bipromet. STI



Jerzy Bernhard, President of the Board & General Director, Stalprofil SA

Production and distribution – the changing role of the intermediary

In a recent conference address, Jerzey Bernhard, general director of Stalprofil, noted that where once the state-controlled Polish steel market was simple, post-1989 changes have shaken everything up to create a complex environment with privately-owned players at every stage from pre-production to post-manufacturing distribution.

The structure of the Polish steel market before 1989 was not a complicated one. The entire industry was under the control of the Ministry of Industry & Metallurgy whose influence was directly reflected in the operations, planning and output of the Polish steel mills. The steel mills would then distribute products either to the foreign trade office (Stalexport) or to the steel sales office, Centrostal.

Stalexport dealt with the exports and supply of imported material to 'big end users' while Centrostal dealt with domestic material and supply to the 'big end-users' (**Fig 1**), as well as supply to the small end-users. The general changes that took place post-1989 involved a near collapse of this old network. The phoenix that rose from the flames brought with it a host of new companies, most of whom were private. There was an increase in European stocks and the domestic distribution network became hugely fragmented.

Jerzey Bernhard explains how tough the situation between 1989 and 1990 became at times: "Polish steelworks lost their financial liquidity so, to buy steel products from them, we first had to finance resources and transport for them. At that time only about a half of our turnover came from selling steel products."

STOCKHOLDERS RAN THE INDUSTRY

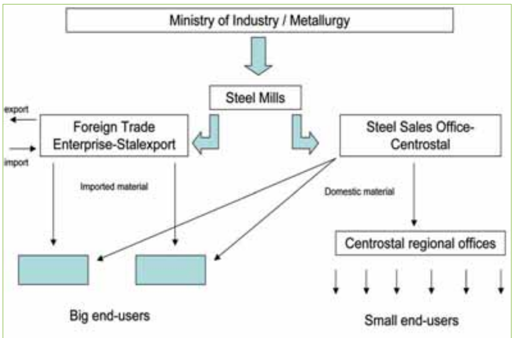
Between 1989 and 2000, the Polish steel industry was so close to extinction that words such as 'bankruptcy' were bandied around lightly. It is safe to say, during this period, all Polish steel mills or 'Hutas' experienced payment blockades and encountered huge difficulties in obtaining capital for production financing. It was at that time that the stockholders became directly involved in financing production, which led to a system of barter that involved the trade of steel products against the delivery of raw materials for steel production. The stockholders were, in essence, acting as payers for the delivery of the raw materials. The stockholders at that time brought in capital for de-blocking payments that in turn included a compensation trade with other brands of industry (**Fig 2**).

Bernhard explains how the arrival of foreign investors helped the mills to turn around and how this changed the relationship and role of the intermediary in the Polish steel system: "In the past, Polish steelworks suffered from a permanent lack of cash. This gave distributors the opportunity to gain advantage from the organisation of deliveries of resources in barter transactions. Thanks to foreign investors, the steelworks recovered their financial liquidity and limited the role of distributors to steel trading. This is a new challenge for them as now they have to search for a competitive advantage through identification of end-receivers' needs and fulfilling them with an adequate trade offer."

For Bernhard's own Stalprofil, the end of this barter system changed the way transactions were made, "Concentrating only on selling steel products obviously caused a decline in sales volume but it also improved our financial liquidity. The elimination of barter transactions unleashed considerable financial means; this is why today we can settle accounts with our suppliers in cash without any problems." Bernhard does not miss the bad old days and is very bullish about the future of not only the upstream industries but also of distribution and what that means for intermediaries too: "The Polish steel distribution market is becoming more and more similar to the western markets. The many foreign companies investing in Poland has speeded up this process. Today, low costs are the main advantage that Polish companies have in the EU market; however, this is expected to change as the economic development of Poland progresses. Better customer service will become a competitive necessity then."

OUT WITH THE OLD, IN WITH THE NEW INVESTORS

2004 ushered in several fundamental differences – these represented more of a step-change than an alteration of an



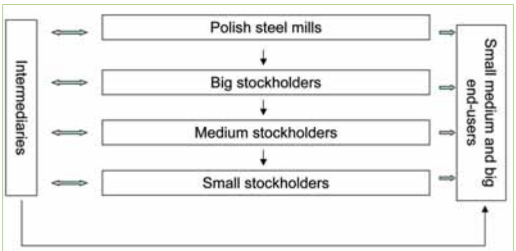
1 Polish steel market before 1989

unsustainable system. After the arrival of foreign investors into the upstream industry – namely Mittal Steel, CMC, Celsa and Arcelor – it became clear that the old network was not going to be suitable for, or compatible with, the newcomers.

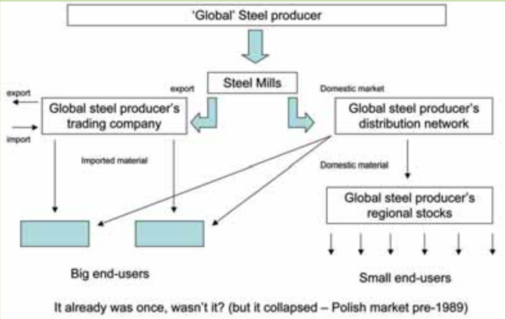
Post-2004, there was a growing market share of steel stockholders and a limited market share of intermediaries and other enterprises treating steel as a method of recovering the debts of the mills. The role of the standard intermediary continues to decrease as steel mills can now pay cash for raw materials and deliveries are purchased directly from the producers. Cash is now the demanded payment for steel products.

At present, however, Polish producers still do not have either their own distribution network or, according to Bernhard a 'clear-cut concept of how it should be organised in the future.' As intermediaries search for supplements to their core activities, adding value en route to the customer (in the guise of service centres or an initial processing of steel products), it becomes clear that the future distribution model is in the hands of the main producers (**Fig 3**).

In Bernhard's prediction for distributors, he sees a growing role of big stocks and service centres: "Companies providing added services (like steel products' initial processing) and with adequate financial potential and trade infrastructure are the future of the Polish steel distribution market. Small intermediaries will gradually disappear [from it]." He adds, "Distributors without suitable trade infrastructure will gradually disappear from the Polish market. Thanks to the investments made many years before, Stalprofil now has large and modern steel depots [Its capacity reaches 80kt] providing competitive advantage to the company. Complex customer service is our objective and we want to achieve it by providing an extensive assortment and by adding value to steel products' initial processing. Our exporting experience and strong position in the EU market are notable reasons for our success. Today Stalprofil sells to about 60 companies from 20 European countries. We gained the 'Bull and Bear' prize for the best-managed company on the Warsaw Stock Exchange. With the strength of a bull, we constantly try to improve our competitiveness." **STI**

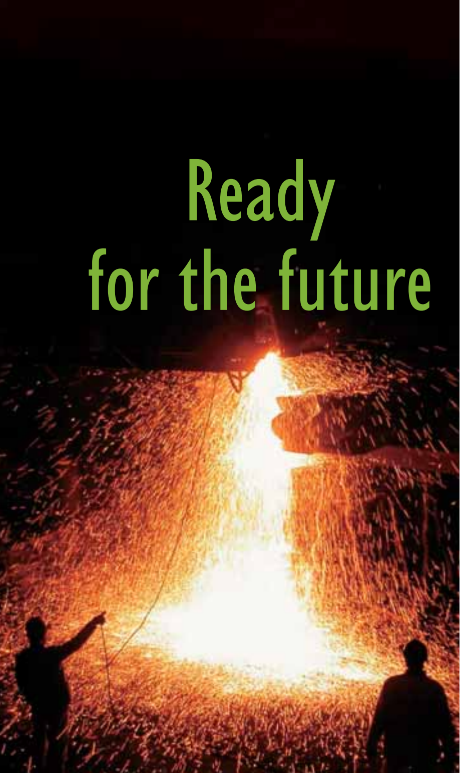


2 Model of domestic steel products distribution network before 2004



3 Future steel market?

Fig 1, 2 and 3 are:"Information extracted from Jerzy Bernhard's SBB Steel Markets Europe 2006 speech"



Ready for the future

POLAND

Poland has done all in its power to drag its steel industry kicking and screaming into the 21st century. It has dropped down in the world rankings of international steel producers because of the emphasis placed not only on responsible production and the elimination of cycles but also because of the implications of being a market rather than a production-based economy. This has meant an obligation to invite foreign investors and owners to come and take a look around. Far from the mills being seen as a second-hand car or jumble sale antique, these facilities, when combined with the investments made by foreign owners and the young, low-cost labour; are showing themselves to be true powerhouses.

The efforts made to increase the grade and varieties of steel produced have helped the development of all parts of the industry. Distribution networks have been upgraded as has the relationships between the producers and the intermediaries. The intermediaries are having to find new ways to process, initially and subsequently, the steel to maintain some place between the producer and the customer. With mills in Poland trying to get ever-closer to the customers, and with investments focusing on downstream production; the space between producer and end user is closing in. Companies such as Stalprofil focus on large stocks and service centres as well as citing the oft-used phrase, "one stop shop" to guarantee that its presence is well deserved. The shift from a production orientation to a market orientation has taken place at a breakneck pace; the evidence in the value created by steel in Poland is clear in the changes in manufacturing and service industries, as a component of GDP: Value, value, value.

All acknowledge that GDP growth is a huge indicator and factor in steel consumption, hopes that steel consumption could one day rise to 400kg are optimistic. But then so were hopes in 2000 that several foreign companies could come and give this industry the adrenalin shot it needed. As the global steel industry becomes more and more familiar and gets closer and closer to the living rooms (Mittal Steel welcome you to Balice Airport in Krakow), the advantages of having an educated, ambitious, populous, low-cost European nation as a manufacturing base, as well as a valuable sourcing destination become ever-clearer. STI

HIPH

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