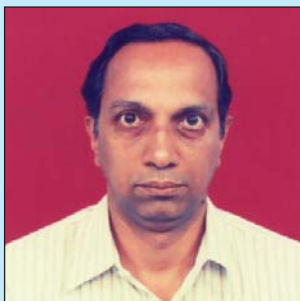


GLOBALIZATION STRATEGY THROUGH INTERNATIONAL ACQUISITIONS

- A CASE STUDY AND EMERGING PERSPECTIVES



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With a view to illustrate the factors that make for the creation of a global industry, a case study of Mahindra Forgings Ltd. (MFL) of Mahindra & Mahindra group and its globalization strategy is presented in this write-up. The sections that follow describe the rationale of corporate strategy, the expanding economic environment and market outlook in Part I. Part II provides MFL's corporate profile and highlights of its financial performance. Part III portrays the international acquisitions made by M&M as a part of global strategy implementation and growth path of MFL. The emerging perspectives from the case discussion are made in the conclusion.

Introduction

1. Strategic decisions of a business organization competing in the global market place have become increasingly complex. The corporate management cannot view global operations as independent decisions. A global industry is one in which competition crosses national borders. In a global industry, the strategic moves of a corporation in one country can be significantly affected by its competitive position in another country. The very rapidly expanding list of global industries includes commercial aircraft, automobiles, mainframe computers, and electronic consumer equipment. Corporate management of a global industry must maximize its capabilities through a world-wide strategy. Such a strategy necessitates a high degree of centralized decision making in corporate headquarters so as to permit trade-off decisions across subsidiaries.

1.1 Factors that make for creation of global industry Among the factors that make for the creation of a global industry are :

- Economies of scale in the functional activities of firms in the industry;
- A high level of R&D expenditures on products that require more than one market to recover the development costs;
- The presence in the industry of predominantly global firms that expect consistency of products and services across markets;
- The presence of homogeneous product needs across markets, which reduces the requirement of customizing the product for each market. The presence of a small group of global competitors;
- A low level of trade regulation and regulation regarding foreign direct investment.

With a view to illustrate the above factors, a case study of Mahindra Forgings Ltd. (MFL) of Mahindra & Mahindra group and its globalization strategy is presented in this research paper.

A Case Study of Mahindra Forgings

2. Mahindra & Mahindra (M&M) through its SysTech Sector had enunciated a corporate vision of creating

one of the leading forging companies in the world by 2010. Mahindra Forgings Ltd. (MFL) is already amongst the five largest forging companies in the world. MFL's rationale for international acquisitions has been driven by four factors:

- (i) Acquiring management, technology and customer access.
- (ii) Cross-selling opportunities across products and geographies (given the M&M SysTech's stake in multiple verticals of forgings, castings, stampings, gears, composites and engineering services).
- (iii) Sourcing synergies.
- (iv) Providing cost-effective solutions to customers.

The main intent is to fully utilize the wide product portfolio of Chakan, Stokes, JECO and Schoneweiss to secure larger orders from clients in different geographies and execute them in the most optimal, cost competitive manner. MFL has already put in place systems and structures to meet these objectives. The results should become apparent in 2007-08 and thereafter.

The second task is technology creation, documentation, transfer and preparation of repository of intellectual property. Since it is the intent of MFL to rapidly morph from being a component supplier to a technology solutions provider, each of its facilities must use best-in-class technology and possess intellectual property rights. The third task of the strategy is systematic scaling up of capacity and successively greater emphasis on higher value added production. The corporate management continuously evaluates the product portfolio of all its businesses and chooses those that can be rapidly scaled up in the value chain to attain the global strategy.

Part-I

The economic scenario

3. Here the automobile industry structure and developmental impacts are discussed, which have urged the companies to adopt the international acquisitions as an integral part of corporate strategy. Europe is the largest producer of forgings (including open die forgings) in the world account-

ing for roughly a third of the world production. Germany is the largest producer of forgings in Europe accounting for roughly half of Europe's production. Forgings production in Europe has grown in the last few years due to increased demand from the automotive industry. From 2006-08, the passenger car production in Europe has grown at a compound annual growth rate (CAGR) of 2.25 percent, while the commercial vehicle production has grown at a CAGR of 7 per cent. This growth is expected to sustain at least for the next few years because of sustained demand from East European consumers. In the case of commercial vehicles, the demand is further strengthened by the increased focus on 'Just in Time' transportation among European producers.

M&M with its European alliances is well-positioned to take advantage of this growth in demand by pooling the capacities of all European plants. The domestic sales of passenger and commercial vehicles in India decelerated in 2007-08 after a period of robust growth in years 2005-06 and 2006-07. The sharp increase in interest rates over the last twelve months has impacted the growth adversely. The medium term outlook for the automotive industry remains positive with the passenger car and light commercial vehicle expected to grow at a CAGR of 5 per cent in the same period.

The reduction in excise duty on small cars and increased exports will drive demand in the passenger car market while the emergence of less than 3T will drive the commercial vehicle market. In the short-term, growth in demand will be tempered by the high interest rates and the increase in inflation. While following the pattern of the auto market, the growth of forgings has outstripped that of automobiles. This is mainly due to a significant growth in exports driven both by the technological capabilities of Indian companies and competitive cost advantages. M&M are responding to the slow down in the Indian automobile market through a three pronged strategy. With regard to new customers, actively increases customer list beyond the three largest customers, *viz.*, M&M, Tata Motors and Maruti Udyog both in India and overseas. Exports for 2006-07 constituted 4 per cent of net sales of MFL, India and are expected to rise further.

MFL exports its forgings to USA, Germany and Italy and have a large order from a European auto major. With respect to new products, substantially increase machining capacities for crankshafts and axle parts. In addition, MFL would develop strategy to increase sales in the non-auto space. In sum, the target would be to upgrade Indian operations to facilitate cross selling from Europe, meaning a plan has been worked out to transfer technical expertise from operations in Europe to India.

Part-II

Corporate profile of MFL

4. With a view to signify the true character and the nature of business activity undertaken by the company, MASL changed its name to Mahindra Forgings Ltd. (MFL) with effect from September 26, 2006. MFL acquired the chakan unit of Amforge Industries Ltd. with all its assets and liabilities. At the time of acquisition, MFL had net sale of Rs. 2,114 million and operating profit of under Rs. 239 million (with a single forgings plant at Chakan). When MFL fully acquired the Chakan plant, the facilities needed considerable scaling up and upgrading to reach the unit to global standards. In addition to the existing four presses, MFL decided to add three more before the end of 2007-08, which would double the capacity and reach 60,000 MT. These would be in the form of imported automated cutting facility, state of art shot blasting machine, environmental friendly LNG-fired heat treatment facility. To improve the quality of forgings, an ultrasonic testing facility and a magnetic particle inspection (magnaflux) machine has been installed.

The secret of successful forging lies in making continuous improvements in die manufacturing and usage. Keeping this in mind, MFL is in the process setting up a world class tool room and die shop, where it will be installing 12 high speed die-cutting machines manufactured by Haas in Germany. In addition, it has designed a modern layout for its tool room and die storage facilities. To concentrate on higher value machine components, MFL has already installed a separate machining facility. This has an optimum mix of a new refurbished machining equipment which has been engineered

to deliver a greater supply of fault free value added products at globally competitive unit costs. The focus is on increasing the production of machines, crankshafts and axle parts. Today, the effective capacity of the machine shop is more than adequate to meet the demand of customers. Despite sharp increase in power tariffs and diesel oil prices, there were distinct improvements in operating cost. Moreover, through enhanced supply chain management, MFL has succeeded in reducing material costs. Cost savings and higher productivity contributed to a rise in operating profit ratio. MFL passionately believes in quality. To this end, it has formally



adopted 5S, namely, Seiri (tidiness), Seiton (orderliness), Seiso (systemized cleanliness), Seiketsu (standards), Shitsuke (sustaining discipline) in its shop floor at Chakan. 5S is a mnemonics for a philosophy and a way of organizing and managing the workspace. Going forward, as 5S stabilizes and becomes the part of the shop floor DNA, Chakan plant will move to formally adopting Total Productive Maintenance (TPM) practices.

MFL is setting up an effluent treatment plant for dealing with oil, scales and sludge from the forging and machining shops. The treated water will then be used for gardening 1 million tree planting program, which is the commitment of Chakan unit to M & M who has undertaken Employee Social Opportunity Programme. MFL realizes that considerable additional efforts are required to improve the quality, environment and safety systems with an aim to reaching the standards of ISO 14001 (environment) and OHSAS 18001 (health, environment and safety) certifications by 2008-09.

When MFL bought Chakan unit, the plant had

little in terms of IT and ERP software. Appreciating that a top class enterprise-wide IT system was a must to secure competitive advantages, during 2006-07, MFL installed all modules of SAP-ECC 6.0 across the plant and offices. Implementation started in November 2006 and the system went live on April 1, 2007 and it has been linked to M&M data center at Kandivli, Mumbai with full network connectivity and dedicated server.

Human resource development at MFL has been made part of overall growth. With the objective of achieving optimal resource effectiveness, four major levers have

been focused. Organization structures, performance management systems reward and recognition system and communication. MFL has successfully implemented a wage settlement up to March 2009. This has linked emoluments to productivity and will ensure wage cost competitiveness while adequately rewarding the workforce. MFL also made it obligatory for all employees to go through training in technical, behavioural and organizational development skills.

MFL's consolidated financial performance for the financial year 2008 is not comparable with financials for the financial year 2007 as it for the first time includes the financials of the European acquisitions.

On a standalone basis, the net income of MFL India grew by 1.8 per cent in financial year 2008. This reflects slow-down in the automotive market as well as break down of some of the key equipments, most notably the 5000 T press. Material costs as per cent of net income decreased from 58 per cent in financial year 2007 to 57.1 per cent in financial year 2008 in spite of increase in price

of some key inputs like steel. Personnel costs as per cent of net income increased from 3.5 per cent in financial year 2007 to 5.8 per cent in financial year 2008. This was because of investments in presses to increase capacity as well recruitment of people for these presses. On a consolidated basis, material cost as per cent of net income in financial year 2008 was 47.95 per cent, much lower than in India alone reflecting the higher realization for the overseas operations.

Part-III

Global strategy

5. In the first stage, MFL chose to focus India and Europe. In addition to its relatively low cost base, manufacturing skills and the ability to ramp up scale at globally competitive costs, rapid market expansion, access to both higher value added technology as well as global clientele was created. MFL had enunciated a vision of creating one of the leading global players in the forging industry in 3 phases during 2005-10.

With the association of M&MSysTech Sector, MFL began a process of international acquisitions. The focus was on acquiring companies that had excellent manufacturing facilities, high technological content, complementary product portfolios, strong management, healthy order books from marquee clients and a track record of consistent growth.

With these objectives in mind, M&M first acquired a 98.6 per cent stake in the Stokes group in UK in January 2006 which was subsequently increased to 99.5 per cent. Stokes manufactures ring gears, pinions, hubs, wheel blanks, focuses on the passenger car segment and sells to global major OEMs and Tier I suppliers. For 2006-07, Stokes had turnover of 27 million Pound Sterling. Its facilities are located in West Midlands, UK.

The second acquisition occurred in November 2006, when M&M through its closely held subsidiaries, bought out a 67.9 per cent stake in JECO Holding AG, a forging company in Germany. JECO enjoys lasting partnerships with all the German OEMs. It has a highly diversified product range and mainly caters to the truck market. Over 15 per cent of JECO's turnover comes from exports. JECO's top

22 customers account for only for 50 per cent of its total revenues. Its sales growth is technological prowess. Each year, JECO develops anywhere between 150 to 200 new parts and over 15 per cent of its annual sales constitutes newly developed products. Moreover, given its strong technological base, JECO often co-designs parts with its customers. JECO is spending an additional 10 million Euro Dollar in 2007-08 to further up its machining facility. For the year ended December 2006, its turnover was 190 Million Euro Dollar.

In December 2006, M&M acquired a 90.47 per cent stake in Schoneweiss and Co. and GmbH, another forging unit in Germany.

Schoneweiss is one of the most respected forging units in Germany with over 140 years of experience in the business. It produces axles, wheel trunks, knuckles, bearings, shafts, tunes, stubs, camshafts, guide racks, con-rods and steering arms and levers. Schoneweiss alone accounts for 20 per cent of front axle beam production in the world. Schoneweiss also enjoys excellent relationship with German OEMs catering to both the truck and automobile segments. It is one of the highly technological driven companies which regularly partners with its OEMs in developing automotive products right from design stage to final testing, validation and commercial manufacture. Schoneweiss is presently setting up a 12,000 MT press to enhance its capacity of front axle beams, at a cost of 10 million. For the year ended December 2006, its turnover was 94 million.

It is supplier to technology driven solutions provider, each of its facilities must use best-in-class technology and MFL would thus possess a large and growing arsenal of proprietary IPR.

MFL inherits such IPR from JECO and Schoneweiss in particular and expects to build on that capability.

The third task is systematic scaling of capacity and within it successively greater emphasis on higher value added production. In this process, MFL would also carefully evaluate the product portfolio of all its businesses and choosing that can scale up the value chain.

MFL has a diversified and complementary product portfolio in both the passenger car and truck

segments. Jeco is a full range provider of forging products to its customers and produces more than 250 products. Schoeneweiss is one of the top four axle beam manufacturers in the world and specializes in suspension and engine parts. Stokes has expertise in producing 'flash less' parts while Indian unit has expertise in design, development and machining of crankshafts. Because of a diversified product portfolio and an orientation towards providing value added products, MFL has a value proposition that emphasizes 'design to delivery'.

Achieving this target will certainly require full fledged attention to integration and getting the best return on the existing employed capital. It may also need one or more value enhancing strategic acquisitions. Through organic growth in efficiencies and inorganic acquisitions, MFL is committed to meeting its vision for 2009-10.

Conclusion

6. MFL's strategy has been driven by the aim to provide the best returns to the shareholders. With this objective in view, MFL created an integrated, commonly aligned international management team which can leverage all the synergies across the different locations. The strategic intent is to fully utilize the wide product portfolio to secure larger orders from clients across different geographies and execute them in the most optimal cost competitive manner. This would achieve the aim to fully unlock the potential of the businesses across the globe.

MFL has scaled up capacity at both the Indian and European operations. In order to have a greater emphasis on higher value added production, MFL has enhanced its machining capability. Simultaneously, operational capability and skills would be upgraded to provide the best possible 'one stop shop' solution to its customers world wide.

Since it is MFL's objective to rapidly morph from being a component supplier to a technology driven solutions provider, each of its facilities would use best-in-class technology and possess intellectual property rights. In order to do so, MFL would constantly identify best practices and transfer the same across different locations. With its wide range of products, MFL is well poised to become a 'one stop shop for forging solutions. MFL's different plants have complementary products and capabilities and its brand name 'Mahindra Forgings' helps in presenting an universalized face to the global buyers. Mahindra Forgings has set itself a target of achieving world class profitability levels. Achieving this target would require full fledged attention to integration and getting the best return on the existing employed capital. Better strategic acquisitions would be added to enhance value further.

The changes in competitive scenario have compelled MFL to take strategic advantage and undertake a series of acquisitions across the globe. The case study brings out the long-term benefits to the stakeholders with a view to enhance shareholder value. The discussion of the case study explicitly brings out six factors that drive the success of global corporations as follows:

- (i) Global management team
- (ii) Global strategy
- (iii) Global operations and products
- (iv) Global technology and R&D
- (v) Global financing
- (vi) Global brand management and marketing

These above factors provide a framework within which the business can effectively pursue the global marketplace.