

**LARRY SEFTON MEMORIAL LECTURE**

**CRISIS AND RENEWAL: ALGOMA STEEL INC. -**

**A CASE STUDY IN ADAPTATION??**

**by: Alexander Adam**

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I receive invitations to speak about Algoma Steel on a fairly regular basis. This request, which I was pleased to accept, represents a particular challenge. The request was for a "scholarly" paper. Unfortunately, somewhere in the academic archives of this university there is ample evidence of my limitations as a producer of scholarly papers.

Also, I assumed my responsibilities at Algoma Steel ----- the subject of this lecture ----- in June 1996. I was not involved in the actual restructuring of the company. Others are better qualified to tell the story.

Finally, I am very aware of the life and contribution of Larry Sefton and that this lecture series is dedicated to his memory. There is an obligation to achieve a level of relevance and competence that does justice to the memory of such a relevant and competent man.

I attended the Graduate School of Business at the University of Western Ontario. The school uses the "case study method". Tonight I will present Algoma Steel as a case study; as a specific and, I believe, somewhat unique response, to the crisis that the Canadian Steel Industry faced in the period from 1980 to 1993.

The question marks in the title represent the central issue ----- Is Algoma a successful adaptation? I will return to that question in my concluding remarks.

According to the Sault Star of February 20, 1902, "*The first steel made within the limits of Ontario was blown-in at the steel plant of Algoma Steel at 3:15 Thursday afternoon, February 18. This novel sight was witnessed by hundreds of*

people. A special car bearing officers of the Lake Superior Power Co. arrived about two o'clock, while scores of persons drove out from the 'Soo'.

In the years that followed, there were high points and lows. Perhaps the lowest point came on January 22, 1991 when Dofasco Inc. announced that it would no longer provide financial assistance to Algoma Steel Corporation Ltd. ---- its subsidiary company. Dofasco's directors had concluded that the viability of the parent was endangered by the financial support required by its subsidiary. Dofasco wrote down its investment to the tune of \$700 million and, while offering operational and restructuring support, refused any further financial support to Algoma. Efforts to obtain interim financing and to develop a restructuring plan failed. On February 18, 1991, ---- 89 years to the day after the first steel in Ontario was "*blown-in*", Algoma Steel sought protection under the Companies Creditors' Arrangements Act or CCAA.

Those involved in the actual restructuring can best tell that story. It is a story worthy of study and understanding. I support the view expressed by an Algoma Director, Tim Armstrong, that the Algoma restructuring represents a milestone in Ontario in joint public - private sector collaboration. It stands up to any cost/benefit analysis and was instrumental in preserving the community of Sault Ste. Marie. Preliminary analysis calculated that approximately 23,100 jobs would be lost ---- 7,800 at Algoma and 15,300 in Sault Ste. Marie and other communities.

The crisis was the exclamation point to a decade of extreme challenge for the Steel Industry ----- a period in which Algoma Steel had losses in seven of the nine years between 1982 and 1990.

I can lend my personal testimony to this story. When I joined Stelco, Canada's largest steelmaker, in 1970, I started work at Hilton Works ----- its largest plant. There were about 13,000 employees at Hilton Works. There were about 40 new graduates in the orientation programme that I attended. Stelco was planning a massive "*greenfield*" expansion at a site on Lake Erie. Business was good and had been, more or less, since the war. When I left Stelco in 1993, I was V.P. and General Manager of Hilton Works. We had only just become cash positive after 10 straight quarters of negative cash flow. There were about 7,000 people employed; many of whom had been laid-off and recalled on a rotating basis over the previous three years. One bad joke at the time was, "*What's the difference between Stelco and Algoma?*" The answer ----- "*two months.*" The landscape had changed. **We weren't hiring new graduates!**

The Canadian Steel Trades and Employment Congress (CSTEC) was established in the 80's as a joint effort by management and the United Steelworkers of America. Since 1988, CSTEC has been providing adjustment services to permanently laid-off workers in the steel industry with the assistance of the Federal Department of Human Resources. CSTEC's data shows that employment levels in basic steel fell from about 57,000 in the early 1980's to 35,000 today. (*Note: In Algoma's case, the local adjustment committees, which were funded by CSTEC, provided services to more than 1,700 laid-off workers.*)

What I am describing was not restricted to Canada. During the period, four major U.S. producers ----- LTV, Wheeling-Pittsburgh, Sharon Steel and McLouth sought protection under Chapter 11 of the U.S. Bankruptcy Code.

Many others closed operations or idled capacity.

In a recent speech, "The Future of Labour Unions", George Becker, President of the United Steelworkers of America, noted the loss of 500,000 members in the steelworkers union; 250,000 in western Pennsylvania alone. He described the impact on the communities in which these plants were located.

*"The communities in which these plants and facilities were located have still not recovered. I can take you to mill towns up and down this valley or the steel valleys in Pennsylvania, to Lackawana, Johnstown, Youngstown and many other places ----- these communities were virtually wiped out. Vital services were curtailed. In many cases, water systems were shut down, schools and hospitals were closed, police and fire services were curtailed and these services had to be supplied from neighboring communities. The devastation in these communities ----- broken dreams, lost homes, separated families, suicides ----- is just unbelievable."*

What Happened? The simple answer is that we faced the worst nightmare of high fixed cost operations ----- declining demand and declining prices, known to some as, "*the death spiral*." Getting behind the simple answer to assign cause and effect is not easy. Various themes have emerged.

The decade saw two recessions. There was a recession in the early '80's and another in the early '90's. When the operations of Stelco and Algoma were restarted after lengthy strikes in November 1990, we returned to work in the midst of a recession that saw Ontario lose hundreds of thousands of manufacturing jobs between 1989 and 1992.

We also saw significant capacity increases based on mini-mill technology. Mini-mills melt scrap to produce steel using electric furnaces. Their lower capital cost and more variable operating cost structure gives them an obvious advantage. Stelco's flagship operation, Lake Erie Steel, an integrated steelmaker cost about \$1.5 billion C in 1970 dollars. A mini-mill can duplicate that capacity (volume not quality) for about \$300 million.

There has also been a decline in the intensity of steel usage. Cars are lighter and stronger and competitive products ----- aluminum and plastics are substituting for steel. This affects the demand side.

The automotive industry is a major factor in our economy. This is probably disproportionately true for Canada. Import penetration increased through the '80's. The Big 3 were hard pressed to pass pricing to customers who had broader choice. This represented two problems for steelmakers: 1) lost volume; imports don't have N.A. steel and 2) extreme downward pressure on prices.

There are other Themes:

The emergence of fiercely competitive Pacific Rim economies.

Free Trade - Good or Bad. If you thought it was bad, you saw cause and effect. If you were a proponent, you still had to concede the unfulfilled promise of N.A.F.T.A. in the wake of the anti-dumping and countervail cases between Canada and the U.S.

Exchange Rates - Many believe that the strong Canadian \$ in the period from '89 to '92 hurt our exporting customers and made a bad situation worse.

How do we sort this out? I'm not sure we can or even that the debate is necessary. Many of these "causes" are beyond our control. While the pace of change varies; change is a constant. I was taught that the basic responsibility of the General Manager is to manage the challenges that change presents; to build organizations that are flexible and competent enough to understand and respond to change. The basic Algebra of our business changed from 1970 to today.

In 1970 the formula was:

C + P.M. = S.P.  
COST PLUS PROFIT MARGIN EQUALS SELLING PRICE

Today, the formula is:

S.P. - C. = PROFIT

The difference is profound and that difference has humbled many a brilliant manager. We could not cut costs or improve productivity fast enough in the '80's and '90's to ensure viability. Why? My view is that we had not structured organizations capable of timely response to challenges. Our functionally organized

businesses were unresponsive to customer needs. Most importantly, we had made very little improvement in understanding our most important asset - our employees.

Consider the following except from an Algoma Steel report to Directors explaining company performance from 1965 - 1969.

*"In 1966, 1967 and 1968, Algoma's performance with respect to production, sales and pre-tax earnings suffered a marked deterioration. Following are considered to be the two principal reasons for this:*

1. *"Algoma has been plagued with strikes, slow-downs and a growing trend on the part of employees to reject authority and their contractual responsibilities. These are attributed in large part to inefficient and irresponsible union leadership with marked antagonisms on the part of the local Union 2251 President and to some extent to an increased proportion of younger employees and longer vacation periods..... orderly planning and scheduling of production on a rational basis has not been possible and orders and customers have been lost."*

This represents an extreme view but one that still prevailed in the '80's/'90's. Perhaps, you can think of workplaces today where this view prevails. It is, quite simply, a mistake. It is the confusion of symptom with disease. People are not the cause of poor results ----- the system of production in which they are asked to work may well be. It is alarming that commitment to the adversarial process consistently blinds us to that possibility.



*(Incidentally, What was reason #2? Well, I've read the report several times and reason #2 is not especially clear. Reduced to its essence, I think that it said ---- "we are not managing the business very well".)*

At its core -- **Manufacturing is People**; people who have families; people who live in communities. Any restructuring or renewal process needs to proceed with that understanding. Underlying the restructuring at Algoma Steel was the resolve of the employees, their bargaining agent, the United Steelworkers of America and the management to change the operating structure and culture to provide for significantly greater employee involvement in planning and decision making. This view was most clearly articulated in principle and most tenaciously pursued by the leadership of the Steelworkers. Many in industry viewed this initiative with distrust and suspicion. Some still do. I don't. I think their insight and flexibility must be recognized and applauded. That is, what makes this restructuring unique and interesting.

Let me describe the New Algoma in terms of the workplace restructuring commitment:

Under the Plan of Arrangement, 15 million shares (60% of the outstanding common shares) were issued to employees. These are held in Trusts that manage the allocation of shares over a five-year period and their transfer to employees on retirement. The Trusts also vote the block of shares. The employees also received employee voting shares that carry rights to approve certain fundamental changes and investments. They also carry the right to elect five of thirteen directors. Three of the five union nominees are employees. In addition, the Steelworkers' Area

Coordinator has the right to attend and participate in Board Meetings, although not to vote. (I should note in passing that employee ownership has reduced to about 26% over time but the governance provisions enshrined in our articles of incorporation remain intact.

A new collective agreement was established in parallel with the approval of the plan of arrangement. It was renewed in 1995. It is based on a labour/management model that embraces key ideas and principles that represent a determined effort to depart from the traditional adversarial model. These ideas and principles are:

- 1) a joint process anchored in a collective agreement can be a competitive advantage,
- 2) a labour-management partnership can function in a non-adversarial manner,
- 3) good decisions can be made by consensus,
- 4) we recognize the of the need for improvement in quality and productivity,
- 5) preference for team based organizational structure,
- 6) employee empowerment,
- 7) income security,

and finally and most importantly, a commitment to a system that strives for mutual trust and respect.

A Joint Steering Committee was established to ensure employee involvement in policy and strategy development. The co-chairs are Algoma's Director of Human

Resources and the Steelworkers' Area Coordinator. Other members are eight senior management personnel, seven union officials from Local 2251, representing hourly employees and one union official from Local 2724 representing salaried employees.

The mandate of the Joint Steering Committee is extensive:

- manage employment levels,
- implement the strategic plan,
- direct workplace redesign and worker participation processes,
- direct the process of technological change
- direct Algoma Steel's Human Resource policies and procedures,
- direct all other joint committees
- review and approve annual business plans
- review capital appropriations before submission to the Board of Directors,

Decision are made by consensus.

In early 1996 the Joint Steering Committee took the next step forward and established 28 Department Steering Committees to deal with department issues. These Department Steering Committees are involved in all aspects of department performance ----- safety, environmental, cost performance, quality, productivity and manning levels.

How are we doing?

In 1995, the company completed a \$740 million refinancing and shares were listed on the TSE and NASDAQ.

In 1996, we shipped 2.1 million tons of steel: plate; sheet; structurals; and seamless tubes. Revenue in 1996 was 1.2 billion dollars. We are one of the lowest cost producers of liquid steel in North America. In our first seven months of operation (i.e. the seven month period ending December 31, 1992, Algoma lost \$74.1 million. In 1993, net income was \$7.1 million. 1994 to 1996 the net income was \$127.3 million; \$109.5 million; and \$67.8 million.

We are investing in our future. We are in the final stages of construction of a thin slab caster linked to a hot strip mill. We call it the DSPC - Direct Strip Production Complex. This facility links the benefits of integrated steelmaking with mini-mill style casting and rolling. The cost is \$400 million Canadian.

Prior to restructuring, there were approximately 6,060 employees in the workforce. By the end of 1996, the permanent workforce had dropped below 5,000 through attrition and early retirement. Raw steel production in Q4 1996 was the best quarter since restructuring.

Over 1,000 employees are involved in self-directed work teams with another 1,000 working toward implementation of the team concept in their work areas.

Before restructuring, there were approximately 300 employees on workers' compensation at any time. This number now is in the 30 to 40 range. A dedicated team has made a concerted effort to get people back to work. Algoma Steel received 15 million in premium rebates from the W.C.B. in 1995 and 1996, reflecting improvements in lost time and accident frequency experience.

Each person at Algoma Steel received approximately 8.5 days of training in 1996.

In February 1997, we further strengthened our balance sheet by selling 6 million shares for \$50 million. Pretty good results from where we started - Pretty good results by industry standards. So, why the question marks in the title? Why is there any uncertainty as to whether the Algoma renewal is a successful adaptation?

One concern ----- strange but true ----- is that we have been fortunate; that we have had good luck. It is true that the business cycle has been favourable. Steel demand improved in 1993 and has remained relatively strong into 1997. Exchange rates have remained at a favourable level. While the business cycle has been favourable, I reject the view of some analysts that we are solely the product of luck. Fierce price competition remains a feature of our business. The algebra remains the same. I worry more about complacency and the understandable desire to relax from the very difficult task of restructuring. We need to constantly remind ourselves of the realities of our business environment and how far back we have come from the edge and how far we have to go.

A second concern is that work place restructuring is hard work. We have other workplace models that we can and do learn from but we have to find our own way. We are a "retrofit" not a "greenfield" project. Retrofits are usually more difficult. We started with an existing structure, habits and behaviours built up over many years. (Our average years of service is approximately 22 years.) Not everyone buys in. Even those that do buy in have to learn new skills, new ways of doing things and work hard at their personal adjustment. A few examples:

- Middle managers and supervisors have concerns regarding their role in a new structure. They have to accept the requirement to share information and teach. We have to understand that these people are themselves the product of a narrow functional structure where their role was circumscribed and where they had limited access to "*information*".
- Some employees fear erosion of the seniority principle. They are sceptical about job rotation. This is completely understandable. You would feel the same way if it had taken you 30 years to get the top job in a line of sequence.
- Local union leadership has a difficult task in our structure. They must reconcile their responsibilities to individual members with a new role of joint decision making for the enterprise. As individuals, they face the political reality of running for election every three years.

We have spent most of the time since restructuring understanding and defining these issues; making them visible and finding mechanisms to deal with them.

Still another concern is that, to a large degree, we are quite dependent on key players who understand what we need to achieve and who keep us moving forward. Most importantly, they continue to build trust and respect by avoiding scape goating and finger pointing when the inevitable set backs occur. We still have much to do. The task now is to move forward to bring greater clarity and accountability to the levels of the structure that has been created. The answer "*to the question marks*" lies in how well we manage this stage of the process.

Time is the issue. You need time to nurture a new culture. We cannot forecast the timing or the depth of the next down turn in the business cycle. We do know it will present challenges. Some of those challenges will test the alignment of stakeholder and shareholder interests. We do believe that we are better equipped to respond than at any time and that we have the commitment of the majority of Algoma Steel employee/owners.

Algoma people faced a disaster in 1991/92. The experience lingers in the memory and there is a strong resolve to make the changes necessary to avoid a reoccurrence. We recognize the structures and processes that we erect have to serve the business; that we have to meet our financial obligations and our responsibility to add value for all shareholders.

We have already built a degree of trust and respect at the Joint Steering Committee that will serve well in dealing with any crisis or challenge. In my short time at Algoma Steel, we have had several difficult decisions to make ----- they were made in a timely fashion with broad support.

I stated earlier that the New Algoma was created from the correct insight that a change in workplace design had to accompany any financial restructuring if renewal was to follow the crisis. Will the Algoma model prove to be a successful application of this principle? I believe it will but if it does not, it does not mean that the general principle is in error. Good adaptations can fail ----- the meteor can land and destroy life. What we do know is that refusing to recognize the need to adapt is not an alternative.