Mining for synergies: Strategies for global mining companies

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# Executive summary

*The global mining sector has seen an unprecedented span of growth and upheaval in the last one decade. All the metal and mineral commodities rose from their low point in 2001-02 periods to an all time high in 2008. Although the global recession in 2008 severely affected their business global mining companies resumed their growth and surpassed their previous highs by the end of 2010. However, standing at this crucial juncture, they face major opportunities and threats in their near future.*

*This report attempts to address these growth opportunities and major hurdles of the mining sector. Further, efforts have been made to understand the serious implications of policy changes by governments and the rise of the emerging markets. The key management strategies and business growth models adopted by the largest mining companies such as BHP Billiton, Royal Dutch Shell and Rio Tinto have been discussed in detail.*

*The key insights that have emerged from the study of the global mining sector are:*

* *Resource nationalism among resource rich countries has created constrained supply exacerbated and has created serious threat to the businesses of global mining companies. Recent experiences of nationalisation of natural resource mining activities show that governments in emerging markets can create a new national mining company and also disrupt the supply to global trade.*
* *Shifting tax and royalty policies have begun to target the mining sector and eat into its profitability. Following the global recession, many governments have fallen short on cash, which has exasperated this risk.*
* *Emerging markets led by the BRIC countries have displayed voracious appetite for natural resources to satisfy needs of their growing populations. This is apparent in the rising commodity prices despite the subdued demand in developed markets.*
* *M&A deals are happening across geographies and mining sectors. Industry players are focussing on these deals for two main reasons: One is to gain market share in their existing segment through vertical integration by acquiring upstream assets.*

# Introduction

The global mining sector is in a major state of transition due to a variety of geo-political and economic factors. The sector is increasingly impacted by drastic political actions of resource-hungry nations, empowered rising demand from emerging markets, local communities in resource-rich areas, climate change negotiations. This report attempts to understand the key issues on global corporate policies and strategies of the global mining and metals industry, including a study of leading companies such as, BHP Billiton, Anglo American, Rio Tinto and Vale S.A.

A recent report by Deloitte (2011) discussing about the major issues facing the mining companies, states that the mining industry will need to change its modus operandi to stay current in the new global economy. In 2011, the mining companies will face a complex mix of problems: getting permits for new mines, finding skilled labour, battling new tax and royalty regimes and along with Chinese activities. In 2009, China made 33 deals with a combined value of US$9.2 billion. Various industry reports have consistently pointed out some major issues of concern.

### Resource Nationalism

Resource nationalism in Africa is becoming rampant with African governments are seeking higher rents and bigger ownership stakes from foreign miners. The Economist noted that Ghana, Africa’s second-biggest gold producer, recently announced a review of all mining contracts to ensure that mining profits are “maximised for the good of the country". Zambia, which is Africa’s biggest copper producer, recently doubled its royalties on the metal, to 6%. Guinea, home to the world’s largest bauxite reserves as well as one of the world’s biggest iron-ore deposits, is helping itself to a 15% stake in all mining projects and an option to buy a further 20%. Namibia has decided to transfer all new mining and exploration to a state-owned company (The Economist, 2012).

Similarly, in Asia, China’s biggest trading partners—Japan, the European Union and America—have complained to the World Trade Organisation alleging that China was unfairly restricting its exports of tungsten, molybdenum and 17 rare earth minerals, obscure elements such as terbium and europium, used in the manufacture of many high-tech goods (The Economist, 2012).

### Taxation and royalty policies

The mining sector’s recovery from the global financial crisis was remarkable with revenues for the world’s 40 largest mining companies rose by 32% to reach a record US$435 billion, driven by surging commodity prices and a 5% increase in production output in 2010.The strong top-line result catapulted the mining companies’ net profit to an impressive US$110 billion – a 156% increase over the previous year (PWC, 2011).

However, PWC in its Mine Trends 2011 report warns that the sector needs to watch out for supply constraints, labour shortages and ever increasing scrutiny from governments. Particularly, shifting tax and royalty policies have begun to target the mining sector and eat into profitability. Following the global recession, many governments have fallen short on cash, which has exasperated this risk. Particularly, emerging countries look at the enormous profits of mining companies as loot of their national resources. Democratic Republic of Congo, Chile, South Africa, Zambia, Tanzania, Burkina Faso and India have all either considered a windfall tax on mining companies or have implemented it (Deloitte, 2011). This is not confined to emerging countries alone. In 2012, Australia passed the Resource Rent Tax legislation that will reap about US$11 billion in taxes from BHP Billiton, Rio Tinto and other iron-ore and coal mining companies as the government seeks to turn its budget to surplus (Bloomberg, 2012).

### Power of emerging markets

All through the modern history of global economics, the flow of resources and finished goods followed a familiar pattern. Developing countries exported natural resources as raw materials to the industries in the developed world and bought back finished manufactured goods (UNECA, 2011). The global crisis has weakened the developed world in Western Europe and North America to such an extent that despite their steady recovery, they will not be able to match the pace set by emerging developing countries such as Brazil, India and China. As predicted by Goldman Sachs, the BRIC countries and the Next 11 economies will spear head the recovery of the global economy and take leadership position by 2050. Catering to their rising commodity needs will be the primary focus of global mining companies.

## Analyzing the leading companies

Multinational companies tend to diversify their interests in various industry sectors. The world’s leading oil and gas company, Royal Dutch Shell also occasionally sought to diversify away from its core chemicals, oil and gas businesses. It acquired the Dutch metals-mining company Billiton in 1970. BHP Billiton is a global mining corporation based in Melbourne, Australia. Established in 1885, the company transformed into its present form in 2001 due to the merger of the Australian company, Broken Hill Proprietary Company Limited (BHP) and the Billiton Plc based in the UK. Through this merger, BHP Billiton became the world’s largest company, which in 2011 earned annual revenues of US$75.46 billion and net income of US$23.06 billion (Yahoo! Finance, 2011). BHP Billiton’s global position and industry standing can only be understood when it is compared to its competitors on various parameters such as annual revenues and profitability.

#### Figure 1: Comparison of various mining industry competitors

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | BHP Billiton | Anglo American | Rio Tinto | Vale S.A. | Industry avg. |
| Market Cap (US$ billion) | 190.51 | 47.37 | 99.94 | 116.47 | 20.80 |
| Employees No. | 100,000 | 61,000 | 63,746 | 79,646 | 8500 |
| Qtrly Rev Growth (YoY%) | 9.9% | 6.0% | 2.80% | 2.4% | 21.7% |
| Revenue (US$ billion) | 75.46 | 30.58 | 60.54 | 56.71 | 30.49 |
| Gross Margin (%): | 78.26% | 31.40% | 40.10% | 60.76% | 43.97% |
| EBITDA (US$ billion) | 39.52 | 11.48 | 27.28 | 31.91 | -1.14 |
| Operating Margin (%) | 44.89% | 31.12% | 37.73% | 49.54% | 3.69% |
| Net Income (US$ billion) | 23.06 | 6.17 | 5.83 | 20.78 | N/A |

Source: Yahoo! Finance, 2011

Figure 1 depicts the comparison of BHP Billiton, Anglo American, Rio Tinto and Vale S.A. BHP Billiton has leadership position in almost all comparable parameters. In terms of market capitalisation, number of employees, revenue, gross profit margin and EBITDA, the company is way ahead of its competitors and industry average as well. Vale S.A. comes close in a few parameters such as revenue growth, operating margin and net income. It is worth mentioning that despite being a Fortune 500 global company, Billiton has maintained gross profit margin of 78% and operating margin of 45%, which is remarkable.

#### Figure 2: Visual comparison of largest four global mining companies

Source: Yahoo! Finance, 2011

Figure 2 visually presents the comparable position of the top four leading industry players. It is clear that both in terms of annual revenue and number of employees, BHP Billiton has a clear lead over its peers. Only in terms of net income, Vale S.A. comes close to match the performance of BHP Billiton......

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