The rise of emerging players in global mining: drivers and future challenges

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Mining companies in emerging countries benefited from market liberalization and the surge in raw materials prices between 2003 and 2008. This allowed them to strengthen their balance sheets, invest in exploration and exploitation, secure their supply chains and go international. The recent slump in prices highlights the challenges they must face: ensure they have access to financing, expertise and techniques, strike the right balance between their shareholders’ different expectations.

The role of emerging market and developing country economies (henceforth emerging economies) in the global demand for minerals grew significantly during the 2003-2008 mineral price boom. Similarly, their contribution to the global supply of minerals since 2000 is striking. They have accounted for most of the growth in global production of iron ore and nickel and all of the growth in global production of aluminum, copper, and steel (Figure 1).

Among these are the world’s largest producers of the following: iron ore (Brazil), aluminum (China), copper (Chile), silver (Peru), gold (China), platinum (South Africa), and diamonds (Botswana).

A similar tendency is evident in global exploration spending, arguably a pointer to future production trends (Figure 2). According to Metals Economics Group (MEG, 2010), at the beginning of the last decade emerging economies accounted for approximately 40% of global exploration spending. By the middle of this decade, that proportion had risen to 60%. This concentration of growth in production and exploration should not come as too much of a surprise.

After all, these economies account for approximately three-quarters of the world’s land surface and, according to United States Geological Survey (USGS, 2010), a similar proportion of global mineral resources (Figure 3). Nevertheless, for much of history, the development of the resources of these economies has been hampered by inadequate geological knowledge, poor infrastructure, inconsistent and ineffective government policies, and a lack of capital.

More recently, the situation began to change. Liberal reforms in the 1980s and 1990s opened up large tracts of land in mineral-rich parts of the world to foreign investors, while the liberalisation of capital markets increased access for all investors to risk capital. Equally important, many companies based in emerging economies started transforming themselves from bureaucratic and conservative national institutions into modern profit-driven corporations with expansionary ambitions, not just within their home territories but also on the wider world stage. Some of these looked to Africa, with its substantial natural resources, as a likely destination for their investment.

Drivers for the rise of emerging players

According to Raw Materials Group (RMG, 2009), four companies based in emerging economies are
among the world’s top 10 mining companies, and 11 are among the top 30, with three of them being South African (AngloGold Ashanti, Impala Platinum and Gold Fields). Several factors have combined to provide a boost to the role and fortune of these companies in mining over recent years.

Firstly, the widespread disengagement of the state from the mining industry was the key to this growth. While under state control, many mining companies in emerging economies were effectively restricted to slow, incremental, and local growth by their lack of access to capital and skills and their lack of knowledge and experience of the industry beyond their borders. The disbanding of state controls opened the door to an inflow of entrepreneurial talent and a more commercial and expansive set of objectives.

Secondly, these companies often had privileged access to local resources. Management were generally politically well connected in their home countries, understood regulations and how to operate within these, and were aware of local resource development opportunities. As the industry began to grow, they had a powerful competitive advantage over newcomers, as well as a powerful lever in negotiations where they needed to involve foreign investors with the technologies and managerial skills they lacked.

Thirdly, the commodity boom of 2003-2008 gave companies in the sector strong cash flows and healthy balance sheets. Coupled with improvements in corporate governance and financial reporting, this increased their access to international capital markets. The maturing of banking systems and stock markets in many emerging economies, combined in some cases with high levels of domestic savings and low borrowing costs, also increased funding for resource projects, most notably for smaller and midcap companies.

Fourthly, many of the larger mining and metals companies in emerging economies have been on a fast-track mission to globalise, to improve their risk profiles through geographic and commodity diversification, and to acquire skills and technology. Sometimes, they have had the tacit support of their governments, to whom hosting a global champion often appeals. In acquiring assets in lower-risk countries, or those of commodity companies that promise to give greater stability to their earnings, management may feel justified in paying a premium if they believe that the benefits of the resulting improvement in risk profile will be reflected in a higher valuation for the business.

Finally, these companies seek to secure raw materials for their metallurgical operations. This flows from the growth of emerging economies as mineral consumers, and associated concerns over the security of supply of raw materials needed to support their industrialisation and the growth of their metal-processing and manufacturing sectors. Chinese and Indian companies have been actively seeking resource development opportunities overseas, with a view to feeding their domestic smelters and refineries. The mercantilist thinking behind this sort of strategic investment often results in buyers valuing a mineral asset more highly than they would using a strict commercial evaluation.

**Challenges for the emerging players**

While the boom of 2003-2008 saw the growth of emerging mining companies, the current market environment is presenting new issues. Falling commodity prices have put pressure on all producers, and risk aversion has afflicted financial markets, impacting particularly heavily on emerging economies, and resulting in the stocks of many companies from these regions being hard hit. Even the most profitable of these companies do not have long track records to point to when asking for understanding and support from banks and investors. For smaller companies, particularly those not yet in production, the sources of funding have almost dried up. The credit crunch has left many banks wholly disinterested in the sector.

Unlike global mining companies, which tend to have diversified shareholdings, the stock of many emerging market companies is concentrated in a few hands, with the minority distributed among a greater number of investors. While the market was strong, reconciling the interests of both sets of
shareholders was not difficult. However, with cash flows diminishing and pressure on personal finances, the temptation may arise for larger shareholders to pressure management to prioritise short-term cash generation at the expense of longer-term development interests, an objective that might be preferred by minority institutional investors.

A third challenge faced by emerging market companies is maintaining momentum on globalisation. Many of these companies were established as national companies exploiting domestic resources, which did not equip them well for the global stage. Many retain a strong national focus in their business and cultural perspectives. The current slowdown in commodity markets will likely aggravate these problems, since downturns force a review of priorities. Protectionist political pressure to invest at home, providing domestic employment, will be intensified, especially where companies have become dependent on state financing. The creation of national champions may accentuate this tendency: while they provide for commodity diversification, they do little or nothing for geographic diversification. In fact, they increase investors’ exposure to one country and to one currency.

Finally, for emerging economy companies growing off a strong domestic base, the skills and knowledge of their management are confined largely to these markets. This applies to both business skills and technical skills. Due to a lack of international experience, they may lack the required communication skills and sensitivities to other countries’ business and cultural practices. This will inhibit their performance overseas and create challenges for foreigners brought in to assist with the globalisation process, restricting their participation in industry and governmental bodies addressing global industry issues and working to develop global industry standards. The economic slowdown could compound these issues, and there is likely to be greater resistance to bringing in highly paid foreigners in a tougher cash environment.

Commercial prospects and development expectations

Much of the literature (for example, United Nations Conference on Trade and Development–UNCTAD, 2007) is focused on the development impacts of ‘north-south’ foreign direct investment (FDI). Less attention has been devoted to the development implications of FDI in mining originating from emerging economy countries, commonly referred to as ‘south-south’ FDI. In principle, companies from emerging economies face the same challenges as those based in developed economies. Yet they sometimes bring a different perspective, emphasising both secure raw material supply considerations and commercial prospects, along with such investments taking place within the context of a broader government-to-government financial and cooperation agreement. This approach to investment is supported by some resource-rich countries, and may in time deliver the benefits it promises, but the political nature of these arrangements will require careful management. Note that not all Chinese investment in mining is large-scale and government-backed. A great deal of Chinese investment going into Africa’s cobalt operations has been from small private enterprises, many of them employing Chinese workers.

Although less well documented, emerging economy mining companies often have substantial experience in grappling with development issues at home. Many have grown up with a wide range of social responsibilities and face high expectations in the communities where they operate, about what these responsibilities should be. Social responsibility forms an integral part of these companies’ corporate history and character. While transforming themselves into competitive commercial enterprises, they have often had to disengage themselves gradually from a range of activities more appropriately carried out by elected, tax-funded authorities. Nevertheless, they continue to play an important role in economic development where they operate, and will doubtless face a tough challenge over the next year or two in balancing the demands of their businesses with the demands of political processes.

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