MANAGEMENT

Survey points to commercial upside

In the asset productivity age, miners can't neglect commercial excellence

Matthias Tauber and Martin Feth

Mining companies' bottom lines have been pummelled by falling commodity prices paired with rising production costs.

Not surprisingly, miners have put boosting asset productivity at the top of their agenda. But to restore (never mind sustain) their profitability, they must also work toward commercial excellence – by strengthening their marketing and selling strategies.

Any single commercial-excellence initiative might exert a relatively small impact on the bottom line.

Yet our analysis of more than 100 commercial excellence projects suggests that, taken together, they can deliver a considerable collective impact—2-8% improvements in operating margin, depending on the liquidity of the markets a miner operates in (*see figure 1 below*).

What's more, capturing this value often requires limited capex, which is decidedly good news for this capital-constrained industry.

Nevertheless, our client work and a recent BCG benchmark study involving a dozen-plus leading global commodity producers show that most miners are not extracting maximum value from their commercial operations.

The reason? Miners tend to be production rather than marketing driven, so their sales and marketing teams have one objective: place volumes of tonnage with customers.

This mindset can do only so much for a miner's bottom line. To beef up margins, they will have to shift their focus from volume placement to value creation. Below, we explore a three-step approach to making this transition (*figure 2 below*).

Step 1: Strengthen your core

Examine your sales book for the past few years. Do a few customers account for the majority of sales?

Have customers and the volumes they buy changed little over time?

Do some contracts seem too good to be true in terms of premiums paid?

If so, your sales managers likely view long-term relationships, large volumes and high premiums as the defining characteristics of an attractive customer – suggesting a volume-placement mindset.

To shift to a value-creation mindset, start paying more attention to netback: a customer's premium minus cost to serve that customer. With netback in mind, review your existing contract portfolio and identify and renegotiate suboptimal contracts to get the full value of your products.

For example, a leading copper concentrate producer identified legacy sales contracts for copper concentrate in which customers had not been paying fully for all by-products, especially precious metals such as gold.

The company renegotiated those contracts successfully, which increased net-price realisation per unit by about 1%. In another instance, a base-metals producer renegotiated a large contract with a leading trading house.

While the premium looked highly attractive, the contract granted an overly favourable pricing option to the trader. When exercised in the trader's best interest, the option took away the miner's entire premium.

Step 2: Expand your options

You will not be able to renegotiate all unfavourable contracts. When you cannot, seek to bring in new customers that will offer higher netback potential. Doing so requires deep knowledge of the market and your potential customers.

For instance, a base metals producer developed a detailed landscape of more than 50 potential higher-netback customers by analysing data such as actual and forecast production volumes as well as client preferences in flexible delivery options, extended payment terms, and other value-added services.

The resulting shift in volumes delivered a 10-15% increase in the total value contribution of the company's marketing team.

But before shifting volumes, weigh possible trade-offs. For instance, smaller customers may be less stable than larger ones. And expanding your customer base may require you to build up your commercial team.

	Examples	Commercial-value potential
Illiquid market	• Lithium • Potash • Uranium	3-7%
Hybrid market	• Alumina • Iron ore • Thermal coal	2-8%
Liquid market	• Copper • Gold • Nickel	2-4%

Figure 1

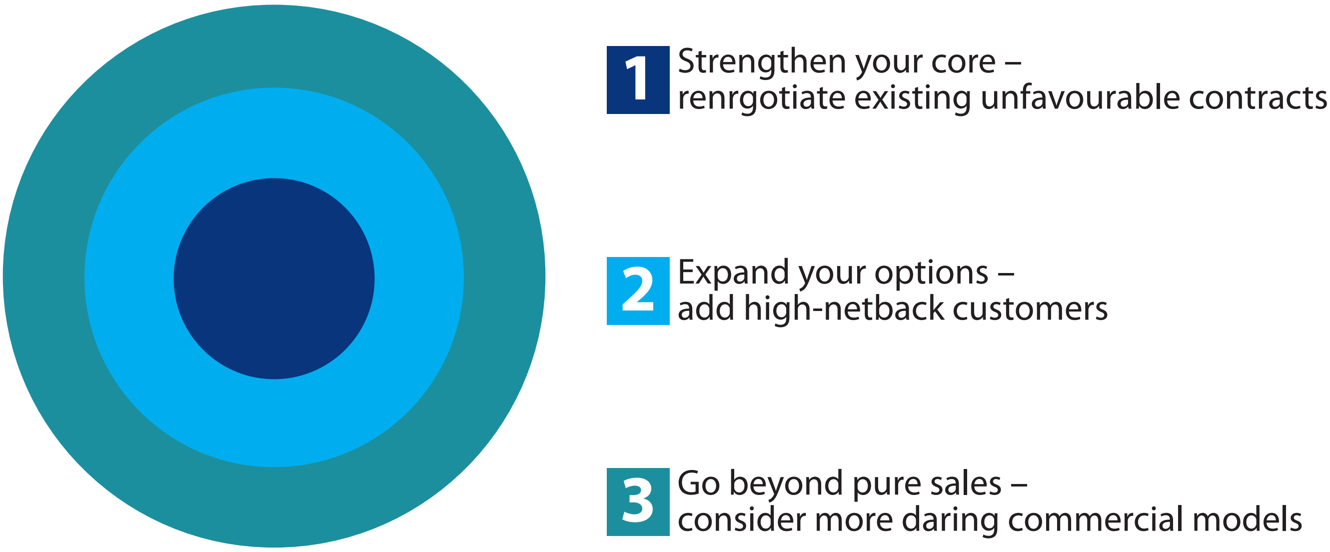

Figure 2

Step 3: Go beyond pure sales

In most mining companies, marketing and sales teams place volumes with end users at market price or at a slight premium for services such as expedited shipping or flexible payment terms.

While this classical commercial model might make sense for some miners, alternative models may present new possibilities for boosting the bottom line (*see figure 3 below*).

We saw three such models in our benchmark study:

▶ **Integrated producer-trader.** Miners using this model run an in-house commercial team but charge it with exploiting the full value of the company's products and asset base.

For example, a bulk-materials producer moved to this model by strategically exploiting market imperfections such as arbitrage opportunities.

Almost 25% of its EBITDA now comes from recently initiated trading activities.

While this model can generate considerable value, it requires a whole new way of doing business, including managing risks that come with transacting frequently with third parties and employing people who can spot and swiftly seize opportunities on a daily or even hourly basis.

Making these changes is not easy, and miners may encounter resistance from commercial managers used to the classical model. The model also requires patience – seeing results may take several years.

▶ **Trading partnership.** Miners unwilling or unable to adopt the integrated producer-trader commercial model may use this model, which involves tendering a share of their volume to a trading company for an extended period.

In return the miner requests favourable pricing from and full transparency into its partner's transactions.

Using this model, the company can capture some of the trading upside. It can also learn how its partner earns its margin and use the resulting insights to strengthen its own margin.

Eventually, it may no longer have to share the value.

▶ **Outsourced marketer.** More common among small miners, this model involves reducing marketing and sales expenses by outsourcing those tasks to an external agent for a fee typically calculated as a percentage of revenues.

The model makes sense for these companies, given that professional-sales costs often exceed agents' fees. The downside is that miners risk losing touch with users of their products.

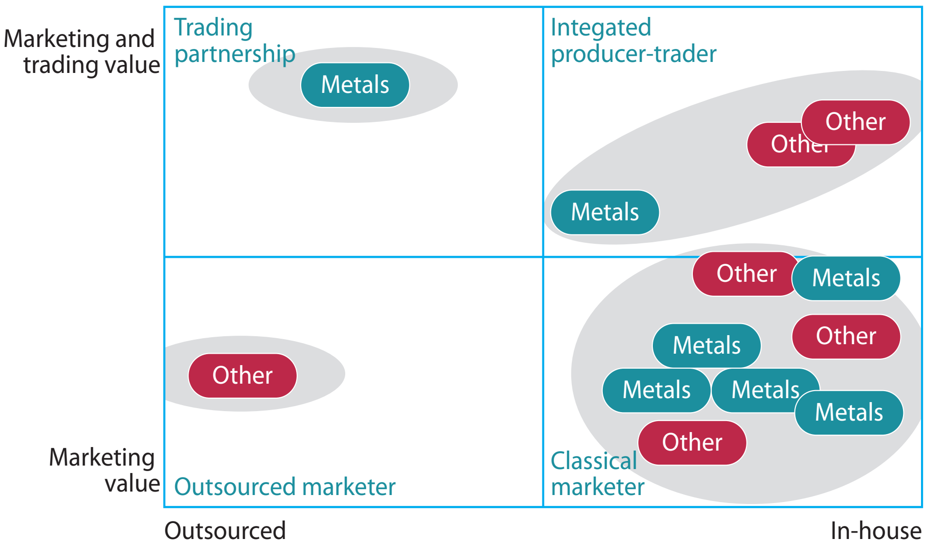

Figure 3

The three-step approach described above requires significant behaviour changes within a commercial team.

To encourage those changes, the right performance metrics and incentives are needed.

For instance, instead of evaluating a team's performance only through top-line-focused metrics (such as volume placement compared to budget), give the team its own P&L so members have responsibility for improving the bottom and top line. And link a larger share of their compensation to individual performance.

For many miners, improving their commercial efforts might not seem nearly as sexy as boosting asset productivity.

However, in times of tight margins, it can constitute a potent lever for surviving in the short run – and thriving well into the company's future. ▼

Matthias Tauber is a partner and managing director at The Boston Consulting Group. He can be reached at tauber.matthias@bcg.com. Martin Feth is a principal at The Boston Consulting Group. He can be reached at feth.martin@bcg.com.