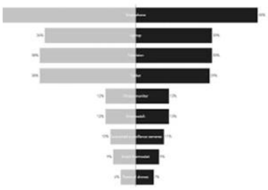
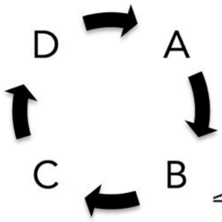
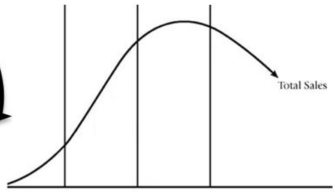
Why miners should welcome opaque pricing environments

By Christian Barbier, CRB Resources



Mining companies often feel uncomfortable when there is no external price reference for their products, and over the last few years a number of them have voluntarily commoditised their production in order to seek a more transparent pricing environment.

Opaque pricing – defined here as the situation where there is no clear external reference determining the price a company should sell at – is in fact the norm; most products and services in the world operate in that environment, where companies excel at identifying the optimum price to charge, generally based on a combination of value-in-use and competitive pressure.

The best known examples of transparent pricing are of course gold and silver, as quasi currencies, as well as the metals and commodities traded on the London Metal Exchange (LME) and other similar commodity exchanges. Interestingly, it is the buyers who have historically pushed for products to be traded in that manner, in order to commoditise them, to be able to switch suppliers instantaneously and even buy anonymously… and put downward pressure on prices. This is why in the 1980s the Japanese industry, the biggest net buyer of metals at the time, supported the rise of the LME. Any salesperson knows a typical purchaser wants its suppliers to offer exactly the same specification, i.e. commoditise the product, in order to limit the decision criteria to the price only.

As the mining industry has become highly capitalistic, investors and financial analysts have increased their influence and also find it easier to understand and to model revenue performance in transparent commodity pricing situations, which helps their investment decisions.

Unfortunately, all these influences are a disservice to the producer, and in a perfect environment to the whole supply chain including downstream. There are two main reasons for this:

1. It amplifies the cycle: transparent commodity pricing helps buyers quickly switch suppliers based on price, hence push prices down when supply overtakes demand, while the opposite happens when the market tightens. Unfortunately, price cycles aren't balanced and history shows that the troughs are wider than the peaks, hence favouring the buyer, not the seller.
2. It facilitates the entry of newcomers: transparent commodity pricing makes it seem safer for investors to commit cash into a new business, for newcomers to find the price point to compete against established producers, and for buyers to switch to a new supplier. The ensuing increased competition obviously serves the buyer's interests, not the seller's.

Conversely, opaque pricing markets create not just favourable conditions for the producer, but also a virtuous cycle of innovation and value-add that benefits the whole supply chain, as well as investors. This is how it works:

- In order to price their products in the market, producers need to understand their value-in-use, which leads to being more customer-focused and to a higher knowledge of the downstream needs and trends. Competitive pressure results in customers obtaining more benefits from their suppliers, who investigate ways to protect their profitability, hence stimulating value generation based on process improvement, increased productivity, higher product quality, and product innovation/disruption.

- Thanks to the higher value provided to customers, more effort is required on the part of the buyer to change suppliers, and as a consequence the whole industry operates in a more stable pricing environment. Price cycles are dampened, sometimes almost disappear.
- Investors also find sizeable benefits: the extra balance sheet strength to sustain the lows of the cycle isn't necessary, which improves shareholder returns. Margins are more consistent, which de-risks investments.

This is the environment most industrial minerals operate in, which has allowed tremendous value generation over the years, in the form of cost reductions and innovation.

There is however one necessary key component mining companies need in order to succeed in this virtuous opaque pricing environment: a structured strategic and technical marketing function. It isn't rocket science, again most industries operate in that situation, but it also requires the leadership to understand and embrace that culture – both on the board and in the management team. This transformation has already started in a number of companies.

As Australia is embarking on a value-adding journey for its mining production - contemplating the processing of metallic ores using green hydrogen, and processing battery minerals and rare earths into intermediate elements and compounds - being able to thrive in opaque pricing markets is a critical skill to develop.