

Bigger is better, except when it's not

BHP strategic search continues



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The dismantling of the increasingly unwieldy BHP Billiton to produce a more streamlined and focused group has left equity investors deflated. Not only was there no capital windfall, but a decade of preaching by a succession of chief executives (CEOs) about the benefits of diversity, marketing synergies and a pipeline of new projects suddenly seemed to have been cast aside.

The structure of BHP Billiton has preoccupied investors and CEOs alike since Brian Gilbertson first described how global customer sector groupings would create value. For all its strategic sophistication, large-scale mines and pipeline of development opportunities, there has been a nagging reality. No matter what it did, commodity prices dominated its profit and share price outcomes.

Operationally, the value contribution was limited. Between 2004-05 and 2013-14, costs rose US\$8.9 billion while volume gains contributed just US\$6 billion to EBIT. Even the benefits of higher commodity prices and growing demand were being eroded by persistent productivity deterioration.

Current CEO Andrew Mackenzie's justification for the new strategic endeavours had all the hallmarks of a careful and skilled wordsmith at work behind the scenes. The key words and phrases were repeated and emphasised to help get the message across. Use of words like assets, capital, productivity, cash, value and shareholders peppered the presentation to investors as he went about explaining the decision to de-merge a large number of the BHP assets from the core.

The arguments sounded persuasive enough, but prompted one obvious question: if Mackenzie's approach has merit, what does it say about the approaches of his predecessors? Mackenzie's view of how the company should look differs markedly from those that went before.

Word analysis software helps to throw some light on the varying explanations of the sequence of business leaders over the last dozen years and confirmed the differences.

Brian Gilbertson's 2002 annual earnings presentation seemed the least structured of those reviewed. There was no outstanding theme and little use of any words reflecting strategy. Interestingly, Gilbertson made conspicuously frequent use of the phrases: "I



After a decade or more preaching the bigger-is-better mantra, BHP is setting sail for new horizons

(don't mean" and, "I (don't) think", suggesting an implicit attempt to impose his personality on the business rather than any specific strategy or business theme.

In 2007, with cyclical conditions well advanced, Chip Goodyear was using words like growth, projects, markets, strategy and portfolio prominently in arguing the virtues of the company.

By 2012, the tone from Marius Kloppers was different again. Costs, production and financial outcomes were his buzzwords as he sought to emphasise the capacity of the business to produce a better financial return.

The record conveys an evolution in thinking as each succeeding executive team has tried to make something from what they had been bequeathed with none being able to demonstrate conclusively the much heralded benefits from the merger of BHP and Billiton in 2001.

One cannot begrudge business executives wanting to adapt to changes in circumstances, but the strength of BHP Billiton was supposed to be its capacity to look through the cycle rather than respond in the same way as lesser mortals to the different pressures along the way. Without that constancy in the face of the cycle, much of the justification for the business model was lost.

A long recognised risk for all investors, whether it is those managing portfolios of equities or direct investments, is what Nobel prize winning psychologist Daniel Kahneman has referred to as 'anchoring'. In "Judgement under Uncertainty: Heuristics and Biases", written with Amos Tversky and published in Science (1974) (K&T), the authors identified the tendency for people generally to put too much emphasis on their most recent experi-

ences when taking decisions about the future.

In this early paper and subsequent writings, K&T also identified a tendency for decision makers to reduce complex tasks to some simple principles. These attempts, they observed, could be quite useful "but sometimes they lead to severe and systematic errors".

The insights by K&T about psychological biases, demonstrated through controlled tests and human experiments, have some important lessons for the conduct of the mining industry and an understanding of why developers are persistently too optimistic.

K&T described an undertaking whose success required each of a series of events to occur. Even when each of these events is very likely, the overall probability of success can be quite low, they said, if the number of events is large. The general tendency to overestimate the probability of what they referred to as conjunctive events leads to unwarranted optimism about a plan succeeding or a project being completed on time.

Over the past dozen years, BHP Billiton attempted to distil the complexities of the largest and most managerially demanding mining house in history into some simple principles. Each of Gilbertson, Goodyear and Kloppers had a shot. At the same time, at each juncture in its recent history, their views of future priorities were being dictated disproportionately by their most recent experiences.

BHP Billiton has just made another judgement about the future based on a view about recent history, namely, the ongoing overwhelming importance of copper and iron ore to the BHP Billiton business. There is a chance Mackenzie is right, but those views are, nonetheless, anchored once again in the most recent past.

Much will depend on how rapidly China moves to reduce its spending on investment. In creating a stronger household spending base, metals such as aluminium, nickel and zinc should display growth characteristics that make them more prized sources of mining income. Copper and iron ore may appear less attractive.

If it had already been in place, the new BHP Billiton could have produced better investment returns over recent years than the existing structure but that is not the same as saying it should be the preferred structure in, say, 2020 which is the judgement successful management now requires. ▼