Mining for synergies:
Billiton's quest to be world class

By Bob de Wit, Richard Renner and Jaco Loci[1]

In less than ten years after buying the loss making ruining company Billiton from Royal Dutch/Shell, Billiton chairman Brian Gilbertson had accomplished what the mighty Shell had failed to accomplish in their twenty three years as a Billiton parent. through the merger with the Broken Hill Proprietary Company (BHP) of Australia, Gilbertson had created the second largest mining and metals conglomerate in the world valued at around US$ 30 billion. Despite a generally gloomy outlook for the industry whole, the prospects for BHP Billiton were good. The BHP-Billiton deal, code-named 'Bardot' because investments bankers considered it a beautiful thing, was seen as a 'sensational fit' spelling good news for both BHP and Billiton shareholders. However, only six months after appointing Mr Gilbertson as the new BHP Billiton CEO, the board forced Mr. Gilbertson to resign in January 2003 citing 'irreconcilable differences'. Is this a sign of trouble ahead for Billiton? In the context of an increasingly difficult economic environment and without its opportunistic, risk-taking leader will Billiton lose its momentum? Or are the synergies large enough to avoid slipping back to the days of underperformance?

Royal Dutch/Shell

The Royal Dutch/Shell Group of Companies originates from an alliance in 1907 between the Dutch N.V. Koninklijke Nederlandsche Petroleum Maatschappij (Royal Dutch Petroleum Company) and the British Shell Transport and Trading Company Ltd. The Group operates on a world-wide basis in oil, natural gas, and chemicals. Shell is well known for continuously striving to look beyond horizons. Their explicit strategic plans are well implemented and controlled, and have been rewarded by sustained high performance in the international oil industry. Shell invests pro-actively and creatively in the demanding and rapidly changing oil industry, and allocates significant resources to promising new activities on the basis of a long-term vision.

The 'Shell Group Planning System', the annual strategic planning cycle, is famous for using scenarios to formulate operating companies' visions since the 1970s. Although the strategic planning process pays attention to financial consequences of the new plans, it is not focused on detailed financial analyses. According to Shell an overly narrow focus on financial details distracts management attention from innovative strategic thinking. Only after the strategic planning process and after developing or adjusting a vision, do operating companies present investment proposals. In this phase detailed financial analyses are made in order to evaluate investment proposals on criteria of feasibility and minimum rates of return.

Each of Shell's operating companies concentrates on one or several of the following activities: exploration, exploitation, production, transport, and marketing and sales. The operating companies are accountable for their financial results, and for building up and maintaining activities. They may consult the group service companies or, through them, other group companies. These service companies bridge the group companies' activities by means of advice and attuning objectives and/or by financial means. They also connect the operating companies' investment plans and the holdings. In addition, service companies carry out all activities that are most efficiently executed centrally.

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[1] *Source: The case was compiled from publicly available sources. ~ 2003 by Bob de Wit*

Shell's diversification plans in the 1970s

At the end of the 1960s the major oil companies showed a strong urge to diversify into remote activities like hotels and office furniture, and more or less related activities such as coal and metals. Between the Second World War and the end of the 1 960s the major oil companies had experienced more than two decades of stable growth. Demand for oil products increased, and the international oil companies became enormous firms, in terms of size, number of activities and financial wealth. However, the 1970s ended the stability of the world energy markets. Oil demand dropped as prices rose, and governments as well as consumers realized that oil and gas reserves were finite.

Many oil companies focused on expansion into the mining and the metal industry, as these industries appeared to have similar characteristics to the oil industry: international dispersion, extensive projects with long lead times, economic and political risks, governmental involvement, and international trade and transports.[2] Consequently mining and metal companies became targets for most of the major oil companies. Shell was no exception. Shell believed that diversification would guarantee long-term sustainable growth. The metal sector was regarded as a potentially enduring and stable source of income. In addition, the -future prospects for metals were favorable at the time. In the short-term the future of the oil- and gas industries looked strong, but Shell worried about some long-term issues such as increasing power of the OPEC-countries and the finite world oil- and gas reserves. Shell generally agreed that the strong growth rates of the oil industry could not continue.

Potential diversification projects had to meet two important criteria at Shell. Compared with the traditional activities the magnitude of the new activities had to be considerable, both in terms of potential turnover and required capital investments, and the new activities had to be related to the traditional ones. In 1984 the head of Shell's Non-Traditional Business, Mr. van der Toorn, explained Shell's diversification philosophy[3]: '. . . one thing Shell still knows for sure is that we will one day run out of oil. At the moment Shell wants to substantially participate in new and profitable industries with growth potential . . . It is important that we search for opportunities in industries that closely relate to the group's strengths. We do this by selectively investing in a limited number of new activities.'

The rationale behind entering the metals business was formulated as follows: (1) Metals are - like gas and chemical products - raw materials for a range of companies and industries: (2) The metals industry explores, exploits, processes, recycles, and sells non-ferrous metals, industrial minerals. and related products, which are exactly the same activities Shell employs in oil, gas and chemicals: Shell strives for more intensive use of its geological know-how, drilling, and technological knowledge in fields other than oil and gas.

Both industries employ geological and geophysical methods; both process the raw materials to products before they are ready to use; all products must be mass-shipped by especially constructed shifts marketing and sale of both industries often focus on the same clients; both industries require high capital investments; and both industries require excellent relations with governments of host countries an. diplomacy skills. These similarities convinced Shell that metals, and more specifically 'non-ferrous metals', should become the fourth leg in Shell's business portfolio on a par with oil, gas, and chemicals.

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[2] *Billiton Brief (1982). 'De diversificatie van oliemaatschappijen in de mijnbouw' ('Diversification of oil companies in mining'), December*

[3] *Shell Venster (1984), 'Activiteiten non-traditional business. Van der Toorn: Eens zal de olie op zijn' ('Activies non-traditional business. Van der Toorn: One day we will run out of oil', September*

The non-ferrous metal industry

The metal industry can be divided into the basic metal and metal processing industries. The most important basic metals are iron and steel, industries with strong (supra-national) government involvement. All other metals are categorized into the 'nonferrous' metals industry. Aluminum is the world's most important non-ferrous metal. In terms of tons produced, aluminum comes third behind only iron and steel. Other important non-ferrous metals are copper, zinc, lead, nickel, tin, gold, silver, magnesium, titanium, and tungsten. The non-ferrous metal industry operates world-wide, and can be subdivided into exploration, mining and metallurgy, metal processing, and sales. The non-ferrous metal deposits are scattered around the globe, and per metal there are typically only few deposits. The buyers are primarily located in the industrial areas of North America, Europe, and Japan.

Ores and most metals (except for the very rare ones) are commodities, just like sugar and coffee. Prices are set by forces of supply and demand and can fluctuate quite dramatically. On the wave of economic cycles the five dominant buyers of metals construction, capital goods, durable consumer goods, packaging and transportation - change consumption patterns of metals greatly influencing market prices.

Vertically integrated firms that cover all activities from exploration to sales, like the integrated oil companies, have only emerged in aluminum. Crucial factors in the aluminum industry are large scale economies, high capital intensity, a need for cheap electricity and closely guarded technology. Six major international integrated firms originally dominated the aluminum industry for many years, from bauxite mining (the primary aluminum ore) to processing aluminum: Alcan, Alcoa, Kaiser, Reynolds, Pechiney, and Alusuisse. Limited competition and the inelastic price of aluminum characterized the period of market dominance by the 'Big Six'. The large integrated companies formed a de facto cartel and kept prices high and stable. High stable prices combined with rising demand gave favorable prospects for the aluminum industry, which led to an incredible investment boom in the 1970s.

Shell buys Billiton

After deciding to enter the world of metals, Shell began to develop some projects on an individual basis, such as exploiting magnesium reservoirs in the northern region of the Netherlands. Shell soon realized however, that an acquisition would be better and quicker than growing activities from scratch. The target firm was required to be internationally active in exploration and processing with a head-office in Western Europe.

Billiton was the preferred target. Billiton was a Dutch firm active in mining, metallurgy and nonferrous metals on a world-wide basis. Billiton was founded in 1860 when a group of Dutch entrepreneurs obtained a concession to mine tin on the Indonesian island Billiton, now called Belitung. After having been active for 75 years in only the exploitation of tin ore and the production of tin, the company extended activities in 1935 into bauxite mining (aluminum ore) on Bintang, Indonesia and in 1939 in Surinam, another Dutch colony. After Indonesia nationalized all bauxite mining in 1958, bauxite from Surinam became Billiton's mainstay activity. During the 1960s Billiton diversified into more downstream activities, not only into related activities, but also into industrial and construction activities. The strategy was to create a fully integrated industry chain, to secure a stable demand and enable the contracting of turnkey projects.

At the end of the 1960s Billiton was active in over 80 participations. All activities were divided into three divisions: mining, metallurgy, and industry. Billiton's image in the Dutch financial world was close to that of a trader in unassorted goods. In most of the firm's industries Billiton was only at best a medium-sized company. Although financial results had been very good, financial institutions had major doubts as to whether the company would ever be able to escape its mediocre status. Billiton could not afford to invest in all of its activities at the same time and would have to change its structure soon.

Shell approached Billiton's management board, which was astonished by Shell's advances, to express its interest in a take-over. Shell said that it would only consider a friendly take-over and that it would withdraw its offer if Billiton rejected their proposal. Billiton accepted the take-over bid on the basis of two arguments:[4]

1. Shell's financial strength and technological capabilities would consolidate Billiton's position and strengthen economies of scale. Billiton realized that its intended further growth would require major financial resources and upgraded technological capabilities. In addition, as a result of increasing scale economies in the metal industry, the political risks and the consequences of a major mining project failure were getting too big to be carried by a firm of Billiton's size.
2. Shell guaranteed independence and a key position within the Group. It was agreed that Billiton would become the core firm for all mining and processing of ores and non-ferrous metals. Billiton would remain relatively independent as a separate division within the Royal Dutch/Shell Group and was promised involvement in all important decisions.

Additional arguments of lesser importance were the projection of a stronger competitive position visa-vis the Big Six multinationals in aluminum, a stronger basis for R&D expenses, positive effects of mutual activities, increased political strength, especially important in developing economies, and entrance to Shell's world-wide contacts in business and finance.

On July 13, 1970 Shell bought Billiton for 423 million Dutch guilders. According to Shell, the benefits were significant. First, because of the significant size of Billiton, Shell entered the metal industry quickly. Billiton would be an excellent basis for rapidly forming a fourth leg within the Shell Group. Without this major acquisition it could have taken some forty years to develop a mining business and Shell did not have that patience. Second, the strong diversification of Billiton allowed Shell to quickly become an important producer of a variety of nonferrous metals, particularly tin. Third, the vertically integrated structure of Billiton was a big advantage to Shell. In one swoop Shell bought competencies in exploration, exploitation, processing, marketing, sales, and research of ore and metals. And last but not least, both companies were Dutch (Shell 60%, Billiton 100%), which made cultural and language problems unlikely.

Absorption of Billiton into the Shell organization

After the merger Billiton was kept relatively independent, a sort of multinational within a multinational. The organizational structure became similar to Shell's. A small number of holdings controlled the many operating companies, and a service company, Billiton International Metals B.V. (BIM), provided centralized support. As with Shell, the management board of each Billiton operating company was held responsible for financial results and for the longterm planning of its activities. However, BIM played a very active role in central strategic planning and was strongly focused on realizing synergies.

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[4] *Sources: (1) Shell Petroleum N.V. (1970), 'Bencht aan de aandeelhouders van Billiton en Singkep Tin' ('Announcement to the shareholders of Billiton and Singkep Tin'), The Hague. (2) a mutual press release of 27 May l^g70: 'Shell doet hod op Billiton' ('Shell makes a bid for Billiton'), and (3) a mutual statement of the management boards of Shell and Billiton, including explanation, July-September 1970.*

The BIM Service Company provided advisors to operating companies in exploration, production, transport, processing, marketing, some applications of metals, and management of large metal projects. BIM also connected the Billiton operating companies and evaluated economic developments, plans, and investments. At Shell's Group level the Metals Panel a coordination committee for metals was established. In this committee future directions were set for Billiton's operating companies and other companies in the metal division. The BIM service company was responsible for realizing and monitoring Shell's corporate planning for the metal division, applying Shell's scenarios of possible economic, social, and political developments on a world-wide scale. On the basis of these scenarios corporate and division plans were worked out, and adapted by Billiton for specific metal issues. Medium-term plans were then prepared per metal and per operating company, to be approved by BIM, which also had a major role in the annual investment appraisals.

Prior to 1970, Billiton's head office mainly focused on financial and administrative support of the relatively independent operating companies. A deliberate strategic planning process across the different businesses for the development of activities and project evaluations did not exist. After 1970, Billiton was expected to design strategies on the basis of recent information and extensive prognoses. Billiton's management was handicapped by its inexperience in this kind of long-term strategic planning. This process soon led to decisions that hurt both Billiton and Shell. Many years after the take-over Billiton's Managing Director Mr. Slechte admitted for example that Billiton's large investments into aluminum should not have been made, and that a significant part of Billiton's losses could be blamed on the laborious cooperation between Shell and Billiton. He said:[5] 'Billiton's mining philosophy did not come about as expected. They just looked up at the new Shell-people. They thought: if they say so, who are we to argue to the contrary. Unjustified, because the Billiton-people possessed the professional knowledge on metals.'

Other differences between the Shell and Billiton organizations proved problematic as well. In the world of metals a well known saying goes: 'One can only talk metals after at least twenty years work.' For this reason most metal companies focus on one or only a few metals. However, Shell's plan for Billiton was to become a geographical dispersed multi-metal group of companies with downstream and upstream activities. Shell introduced this distinction between upstream (exploration and exploitation) and downstream (processing, refining, transport, marketing and sales) activities at Billiton, because it was useful and accepted in the oil industry. However, the characteristics of upstream and downstream oil activities proved inapplicable to the metal industry. In the oil industry only a few dozen major oil firms perform significant upstream activities, in the metals industry many hundreds. The downstream oil sector generates well-defined products for well-defined markets (e.g. car fuels), while there are thousands of applications of metals for very diverse markets.

Another deviation from conventional metal-wisdom after the take-over was the introduction of job rotation at Billiton. In the metals business it takes a long time before someone really feels settled in a particular branch, and so job rotation is an exception. Billiton deviated from this practice after 1970, because Shell emphasized the advantages of job rotation. The Billiton employees were also restricted in gaining more in-depth experience in metals because of a large inflow of Shell-people during Billiton's fast growth period. The pool of Billiton employees was insufficient to fill higher management positions, so many new managers and specialists came from Shell. These people did not bring specific knowledge and experience in metals, and often returned to oil, gas, or chemicals after a number of years. The involvement of Billiton employees in new joint ventures was also limited. Although Billiton deliberately formed joint ventures to learn from the new activities in nonferrous metal, few Billiton people got that chance.

[5] *Het Financieele Dagblad (1989). 'Billiton wacht op seven vette jaren' (Billiton is waiting for seven fat years'), 4 March*

Although mutual love was initially abundant, the newly weds clearly had to get used to each other. Company cultures, systems and processes differed in crucial areas. Shell's assumption of clear and important similarities between Billiton's and their own activities had to be counterbalanced with the realization that the differences were just as important. Fundamental differences showed up in applied technologies, competition, markets, and characteristics and applications of the products - differences that sometimes proved irreconcilable.

Billiton's aggressive growth strategy

Shell's intention was to rapidly develop the new Mining & Metallurgy division. Billiton would set up new projects, form joint ventures with several partners, and take over companies, in order to quickly become a diversified and substantial division. Shell gave Billiton 25 years to reach this goal, because it expected a severe downturn in the oil industry in the mid-nineties. Mr. Swart, Group Managing Director of Royal Dutch/Shell at the time, said: 'In 1990-1995 Shell should ask the question whether it has reached its goal of having a strong position in the metal industry, because then the oil industry has just sunk.[6]

The new metal division had to grow until it counted for at least 10% of Shell's turnover. This meant that Billiton had to become a firm with an asset base of US$ 12 billion. In the context of the total metal industry turnover this was an extremely ambitious goal, a goal which in the eyes of some Billiton managers was clearly unrealistic. Billiton's activities in the metal industry at the time were of limited volume, with mining activities in only bauxite and tin. 40% of Billiton's turnover in 1970 was realized outside of the metal industry. Pressured by its new parent, this hotchpotch of unrelated subsidiaries was quickly cut back. Within a few years Billiton's activities were fully focused on mining, metallurgy, and trade of non-ferrous metals.

After this period of restructuring Billiton was ready for rapid expansion. The first plans included expansion of existing sectors, the development of an extensive world-wide exploration program to find ores and develop mines, and participation in many joint ventures. In the field of research new ideas were developed on ore processing and production of metals. Much of Billiton's early growth came from acquisitions. Through these acquisitions Billiton quickly became an internationally dispersed firm that covered the whole spectrum of non-fer~ous metals. After the period of restructuring from 1970-1972, the total number of employees increased between 1973 and 1979 from 4100 to almost 6000 and turnover grew rapidly[7] (see Table 1).

Around 1977 Billiton started to invest heavily. Hundreds of millions of dollars were spent in research, exploration, and promising new projects, even while the metal industry was in a deep crisis. At the center of Billiton's expansion was its aluminium strategy, developed in the mid-1970s. Shell aimed at making Billiton one of the world's biggest six or seven aluminum companies.

TABLE 1 Billiton turnover 1970–1979 (in £ million)

	1970	*1971*	*1972*	*1973*	*1974*	*1975*	*1976*	*1977*	*1978*	*1979*
Turnover	45	123	142	159	253	223	482	597	613	770

Source: Shell annual reports.

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[6] *Shell Venster (1985), 'Overneming Billiton 't best bewaarde geheim' ('Acquisition of Billiton the best kept secret' October.*

[7] *Shell Venster (1 97^9), 'De Toekomst van Billiton' ('The Future of Billiton'), April*

Billiton initially focused on mining only, but in 1975 the strategy changed to also include smelting and refining. Vertical integration was necessary to get control over all aluminum activities, from bauxite and alumina to the production of aluminum. Billiton invested in major joint ventures in Brazil, Australia, and Ireland, for a total amount of US$ 2.3 billion. The Surinam operations were expanded (bauxite and alumina), and in Guinea (Boke) it participated in a bauxite mine. The peaks in Billiton's investments in 1977-1978 and 1980-1984 are both related to expansion into the aluminum industry (see Table 2).

Growth remained the most important strategic driver for 13 years after the take-over. Despite a continuing crisis in the metal industry. Shell invested more money in Billiton in the few years after 1980 than in the whole previous decade since the takeover. Billiton was convinced that the new investments would prepare the company to benefit from the next economic recovery. Shell knew that Billiton's investments did not pay off as projected, but it preferred long-term growth to short-term gains. It understood that exploration, development, and research were expensive but necessary means to gain a strong position in the long-term.

The effects of a structural downturn in the industry

The 1970s marked an unexpected decline in growth in demand for metals. The first significant decline took place in 1973 during the first oil crisis. The second decline coincided with the second oil crisis in 1979. Despite these crises the total industry production capacity continued to expand at the same rate as in the post-World War period. Consequently huge overcapacity and unbalanced world metal market characterized most of the 1980s. During this period the non-ferrous metal industry fell into a depression. The industry was plagued by over capacity, weak demand, and severe price drops. This led to extensive world wide losses, cost reduction programs, and eventually closures of mines and plants. There was so much overcapacity on world markets that even when demand picked up, prices remained low.

Shell's expectations for the metals industry thus turned out to be much too optimist&. The depression in the aluminum industry, of central importance to Billiton's growth strategy, continued into the 1990s despite a brief recovery at the end of the 1980s. The collapse of aluminum demand was primarily related to shrinking worldwide industrial activity in the early 1980s. However, the high pricing policy of the aluminum cartel also contributed to the crisis as it led to increased substitution of plastics for aluminum, particularly in construction, packaging, and transportation. The Impact of lower demand was aggravated by permanent oversupply of aluminum a result of large investments in the 1970s. As many investments came from governments of developing countries whose primary interests were not always profits, the Big Six companies on the aluminum market slowly lost control of the industry. This was most clearly reflected in their inability to prevent quotation of aluminum prices on the London Metal Exchange in 1978 and the Commodity Exchange in New York in 1983. Until then, aluminum prices were set by the Big Six. Fluctuations of aluminum prices have since become as common as fluctuations of other commodities' prices.

TABLE 2 Billiton investments 1970–1986 (in £ million)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Investments	7	24	25	37	26	35	20	70	63	34	126	316	504	310	176	66	55

Source: F. Hendriks (1987), *Shell: Energie, Metalen, Bosbouw en Zaaizaad* (Shell: Energy, Metals, Forestry, Sowing Seeds), Utrecht: Jan van Arkel, pp 286–287

The structural downturn in the metal industry severely affected Billiton, which continued to make losses throughout most of the 1980s (see Table 3). Economic growth at the end of the 1980s made a change, albeit for a short time, as after 1989 the world economy deteriorated again, prices for metals dropped, and losses returned to the industry. The subsequent years showed further worsening as demand continued to be low while supply continued to grow.

Given these poor financial results it was not surprising that Billiton's diversification policy was questioned and discussed more than once during the 1970s and 1980s. Billiton argued that broad diversification would spread risk as it became less dependent on a cyclical decline of one metal. For certain periods some of Billiton's activities were indeed remarkably profitable, but after 1980 prices for all non-ferrous metals were so low that no metal could compensate losses in others. Billiton's poor performance in investment projects was also striking. Time after time 'me-too' projects were developed after Billiton had analyzed markets and followed trends. This behavior of adaptation and imitation made Billiton a sure participant in projects at the brink of overcapacity and spoilt markets.[8]

Rationalization and strategic reorientation

During the 1980s Billiton slowly came to the conclusion that the market situation would deteriorate, and changed course. New activities were postponed, only running projects beyond the point of no return could proceed. It was decided to concentrate on bringing existing projects into operation and efficiently exploiting running installations and plants. Billiton's top manager Mr. Van der Graaf said in 1983:[9] 'Our policy is now to finish projects and bring them into operation. New investments will only be available for current and proven companies. We feel something is structurally changing in the West, as a result of which future developments are less predictable than before. We have to be careful with new expansion plans, because mistakes will never be compensated.'

In 1983 approximately 100 out of 430 employees of BIM were relocated. These were mainly people that generated new projects. The exploration program was also reduced. By 1984 consolidation, cost cutting, and disposal of unprofitable and marginally profitable activities had replaced Billiton's growth strategy. In that year Billiton took provisions to close or sell off cash demanding activities with poor prospects. Its ambition to become one of the world's leading upstream aluminum firms was put on hold. Although projects in Ireland, Australia, and Brazil had brought Billiton a firm basis of raw materialsbauxite and alumina, its melting capacity was still far lower than those of the Big Six

TABLE 3 Turnover and profits of Billiton 1980–1992 (in £ million)

	1980	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Turnover	720	617	641	733	995	961	772	862	1185	1662	1361	1287	1260
Profits	23	−39	−95	−91	−62	−187	−44	15	109	168	97	8	−41

Source: Shell annual reports.

After the appointment of Mr. Slechte as Coordinator Metals in 1986, Billiton's new 'mission' was to provide a positive contribution to the Royal Dutch/Shell Group. No later than by 1988 was Billiton to return to black figures. In order to become profitable quickly, Billiton aggressively cut costs, especially in its aluminum activities, which were the biggest loss-maker. Many other loss-making or

[8] *F. Hendriks (1987), Shell: Energie, Metalen, Busboy en Zaaizaad (Shell: Energy, Metals, Forestry, Sowing Seeds}, Utrecht: Jan van Snorkel.*

[9] *Shell Venster (1983), 'Billiton moet op adem komen' ('Billiton has to take a breath after a stormy growth period'), May.*

marginally profitable activities were stopped or sold. The head office near The Hague was further reduced until only 125 employees were left. In 1983 Billiton counted 5800 employees worldwide, by 1986: 4600.

Billiton's strategic planning process was also changed. In the 'good old days' of expansion BIM had acted as a centralized strategic planning unit that was primarily responsible for deciding on investments in new projects and activities. According to Shell, this was not how a service company should operate. Shell made clear to BIM that its raison d'être was related to a demand for its services based on added value for the operating companies. It had to become less bureaucratic and truly act as an adviser and service company. BIM's formal hierarchical pyramid was replaced by a Shell-style matrix-organization and planning responsibilities returned to the operating companies that were closer to the subsequent markets. They knew better how to survive in their branch, and how to prosper in the future.

For the first time since 1980 Billiton returned to profitability in 1987. A modest profit of £15 rnillion (2% ROI) was followed by £109 million in 1988, which represented a healthy 13% ROI. The objective to quickly return to profitability was reached. However, Mr. Slechte indicated that higher prices of metals were the primary reason for the financial improvements, and that the real proof of a structural change for the better would be given in a new recession. In the early 1990s the economic situation deteriorated again, and Billiton again faced overcapacity and plummeting metal prices, returning to losses in 1992. One of the key problems was the situation in the downstream sector. The performance was disappointing as most of the activities were loss-making. It had proven extremely difficult for Shell to find the synergies for which it had been looking for so long. The downstream activities were Billiton's only loss maker in 1991, in 1992 they were the principal loss-maker. In 1992 Billiton announced withdrawal from the loss-making downstream sector. Within a few years Billiton would dispose of all doves stream activities, which meant withdrawing majority of its home country activities.

Shell sells Billiton

Despite its large investments in Billiton, the metal sector had remained a small part of the Royal Dutch/Shell Group of Companies. In 1992 it represented only approximately 25~o of its US$ 80 billion turnover, and 3.5% of the Group's investments of over US$ 60 billion. In 23 years Billiton had become an international firm, but the main ambition to represent approximately 10% of the Group's turnover was not achieved by a long shot. Billiton had nap become the group's cash cow Shell had planned for in the early 1970s. On the contrary, the metal industry turned out to be much less profitable than the oil industry and highly cyclical in nature.

The explosive growth that had been projected in the 1970s never materialized. Although Shell is well known for looking beyond horizons, it had not been able to 'read' the future of metals. It therefore did not come as a great surprise when on May 11, 1993. Royal Dutch/Shell announced Gencor's interest for Billiton's metal activities. Gencor was a South African mining company, and was primarily interested in Billiton's mining and aluminum activities and its market and trading activities. Gencor had thus far mainly been active in South Africa and the acquisition would make Gencor an international mining firm. Shell would withdraw from the metal market altogether, a move that would fit into its new strategy 'to concentrate on its core activities oil and gas'. Shell would be the last of the multinational oil firms to leave the metal industry.

Within Billiton people did not react negatively to the idea of transferring to Gencor. Billiton's way of thinking would possibly correspond better with Gencor's than with Shell's, whose dominant direction was now clearly oil and gas. In addition, Gencor would continue Billiton as a 'going concern', including its name, and as a core for a new international mining company. Gencor also promised not to change the management of the Billiton companies. Gencor expressed its confidence of a successful take-over, because of Billiton's low production costs in mining and aluminum, and high quality management. Moreover, the phrase in Gencor's mission statement: '. . . real long-term growth and an internationally leading position in mining and metals' sounded very familiar to Billiton, while the effect of the 'merger' was music to Billiton's ears: Gencor/Billiton would become one of the world's top-5 mining companies.

Gencor's core is ore

In the mid-1980s Gencor was known among investors as a bureaucratic conglomerate that performed badly. In 1986 institutional investors appointed Derk Keys as the new CEO. After five and a half years Derk Keys left a highly successful entrepreneurial and decentralized group, and became Minister of Economic Affairs. Investors were happy and Gencor's rating improved substantially..In 1993 Gencor decided to only focus on mining activities and unbundled its major industrial assets by distributing shares in Engen, Genbel, Sappi and Malbak to its shareholders. That left it to focus on its aim of becoming a major international mining group, instead of a huge conglomerate. 'Today, conglomerates are out of favor around the world,' Gencor chairman Brian Gilbertson contended. 'Investors like focused, pure-play businesses. The general public is suspicious of corporate giants.' This strategy created a mass of new energy among management, and became an enormous success. Stripped of its industrial interests, Gencor shrank by a full third, but the stock value of the new focused mining firm quickly rose higher than the former conglomerate's. Gencor invested almost a billion US dollars in the Columbus stainless steel project and started building one of the world's biggest aluminum smelters, Alusaf.

Gencor's activities were almost entirely concentrated in South Africa. It had to internationalize to compete with other, international, mining companies. For Gencor, Billiton presented an exceptional opportunity to acquire assets outside South Africa. In line with Gencor's new vision 'world-class ore is our core', Gencor thus paid Shell $1,144 billion for the Billiton base metals group in October 1994. The question was however whether Gencor's ambitions could be realized. The newly acquired Billiton could reveal itself again as the huge loss-maker it had been for the majority of 23 years as a Shell subsidiary. These losses didn't hurt Shell too much since Billiton accounted for only 2% of total revenues, but for Gencor continued Billiton losses could jeopardize the future of the whole company. Despite these risks Gilbertson remained confident, and even Shell's President Mr. Herkstroter admitted at a shareholder meeting that the new parent might bring Billiton back into the black figures: 'Maybe Gencor can do something Shell could not.'[10]

Billiton 's 'miraculous ' recovery under Gencor's transformation

The acquisition of Billiton was a bet on the aluminum industry, for this was Billiton's center of gravity. Including the Alusaf smelters the new Gencor would be the world's seventh aluminum firm in terms of size. The new Gencor generated 24% of turnover in aluminum and related metals, 18% chrome, manganese and stainless steel, 16% titaniumminerals, 12% gold, 10% platina group-metals, 10% coal, and 2% nickel. In all activities except nickel Gencor would be a world top-10 firm. Since Gencor was relatively inexperienced in aluminum, it decided to change little at Billiton.

It wasn't long before the acquisition of Billiton helped Gencor record a 62.7% increase in attributable income for the year to end-June in 1995. Billiton's maiden contribution to income from operations represented 43% of the total. Excluding the contribution from Richards Bay Minerals - previously 50% owned by Gencor but now part of Billiton - Billiton's contribution was 27% of the total income.

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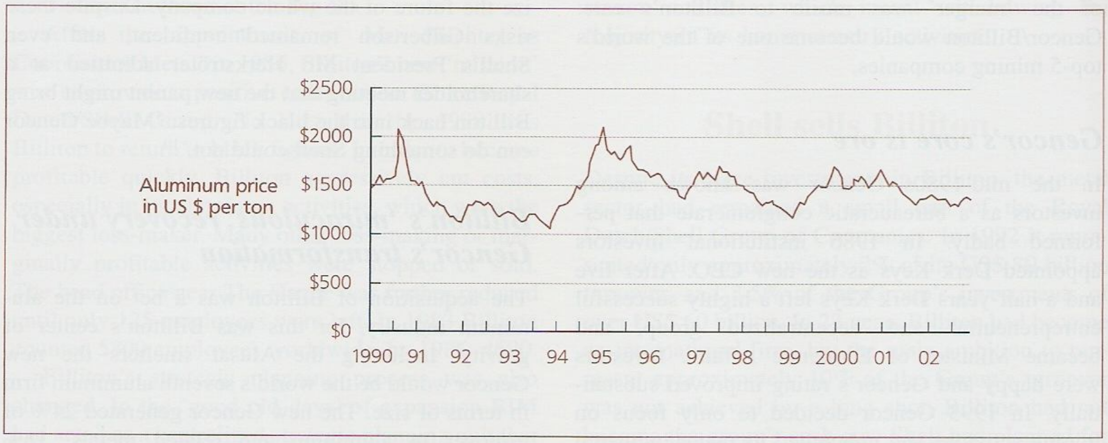
[10] *De Volkskrant (1993), 'Met Billiton vertrekt een oud-koloniaal naar Zuid-Afrika' ('The once colonial Billiton moves to South Africa'), 15 May.*

FIGURE 1 20 day average aluminum price, 1990–2002



Source: London Metal Exchange.

Analysts were obviously enthusiastic about the transformed Gencor, although they were quick to point out that the group was lucky with the timing of the Billiton deal and start-up of the Alusaf smelter. Both were completed just in time to benefit from a sharp rise in the aluminum price, which increased by more than a 100% from its low of US$ 1,109 on November 1 1993 to a high of US$ 2,147 on January 25 1995 (see Figure 1).

However, Gencor's initial success was not solely based on the rise of aluminum prices that greatly benefited Billiton. There were other important building blocks in Gencor's transformation. In South Africa it built some strong businesses; one through a significant platinum merger creating a new company of the same size as the leader Rustenburg Platinum, another by increasing its shareholding in the Richards Bay Minerals mineral sands business so that it was in 50-50 ownership with RTZ of the UK, and thirdly by merging Trans-Natal Coal with Rand Mines, two companies that made a perfect fit, to form Ingwe, a deal that leap-frogged Gencor to being world-class in the coal business.[11]

After this series of major deals Mr. Gilbertson focused on tidying up Gencor's portfolio, discarding any mineral assets that did not meet his definition of 'world-class'. In the meantime, Mr. Gilbertson introduced several new management practices. He encouraged his managers to be responsive to market opportunities and gave his managers more freedom to take risks. He slimmed down the head-office staff from 1,100 to 550 in five years and consolidated the maze of different companies, restructuring Gencor into seven global product businesses: 'one commodity, one brain'.'[12] Gilbertson also encouraged 'opportunism', realizing that in a fluctuating market there were always opportunities for good take-over deals Although some analysts expressed concerns that Gencor's small management team might be overstretching itself, Gencor successfully managed to keep Billiton profitable until the end of the 1990s, despite a complete collapse of metal prices during 1997 and 1998 (see Table 4).

Gencor's subsequent demerger

In the mid- 1 990s Mr. Gilbertson decided that Gencor needed to address 'the difficulties that a South African company faces when it wishes to finance major international acquisitions'. He had become increasingly convinced of the difficulty of expanding and funding an international mining operation under South Africa's restrictive foreign exchange controls. He therefore decided to relocate the base metals business to a market with less strict exchange controls.

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[11] *The Economist, March 9, 1996.*
[12] *Ibid*

The best way to achieve this aim was to demerge the larger base metals business from the precious metals (gold and platinum) operations and list the base metals business on a stock exchange outside South Africa. Gencor subsequently sold to a new Billiton group all its interests in aluminum, coal, mineral sands, nickel, Samancor (which houses Gencor's manganese assets), chrome and stainless steel - equivalent to 80% of Gencor's net assets. To pay for them. Billiton made a share issue to Gencor that was redistributed to Gencor's shareholders, giving Billiton a listing in South Africa in addition to its international listing. To build a strong balance sheet, Billiton simultaneously made an offering of 375 million new shares to international investors. As Billiton already had an office in London, the company chose the UK capital as its base. On September 22, 1997 Billiton entered the FTSE-l00 index as the UK's 48th largest company, valued at US$ 7.5 billion.

TABLE 4 Five years financial summary, in US$ million, except per share data

	1994*	1995**	1996	1997	1998
Net turnover	3063	9061	10841	5286	5446
Operating costs	−1314	−3933	−4526	−4658	−4808
Operating profit	1749	392	667	628	638
Attributable profit	177	261	433	537	481
– as % of turnover	10.5	5.5	7.7	9.2	7.9
Investments	1221	1585	1220	1059	632
Attributable net assets	1456	1791	1997	3014	4582

*10-month period only (September 1, 1993 to June 30, 1994).
**Years run from July 1 to June 30 of the given year (e.g. 1995 runs from July 1, 1994 to June 30, 1995).
Source: Billiton annual reports.

As a result of the demerger, the number of employees at Gencor dropped to 5 by February 1998, from more than 100,000 people 10 years earlier. Thus, in the course of only l 2 months, Gilbertson brought more than a century of development as a traditional mining finance house to an end. Gencor became an investment holding company with stakes in three of the world's finest mining companies: a 59% stake in Billiton (base metals), 47.9% in Gold Fields (gold) and 18.7% in Implats (platinum group metals). The holding company passed the receipts from the underlying investments directly to Gencor’s shareholders.

Navigating Billiton into the 21st century

It wasn't long before the slump in the metals market caught up with the new Billiton, despite managing to remain profitable. A year after its listing in London at 220p per share, in which it raised US$ 1.5 billion in new equity, the Billiton share price dipped below l 00p, and it decided to buy back 2.5 percent of the equity. Investors were very unhappy and accused Billiton of not spending the extra capital it had raised on profitable projects.

However as soon as the 1997 and 1998 crisis was over, Billiton started both buying up minority interests and investing in new projects. Its average capital expenditure at the end of the 1990s was US$ l billion a year, and Billiton's stock price quickly recovered in parallel to the rise in metals prices. Gilbertson continued to invest heavily, buying Alcoa's Worsley stake for US$ 1.5 billion making Billiton more than self-sufficient in alumina, and spending US$ 2 billion on Rio Algom (copper in Latin America). Especially after this last deal investors started to get worried and instead of accusing Billiton of doing too little with its money, they now accused Billiton of spending too lavishly. By the end of 2000 Billiton was beginning to be seriously constrained by its balance sheet, with gearing up to some 70 per cent. Despite a succession of deals, its market capitalization remained at less than US$ 8 billion, a value comparable to its value at its launch on the London Stock Exchange in 1997.

Mr. Gilbertson was critically asked how much he was driven by being big and how much by running an operation which is profitable for its shareholders. He replied that Billiton was not driven solely by size, but he had also made it clear earlier than he believed the future mining scene would be dominated by a small number of large international companies and that Billiton wanted to be one of them. Gilbertson was unhappy with the share price, but realized that Billiton was not large enough yet, still too dependent on aluminum prices, and too overstretched financially to be one of the few large dominant players of the future.

He thus set out to work on a deal with would surmount all of his previous deals, a deal that would launch Billiton straight into the major league of mining and metals companies. Gilbertson had long been interested in exploring the possibility of a merger with Broken Hill Proprietary Company (BHP), a large Australian mining, metals and oil conglomerate, which was undergoing major restructuring after its diversified growth strategy of the 1 980s had failed miserably. Within weeks of Billiton's London debut, Billiton's bankers approached BHP at a conference in Edinburgh, followed by a meeting of executives of the two companies in early 1988. But BHP was in the midst of a major overhaul, and was not in the mood to talk.

Things changed after Mr. Anderson became CEO of BHP in December 1998. BHP had experienced Australia's biggest financial loss ever, after which it restructured and sold US$ 3.6 billion of assets. The BHP share price recovered, but the price was still half of where Mr. Anderson and his fellow American, Charles Goodyear, CFO, thought it needed to be to fund growth. The collapse of the Australian dollar made overseas deals expensive and BHP vulnerable to foreign predators. BHP became increasingly convinced that it needed to be on either the New York or London Stock Exchange to attract investor attention, win a re-rating and have access to deeper capital markets.

A third 'parent' for Billiton: BHP of Australia

Brian Gilbertson had already told Anderson in 1998 that a merger between their two companies was the best deal in the industry. But the critical meeting came in early 2001 in Johannesburg where Mr. Gilbertson and Mr. Anderson, in a couple of hours, sketched out the main elements of a deal that was subsequently billed as 'the largest in Australia's corporate history'. On June 29th 2001, after only four months of preparatory work, the deal was completed. The merger created a mining and metals powerhouse, second only in size to Alcan, the Canadian aluminum group. As the world's biggest exporter of metallurgical coal, its third largest producer of iron ore and its fourth of copper, BHP Billiton had annual sales of nearly US$ 19 billion and had US$ 8 billion to spend on capital projects over the next four years.[13]

In spite of BHP's pre-announced market capitalization of US$ 18.5 billion being almost double Billiton's, BHP agreed to a 58% stake in the merged entity and thus paid a significant premium. It was also agreed that within a year, the leadership of the combined group would pass to Billiton's management when Paul Anderson was to retire to make way for Brian Gilbertson. Headquarters would be based in Melbourne, and the company would retain its dual listing in Australia and in London.

Mr. Anderson considered the deal to be a 'sensational fit'. Billiton would give BHP a better understanding of business in Africa, a broader portfolio to ride out cyclical movements in the commodities markets and advantages of scale in shipping, marketing and purchasing. In return, Billiton would have access to cheaper financing for new projects and existing debt, greater liquidity and better protection from political risks. Billiton's proposed merger with BHP also removed the UK group's high exposure to African-based operations and a reliance on aluminum as a major earnings

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[13] *Financial Times, March 24, 2001.*

driver. The two groups clearly complemented each other's portfolios. BHP brought in iron ore, coal and its share in Chile's Escondida, known as the world's best copper mine, as well as a small but highly profitable oil and gas business. Billiton provided BHP with three new businesses - aluminum, nickel and titanium- all areas BHP had said it wanted to enter.[14] In addition, savings from the deal were set to reach US$ 270 million net of restructuring costs by 2003.[15]

Mr. Anderson dismissed criticism that the deal would leave BHP Billiton too diverse, with interests in base metals, oil and gas, coal, ferroalloys, iron ore, nickel and aluminum. He said:[16] 'Fund managers are schizophrenic: they say they want a $ 30 billion company but they want it to be focused. You could put all the copper in the world together and you wouldn't get a $ 30 billion company.' BHP Billiton was aware however that some activities did not fit its portfolio particularly well. As part of the deal it was therefore agreed that BEIP would spin off its remaining steel assets, which represented about 5 per cent of the combined group's portfolio.

However, despite expectations that this signalled a concentration on its minerals business, the BHP Billiton group did decide to hang on to its oil interests, which delivered 39% of its earnings. BHP Billiton Petroleum's president Phil Aiken confirmed the group's commitment to its petroleum business: [17] 'I have had no suggestion at all that there is anything but 100 per cent support for petroleum to be part of BHP Billiton for some time to come,' he said. 'I think it has very good growth opportunities with a number of brown(field) and greenfield projects to continue into the future and be an important part of the group.' He expected to boost output by 37% by the fiscal year 2006.

BHP Billiton 's successful start

Shortly after the deal was completed BHP Billiton announced a record combined profit of US$ 2.189 billion before exceptional items for the year ending June 30, 2001. The result was up 26% from the companies' combined profit of US$ 1.743 billion in 1999/2000. BHP Billiton received a further boost when Standard & Poor's upgraded its long-term debt rating for BHP Billiton to 'A' Outlook Positive. The credit rating upgrade from Standard & Poor's was an endorsement of one of the elements of the strategic rationale for the merger and reflected the stronger financial position and more diversified risk structure of the combined Group.

After the merger BHP Billiton focused on sequencing the extensive pipeline of growth opportunities, streamlining the organization and realizing merger synergies. 'Reducing costs remains a prime area of focus for the management team,' said Deputy CEO Gilbertson.[18] 'Many commodity markets have deteriorated materially and several traded commodities, including copper, nickel and aluminum are trading at near record lows. If these conditions persist our earnings will not escape the impact. However, the quality, size and diversity of the BHP Billiton portfolio provide us with more options for responding to the slowdown than may be available to many of our competitors.' BHP Billiton made deep management staff cuts, involving up to a third of former Billiton head office staff in London. There were rumours that the company was internally targeting much bigger savings than the announced target of US$ 270 million.

The Group also remained focused on further growth, although Paul Anderson took a much more vigorous approach to capital expenditure than Gilbertson in his days at Billiton. The financial year 2002 saw the pipeline of growth opportunities expand further. Some long-time investors and observers of BHP drew parallels with BHP's early-1990's disastrous growth program and asked

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[14] *Ibid*
[15] *Ibid*
[16] *Financial Times, March 20, 2001*
[17] *Daily Telegraph, November 27, 2001.*
[18] Ibid.

themselves if the same couldn't happen again. However, most shareholders were reasonably content with BHP Billiton's progress as its share price had significantly outperformed relevant indices since announcement of the merger (see Figure 2).

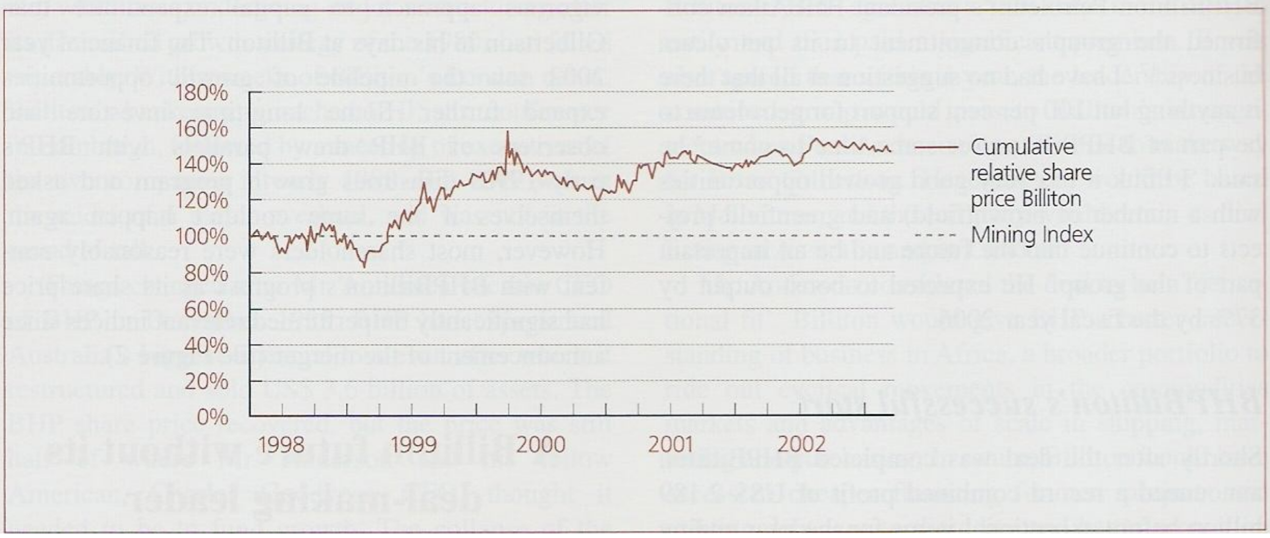
A Billiton future without its deal-making leader

In December 2001, only six months after completion of the merger deal, BHP Billiton claimed that that integration of the two companies was complete. Meanwhile Mr. Anderson was preparing the way for Brian Gilbertson to take over the CEO position in July 2002. 'In the interim, there will be a gradual transition, with more and more of the future direction of the company left to Brian,' Mr. Anderson said.[19] 'I will be more and more focused on putting together this financial year and wrapping up loose ends, like steel.' Throughout 2002 Mr. Gilbertson took on a greater role in shaping the future of the company. BHP Billiton managed to get through the year relatively well reporting a 7.2% drop in earnings, notwithstanding much weaker commodity prices. As agreed, at the end of the financial year 2002 Paul Anderson passed the baton to Brian Gilbertson, who was now CEO of one of the world's largest metals and mining companies.

As usual though, Gilbertson had his mind fixed on further aggressive growth. He drafted a 'hit list' of potential merger partners, including some of the biggest mining and oil groups in the world? and started work on a proposed secret deal, dubbed Project Six, which was rumoured to be a 'very significant, single transaction' and was due to go to the board in February 2003.[20] There was speculation that Alcan Inc. may be involved, which was itself rumored to have been planning a bid for Billiton within days of the BHP-Billiton merger. Media reports also suggested Mr. Gilbertson might have in his sights Australia's Woodside Petroleum Ltd., Canada's biggest oil producer Imperial Oil Ltd., and U.S.-listed oil exploration and production firm KerrMcGee Corp.

Then, on January 6th 2003, BHP Billiton stunned investors by announcing the abrupt departure of Brian Gilbertson after less than six months in the CEO job. Mr. Gilbertson was replaced immediately by chief development officer Charles Goodyear, former CFO of BHP. BHP Billiton Chairman Don Argus, one of Australia's most important businessmen nicknamed 'Don't Argue', had moved against Gilbertson's expansion plans and forced his resignation.

FIGURE 2 Billiton's share price relative to the LSE Mining Index, 1998–2002



[19] *The Asian Wall Street Journal, December 24, 2001.*
[20] *Reuters, January 14, 2003.*

Since the merger, the market had speculated that Mr. Gilbertson could not reconcile himself to working under the chairman of an independent board in a company known for its bureaucratic culture. Russell Skirrow, global head of metals and mining research at Merrill Lynch, said:[21] "The two companies had very different cultures and styles. Brian Gilbertson was like a racing car. He could get you there very quickly but there was always a chance of a crash on the way.' BHP Billiton cited unspecified 'irreconcilable differences' with the board as the reason for Mr. Gilbertson's sudden departure, but some observers argued that Don Argus fired Brian Gilbertson after it became clear that Gilbertson's proposed merger meant that Argus' chairmanship was at stake.

A BHP spokesman later said the differences between BHP Billiton's board and Mr. Gilbertson were 'related to matters of style and approach'. However, some London investors said they were unhappy with the group's explanation of Mr. Gilbertson's departure and were left wondering whether there had been a split between Gilbertson and Argus over strategy, not just management style. 'Gilbertson would have been looking at the possibility of a company-transforming type acquisition, and the board has seemingly decided that maybe the emphasis will be much more on the organic,' said Deutsche asset Management resources analyst Lawrence Grech.[22]

Mr. Argus emphasized that the installation of a new chief executive would not detract from the strategy unveiled by the company in 2002. This included the promise to cut costs by US$ 500 million a year by 2005 and to invest US$ 10 billion in new growth projects over the next few years. However, Mr. Gilbertson's departure did fuel speculation that the merger was unraveling. 'It has certainly changed the power balance,' said one insider.[23] 'If you look at the Billiton-ness of the company versus the BHP-ness, the power has shifted back the other way.' Other investors and analysts were less pessimistic and said that BHP Billiton still had a strong growth profile even without major acquisitions. They would not lose any sleep over Mr. Gilbertson's departure and the demise of his mysterious grand plan, Project Six.

Is Gilbertson's departure a sign of trouble ahead for BHP Billiton? In the context of an increasingly difficult economic environment and without its opportunistic, risk-taking leader, will the company lose its momentum? Or are the BHP Billiton synergies large enough to avoid slipping back to the days of underperformance?

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[21] *The Times, January 7, 2003.*
[22] *Reuters, January 14, 2003.*
[23] *The Australian, January 7, 2003*