

Metals & Mining Practice

# How procurement leaders can bring metals and mining up to speed

Procurement is critical to manage the fallout of the COVID-19 crisis. Assertive and resourceful leaders can help mining companies address immediate imperatives and prepare for a quick recovery.

*by Zak Gaibi, Marta Mussacaleca, and Mike Parkins*



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**It is often said that** the coronavirus has no boundaries, as evidenced by its impact on the lives and livelihoods of people around the world. In response, some governments have closed borders and imposed large-scale quarantines and physical-distancing measures—moves critical to minimize the spread of the virus and to avoid overwhelming healthcare systems. The safety and well-being of workers was rightly the top priority, but now companies must turn their attention to the economic effects of the pandemic, which are now apparent.

Companies have taken drastic measures—from asking nonoperational staff to work from home to scaling back production, even to temporarily halting operations—to support the health of their employees and communities. The productivity and profits of many industries, not the least of which is metals and mining, have declined precipitously. Before things can get back up to speed, however, companies must make strategic choices to build their cost resilience, prepare for the recovery, and rethink their operating models.

Chief procurement officers (CPOs) are uniquely suited to handle such demands. In this article, we touch on four actions they can take to help mining companies make the transition to the next normal.<sup>1</sup>

## **COVID-19's impact on metals and mining**

Since early March, the metals and mining industry's average share price has dropped 10 percent, and individual companies have lost 30 to 50 percent of their market value (Exhibit 1).

Moreover, shutting down sites or temporarily halting operations could lead to an industry production loss as high as 20 percent. Depending on the strength of the recovery, market shocks mean the industry may lose as much as \$200 billion in earnings before interest, taxes, depreciation, and amortization (EBITDA) in 2020 compared with 2019 (Exhibit 2). Thus, cost competitiveness has never been a clearer imperative.

## **Four actions to bring mining up to speed**

Under these circumstances, procurement leaders must play a central role in mitigating supply-chain risks, protecting cash, enhancing productivity in operations, and making strategic choices that will help the company bounce back with a more resilient and competitive cost base. The steps that CPOs take now can also cement their positions as critical creators of value and true strategic partners in the organization.

The following four actions can help mining CPOs build their companies' cost-resilience, prepare for the recovery, and rethink the operating model in the next normal.

### **1. Assemble a control tower to safeguard company livelihood**

By working closely with operations, CPOs can quickly segment all spending into what can be stopped, what can be stalled, what can be shrunk, and what must be sustained. With this accomplished, they can set up a control-tower methodology to review and challenge all of the spending segments.

Control towers are most successful when the procurement organization partners with not only operations, to effectively challenge internal demand, but also finance, to ensure that the impact of a reduction in spend is carried through to the company's cash position. Importantly, the discipline instilled during the crisis to rigorously control spend should have significant long-term benefits. In fact, CPOs should expect this discipline to continue and should set targets and key performance indicators (KPIs) to ensure that it does. For example, when the COVID-19 crisis first unfolded, one basic-materials company quickly set up a control tower to manage consumption as part of a joint initiative led by procurement and operations and supported by finance, which audited the impact. After two weeks, this company had reduced demand by 15 percent through a combination of ceasing, stalling, or shrinking its spending.

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<sup>1</sup> See "The Next Normal," article collection, on McKinsey.com.

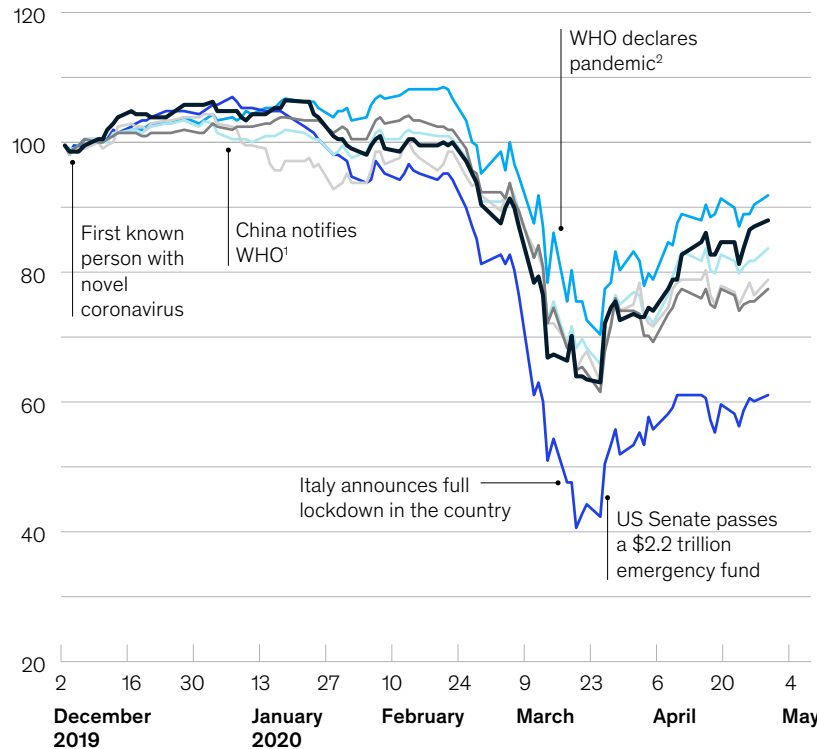


Exhibit 1

## The metals and mining industry was among the hardest hit on the financial markets—but shows signs of recovery.

### Metals and mining saw a drop of 10%

Share-price movement, index, (100 = Nov 2019)



|                           | Delta, %                      |                      |
|---------------------------|-------------------------------|----------------------|
|                           | Pandemic to date <sup>3</sup> | Current <sup>4</sup> |
| Metals and mining         | -11                           | -10                  |
| S&P 500                   | -8                            | -14                  |
| Energy                    | -37                           | -34                  |
| Chemicals                 | -15                           | -16                  |
| Paper and forest products | -20                           | -19                  |
| Industrial                | -21                           | -24                  |

<sup>1</sup> World Health Organization; assumed as start of pandemic.

<sup>2</sup> March 3, 2020.

<sup>3</sup> Since February 10, 2020.

<sup>4</sup> As of April 27, 2020.

Source: Bloomberg

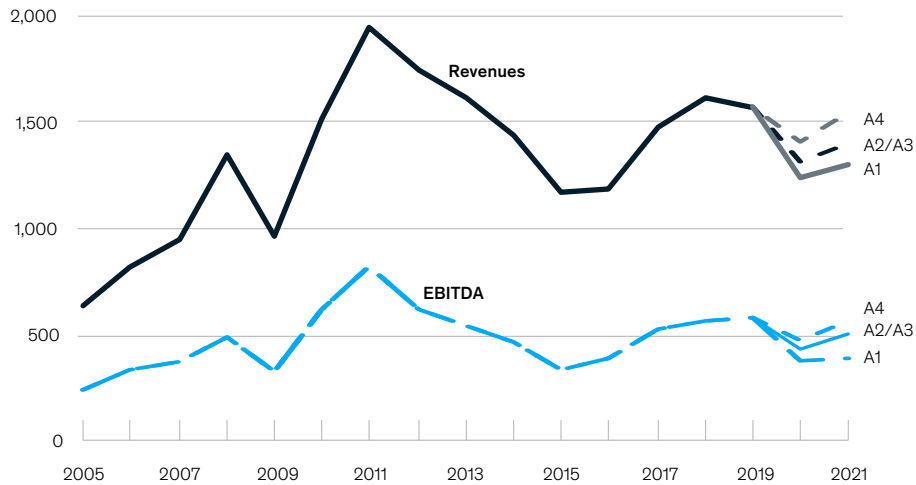
The commodities slump that has followed the COVID-19 crisis offers a quick source of cash: most bulk, commodity, and logistics contracts have price-adjustment formulas tied to commodities. CPOs can lead a systematic review of their contracts to ensure benefits from price adjustments are captured. For some mining companies, this process may be manual, given that most contracts are not centralized and digitized. If this is the case, the effort should be prioritized according to contract value. CPOs can consider rolling out a contract digitization

solution that will allow them to map, query, and monetize contract terms going forward. For example, in a previous oil-price slump, one mining company captured a 5 percent cost reduction by enforcing the downward fuel adjustments in their freight contracts. It was done quickly and required no commercial action. In fact, it prepared the company well for the negotiations that followed the expiration of the contracts by resetting the power balance in the category.

## The mining industry risks losing \$100 billion to \$200 billion in EBITDA.

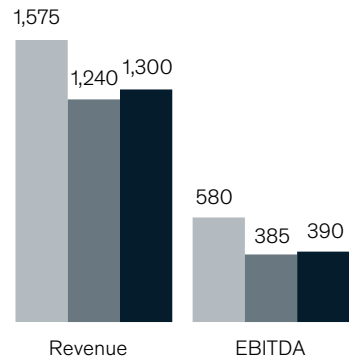
**Demand loss and price pressure will be partially compensated by lower oil price and foreign-exchange effects**

Mining revenues and EBITDA, \$ million

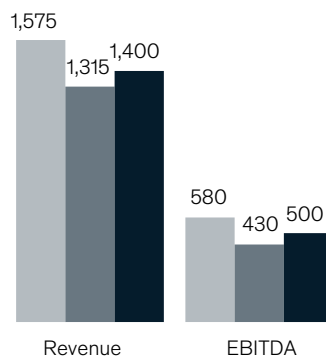


■ 2019 ■ 2020 ■ 2021

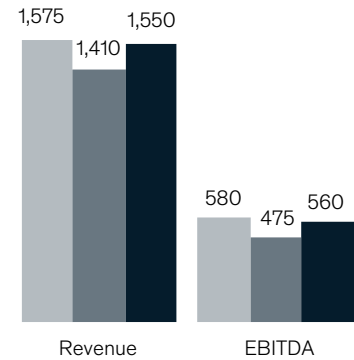
### Muted recovery (A1)



### Virus contained, slow recovery (A2)/ strong world rebound (A3)



### Virus contained, strong rebound (A4)



## 2. Rethink the supply chain

Crises inevitably bring to the surface vulnerabilities in the supply chain. Mining CPOs should focus on two sets of actions:

1. Immediately, identify and mitigate vulnerabilities amid the complexity of their supplier-network, logistics, and products. The focus should be on

supporting the operations and maintaining supply security. For this, CPOs may need to accelerate the onboarding of new suppliers while working on a safe and efficient qualification process.

2. Once the immediate risks have been mitigated, CPOs can build resilience in the supply chain by leading a comprehensive analysis across the entire

# The use of advanced analytics will further increase the success of hedging strategies aimed at capturing the benefit of today's once-in-a-blue-moon commodities opportunities.

supply-chain life cycle. This effort should also include a financial stress test of the supplier network, attention to sub-tier-suppliers' visibility, and a review of organizational maturity. Finally, a joint task force—consisting of procurement and operations—should use the outcome to systematically mitigate or eliminate these procurement-related risks and emerge more resilient than before. In other words, companies should focus on achieving risk-adjusted efficiency in the supply chain.

For example, CPOs at a global materials company that experienced COVID-19 disruptions in its Asia location mobilized its remaining regions and mapped vulnerabilities in the supply chain. With this comprehensive approach, the company was able to mitigate the risk of disruptions in Europe and North America—and quickly resolved transportation and product complexity issues. It has since been able to sustain profitable production and delivery commitments.

Now is also the time to rethink approaches to bulk commodity purchases. Most commodity prices have dropped dramatically since the crisis began (Exhibit 3), creating an opportunity to build inventories (should the company's cash position allow) or negotiate new contracts for vendor-managed inventories. Many of these operations typically are quite lean and maintain

as little inventory as possible. However, there is opportunity for companies to build their inventory by taking advantage of the cheap commodities prices. A CPO can also lead revisions of the company's risk management strategy, providing confidence in the demand forecasts in the near and longer term. The use of advanced analytics will further increase the success of hedging strategies aimed at capturing the benefit of today's once-in-a-blue-moon commodities opportunities.

### **3. Shift capacity to creative thinking and planning**

While working from home—and possibly at lower levels of productivity—some teams might have excess capacity. CPOs can put that capacity to good use by creating cross-disciplinary teams (consisting of procurement, operations, and maintenance) and embracing agile delivery. For instance, procurement and operations teams typically have ideas about how to reduce waste or overconsumption, or perhaps how to simplify fit-for-purpose specifications or find alternative vendors with lower prices. However, a rigorous, data-driven approach must be applied before such thinking can result in decision making, so as not to jeopardize asset uptime.

CPOs can help identify and build in cost efficiencies. Investing a team's excess capacity in finding

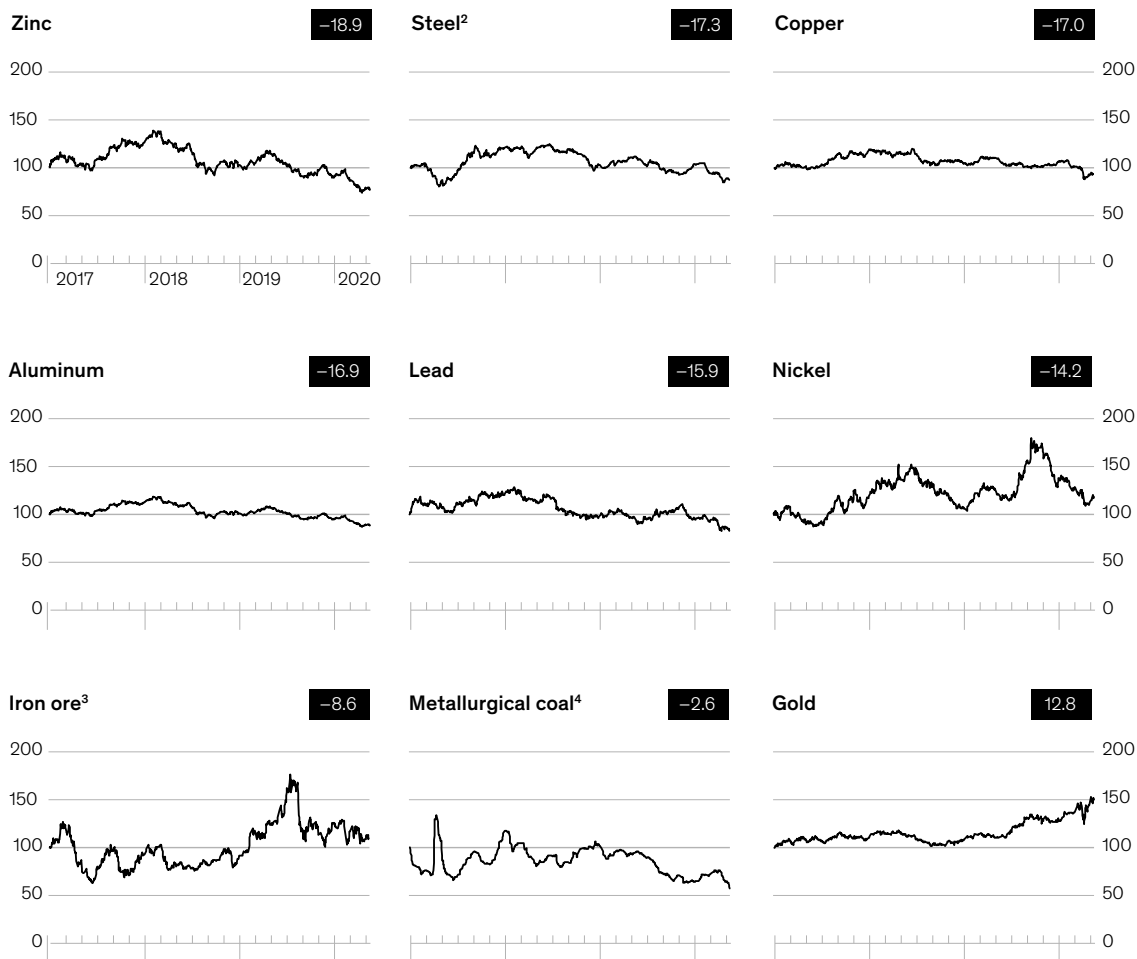
### Exhibit 3

## Concern about COVID-19's impact on markets results in commodity price drops.

Gold prices remains strong; met coal and iron ore perform well supported by dynamics in China

Price, index, (100 = Jan 2, 2017)

xx % change in commodity price,  
January–April' 2020



<sup>1</sup> Until April 24, 2020, for most commodities.

<sup>2</sup> Domestic hot-rolled coil, delivered northern China.

<sup>3</sup> Platts IODEX 62% Fe daily index, until April 27, 2020.

<sup>4</sup> Hard coking coal peak downs FOB, until April 27, 2020.

Source: Bloomberg; Metal Bulletin; SBB Platts; World Bank

opportunities to structurally lower the company's cost base could allow the company to outcompete during the recovery, especially if input costs continue to rise (Exhibit 4). For example, one North American mining company assembled small, agile teams of leaders from procurement and the supply chain who were tasked with identifying savings

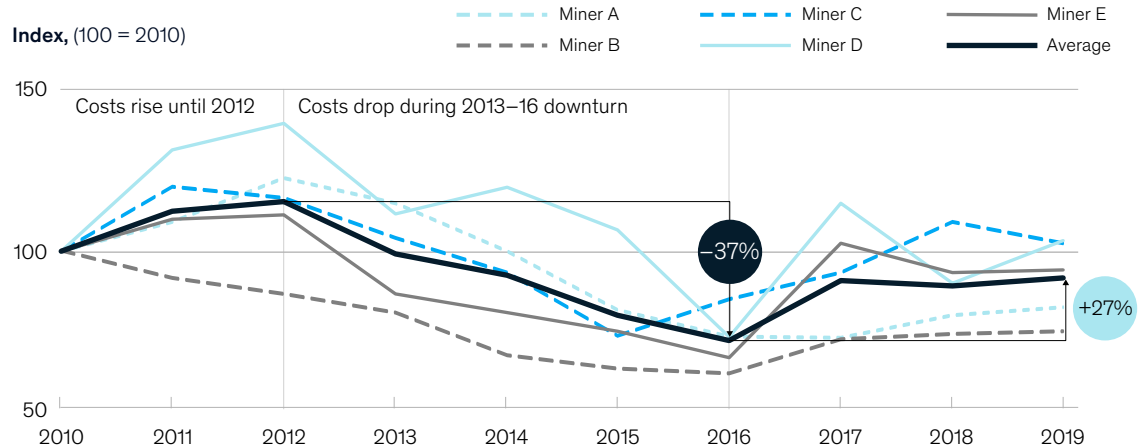
opportunities. Working in short sprints, the teams identified 7 percent average savings across categories, while maintaining existing service levels and quality.

When commodity prices collapsed after 2012, mining companies demonstrated an ability to

Exhibit 4

## Mining input costs are up 27 percent since the new mining cycle started.

Unit cost of raw materials and consumables, \$, adjusted by strength



reduce costs. However, they also historically allowed cost rigor to slip during periods of rising commodity prices. This trend is holding in the current cycle: as commodity prices have increased since bottoming out in early 2016, so too have costs. The new mining cycle offers CPOs the opportunity to differentiate: procurement excellence can preserve cost improvements that were made during the downturn from 2012 to 2016 and bring on a new wave of value.

Another good way to use available time is to invest in building a team's capabilities. Procurement functions tend to underinvest in upskilling programs, which creates a ceiling for the performance of employees. A short curriculum of high-impact modules—on topics such as building business partnerships, should-cost modeling, advanced negotiations, remote negotiations, and data analytics—can be created to engage experts and motivate the team via training. For instance, one metals company, whose nonoperations employees were working from home, quickly identified the top three skill gaps of the team and set up virtual training sessions led by experts. As the company prepared for its transformation, it became clear that

those who had been trained would be expected to play critical roles in leading the change. Thus, it is important to ensure that the newly acquired skills and knowledge are quickly incorporated into the fabric of the function at every level.

### 4. Reinforce the company's purpose in its community

Metals and mining, much like other industries, typically carries a sizable inventory of personal protective equipment (PPE). CPOs and other procurement leaders can use their knowledge of existing PPE supplies and work-site needs to identify a possible surplus that may be donated to local health facilities. This effort may be particularly relevant in smaller communities, where miners may indeed hold a relatively large supply of PPE in a region. If surplus supply is not available, CPOs can use their supplier base, volume, and leverage to help negotiate critical items for local hospitals.

Procurement leaders can also identify materials that may aid in the construction of crisis-relief facilities in their communities or, again, use their positions to negotiate purchases. A great example of this is a metals company in China, which donated the steel

to build a permanent hospital in a region stricken by COVID-19. Built in record time, the hospital allowed the metals company to reinforce its corporate purpose of serving its community.

for bold actions and assertive partnerships with other functions in the company. And now is the time to lead with purpose, boost employee morale, and pave the way to winning in the recovery.

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Metals and mining CPOs have a real opportunity: to help mitigate this crisis now, improve the effectiveness of the procurement function, and position their organizations to become more resilient after the crisis has passed. Now is the time

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