



MBA Business Policy
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Strategic Options

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Executive Summary

The world has recently been experiencing a global commodities boom and BHP Billiton LTD (BHP) has executed growth plans and increased shareholder value during this time. The purpose of this analysis is to evaluate three key areas of the company and make recommendations about strategic issues related to the operation and performance of the company.

- Execution of growth plans
- Communication with Stakeholders
- Leadership

This analysis will incorporate several tools: PESTEL Analysis, Porter Five Forces Analysis, Key Success Factors Analysis, Value Chain Analysis, Financial Ratios Analysis and SWOT Analysis to understand the internal and external positioning of BHP. Next steps are to formulate and identify the strategic issues facing the company followed by development of strategic options and alternatives to address the strategic issues.

Specific recommendations will be given on how and why the strategic alternatives will resolve the strategic issue. Core recommendations relate to:

Cost containment	Human Resources
Quality Program	Corporate Communications
Sustainable Development	Joint Ventures
Management	

Action steps will describe the chosen approach and what organizational structure and culture changes are required to implement the change and identification of the sources for funding the alternative.

1. Introduction

1.1 Context of Analysis and Approach

This research analysis report is driven by several fundamental questions about BHP:

- What are the critical risks and strategic outlook for 2008-2010?
- Is the company positioned well for growth?
- What if commodities demand slows down?
- What market forces are helping or hurting the company?
- Are there capacity issues?
- Are there project costs over run problems?
- When will the project results be known?
- Is the company communicating effectively?
- How can communication be improved with governments, investors and stakeholders?
- Does the company have effective leadership?
- Is the company focused?
- What are the management succession issues?

This report proceeds with establishing a base line of understanding about BHP Billiton. It is important to develop knowledge of the company history, corporate structure and the stated company mission, vision and strategic drivers.

Establishing this foundation allows the context of the company to be understood before specifically analyzing the external and internal environment and offering strategic choices.

1.2 Company Information

The BHP Billiton Group (BHP Billiton or BHP) is known as the world's largest diversified resources company. The corporate headquarters is located in Melbourne, Australia. BHP Billiton was formed on June 29, 2001 during the merger of BHP Limited and Billiton PLC. The company has a dual listed structure where BHP Billiton Limited (Melbourne) and BHP Billiton PLC (London) legally operate as separate publicly traded companies but operate as one business

entity with combined assets, BHP Billiton Group . The company has the same board of directors and management team.¹

The dual listed company structure remains in force indefinitely due to compliance with the Australian Takeovers Act of 1975. Following the merger of the two companies, according to provisions of the Takeovers Act and the Treasure of Australia, BHP Billiton Ltd must remain as an Australian company which is located and managed from Australia.²

1.3 Company History

BHP Limited was incorporated in 1885 in Broken Hill, New South Wales, Australia as a silver and lead mining company. From the early 1900's until the late 1960's, the company expanded within Australia into iron ore, steel making, coal, and petroleum. From the 1970's to the 1990's, the company pursued domestic and global growth with exploration, acquisitions and discoveries of coal, copper, natural gas in Chile, The United States and Canada.³

Billiton PLC was formed in 1860 in The Hague, Netherlands. The company early growth focused on tin mining in Indonesia on the island of Billiton and lead and tin smelting in The Netherlands followed by bauxite mining in Indonesia and Suriname during the 1940's. The company growth accelerated in the late 1990's by inclusion in the FTSE 100 Index. The broad product portfolio included aluminum and nickel smelters in South Africa and Mozambique, metal mines in South Africa, South America and Canada, coal mines in Columbia, Australia and South Africa and operations in Brazil and Surinam.⁴

¹ BHP Billiton Website. www.bhpbilliton.com

² BHP 2006 Annual Report, page 50.

³ BHP Billiton Website. www.bhpbilliton.com

⁴ BHP Billiton Website. www.bhpbilliton.com

1.4 Company Structure

BHP is divided into seven business units or customer service groups.

Aluminum	Stainless Steel Materials
Base Metals	Petroleum
Carbon Steel Materials	Diamonds and Specialty Products
Energy Coal	

The company has a minerals exploration group, technology group and freight, transportation and logistics operation.

Descriptions and analysis of these customer service groups will be given in areas of the analysis on the basis of how and why the customer service group relates to a key strategic issue facing BHP.

1.5 Company Mission

The BHP company mission is listed as:

Our core purpose is to create long term value through the discovery, development and conversion of natural resources, and the provision of innovative customer and market-focused solutions.⁵

To achieve the charter and create growth and prosperity, the CEO Chip Goodyear stated that BHP must:

- Actively manage and build the portfolio of high quality assets and services.
- Continue to drive toward a high performance organization in which every individual accepts responsibility and is rewarded for results.
- Earn the trust of employees, customers, suppliers, communities and shareholders by being forthright in communications and consistently delivering on commitments.⁶

⁵ BHP 2006 Annual Report

⁶ BHP 2006 Annual Report

1.6 Company Values⁷

The company values are listed as:

Safety and the Environment	Integrity
High Performance	Win-win Relationships
The Courage to Lead Change	Respect for Each other

The company lists successful value creation as:

- Superior shareholder return on investment
- Customers and suppliers benefiting from BHP business relationships
- Communities valuing company citizenship
- Employees working with a sense of purpose and accomplishment

1.7 Strategic Drivers⁸

The company strategic drivers are listed as:

Growth Options	Project Pipeline
Financial Strength and Discipline	The BHP Billiton Way
World Class Assets	License to Operate

The company vision, mission, values and strategic drivers are the corporate DNA and stated performance aims of the enterprise. All of the operations and purpose flow forth from this source of top line information. It is an important part of understanding the statement of the company identity. How the company competes and performs in the marketplace is driven by the power and purpose of the vision, mission, values and strategic drivers. The competitive strategies for BHP Billiton and the marketplace reality will be evaluated based on this corporate positioning.

⁷ BHP 2006 Annual Report

⁸ BHP 2006 Annual Report

2. Positioning- External Analysis

The purpose of the external positioning section is to review the variables from the external environment, industry and competitive forces. The context of the external analysis for BHP Billiton is understood by a careful review of the impact of the environment, comparison and key drivers for change.⁹ The meaning and significance of the external analysis has a direct impact on strategic options for BHP Billiton. It is necessary to scan the market for multiple future scenarios so that the proposed external strategy can be adjusted as necessary.¹⁰

2.1 Commodities Market Macro Trends

The external market environment is characterized by the dominant traits of strong demand and growth for commodities on a world wide basis and limited supplies. BHP Billiton and all of the companies who operate in this segment have been beneficiaries of strong external demand for commodities. During 2006 the average prices for the following commodities were at prices levels not seen since the late 1970's: copper, zinc, iron ore, coking coal, thermal coal, crude oil, natural gas and uranium.¹¹ The commodities of aluminum, nickel and lead are at 15-20 year peaks.¹² The world has taken notice of the strong GDP growth and industrialization of China and the rise of India. The external environment is characterized by the fact that the world is operating in a strong demand cycle for commodities which is being driven by emerging countries and industrialized countries including the United States. Table 1 indicates the prediction of the increase in long term price trends for metals, not including the price for oil.

⁹ M2: 'Strategic Positioning' by Pierre - Yves Benain. Page 5.

¹⁰ M2: 'Strategic Positioning' by Pierre - Yves Benain. Page 6.

¹¹ BHP Billiton News Release 7/2/07, www.bhpbilliton.com

¹² BHP Billiton News Release 7/2/07, www.bhpbilliton.com

Table 1: Commodity Prices

KEY COMMODITY PRICE & EXCHANGE RATE CHANGES													
		2005e			2006e			2007e			Long-term		
		New	Old	Change	New	Old	Change	New	Old	Change	New	Old	Change
A\$/US\$		0.80	0.80	-1%	0.80	0.80	0%	0.70	0.75	-7%	0.70	0.65	8%
US\$/ZAR		5.93	6.76	-12%	6.32	7.33	-14%	6.77	7.89	-14%	9.00	9.00	0%
Aluminium	US\$/lb	88	85	3%	82	80	3%	75	78	-4%	70	65	8%
Copper	US\$/lb	130	118	10%	115	110	5%	100	105	-5%	95	85	12%
Nickel	US\$/lb	5.60	4.98	12%	4.00	4.00	0%	3.50	3.75	-7%	3.50	3.25	8%
Zinc	US\$/lb	58	52	11%	55	50	10%	48	49	-2%	50	45	11%
Lead	US\$/lb	40	37	7%	32	30	5%	23	27	-15%	27	25	8%
Oil - WTI	US\$/bbl	36	36	0%	28	28	0%	28	28	0%	28	28	0%
Iron Ore	% chg	+45%	+30%		0%	0%		0%	0%		45*	35*	29%
Coking Coal	US\$/t chg	+71	+38		+10	+10		+0	0		62**	48**	29%
Thermal Coal	US\$/t chg	+12	+12		-5	-5		+0	0		33**	30**	10%

Note: Although we have not changed our LT Rand, we no longer depreciate it at 2%/yr (the inflation differential we assume between South Africa and US); * US\$/Fe unit; ** US\$/t. Source: Smith Barney estimates.

Source: Smith Barney Global Equity Research: Metals and Mining 2005.

One of the reasons for the strong demand is the estimation that commodities markets are operating in a strong “long term super-cycle”¹³. The implications for the super-cycle is strong long term earnings growth, stable long term profit margins, and a new emphasis on quality earnings, which have not been seen in past commodities markets.¹⁴ The industry is attractive from a profit perspective.

The metal and mining commodities industry is characterized by strong capital spending to bring on new capacity to meet market demand, but it is expected that it will take several years to increase capacity which will cause an increase in supply which could cause a downward pressure on prices. It is estimated that the downward pressure on prices will be limited due to the high costs to increase supply.¹⁵

There are alternate view points which state that strong 20% annual growth in raw materials demand from China is not sustainable and that growth of 10% is more reasonable.¹⁶ If the peak in commodities prices occurred during 2005, then the capital spending peak is likely to occur two years later during 2007. The

¹³ Smith Barney Global Equity Research: Metals and Mining 2005.

¹⁴ Smith Barney Global Equity Research: Metals and Mining 2005.

¹⁵ Smith Barney Global Equity Research: Metals and Mining 2005.

¹⁶ “The Changing Nature of the Base Metals Cycle” by David Humphreys. Commodities Now. December 2005.

predictions of strong demand and the projected increase in commodities prices are traditionally based on a view of using the past to predict the future. The meaning and significance of these predictions (for example Table 1) must be discounted to some degree as it is impossible to predict the future of commodities markets with any degree of reasonable certainty. This means that regardless of the state of the markets from 2008-2010, BHP Billiton must be positioned effectively to succeed in the competitive raw materials commodities markets.

2.2 PESTEL Analysis

To compliment the understanding of the general macro environment for commodities, it is necessary to now move to an analysis of the external market through forming a PESTEL Analysis. The elements of the factors in the PESTEL Analysis have an impact on the strategic drivers for BHP Billiton.

2.2.1 Political Factor

BHP Billiton is a global resources company that is susceptible to political risk factors in all markets. Political factors can have a big impact on the company's stated key drivers: license to operate, project pipeline, growth options and world class assets.

BHP has committed capital to exploration and development projects in countries where there is the risk of political instability: Democratic Republic of Congo, Western Africa, Mongolia, and Kazakhstan.¹⁷ The stated political risk factors of operating in emerging markets include: civil unrest, terrorism, nationalization, changes in government policy and nullification of existing contracts, lease agreements or permits.¹⁸

¹⁷ BHP 2006 Annual Report. p 44.

¹⁸ BHP 2006 Annual Report p 7.

BHP mining operations in South Africa have undergone adjustment due to the passage of the Mineral and Petroleum Resources Development Act of 2002 which took effect in 2004. This means that under the new act and mining charter, BHP will be mandated to restructure an eventual 26% percent of the ownership rights in the mining properties and offer these disadvantaged South Africans.¹⁹

Governments have the ability to increase taxes which can adversely affect operations. Chile introduced a new 5% mining tax “royalty” which applies to operating taxable income from mining.²⁰ BHP owns and operates the Escondida cooper mine in Chile, which the company states is the largest source of cooper in the world. The mandated tax adds uncertainty to profit projections for the base metals product division of the company.

2.2.2 Economic Factors

BHP Billiton is susceptible to the economic factors of inflation in energy costs, exploration expenses, labor costs, operations costs, materials costs. These increases could adversely impact the company expansion plans, development projects and company profitability.²¹

The company depends on the recent strength in global commodities prices that are correlated with the health of the global economy. The company is exposed to fluctuating currency valuations and general economic risks in the world industrial economies. Any major weakness in global economies could cause a fall off in commodities demand resulting in increased supply and reduced prices which could impact company profitability.

BHP Billiton is heavily dependent on the China economy for 16.8% of company revenue (\$6.6b). China global demand for commodities accounts for 41% of

¹⁹ BHP 2006 Annual Report. p 45.

²⁰ BHP Mining Copper Mining Presentation. p 24.

²¹ BHP 2006 Annual Report p. 8.

seaborne iron ore, 22% of copper, 22% of aluminum, and 16% of nickel demand.²²

2.2.3 Socio-Cultural Factors

BHP Billiton is susceptible to socio-cultural factors in all operations and stakeholder relationships. These factors require the company to financially support local communities and provide resources for infrastructure such as schools, roads and housing. New mining and development projects often require 'social approvals' which can add to development costs and impact profitability. The Company has taken steps to build on its reputation in Chile by focusing on improving worker conditions and the quality of life in the city of Antofagasta, near the Escondida copper mine.²³

2.2.4 Technology Factors

BHP largely depends on the technical factors of efficient mining, exploration and discovery of mining and energy assets. The company relies heavily on the use of technology for exploration. The investment in technology is a vital expenditure for the company. All of the technical factors affect two important key strategic drivers for BHP Billiton: project pipeline and world class assets.

2.2.5 Environment Factors

As a natural resources company, BHP Billiton is susceptible to regulation and public policies regarding the environment including the 1997 Kyoto Protocol, the European Union Emissions Trading System, the Asia-Pacific Partnership on Clean Development and Climate, clean emissions, recycling and renewable energy. Environmental groups and NGOs exert continual pressure on the company. BHP Billiton attempts to follow a practice of 'zero harm' and sustainable development. BHP Billiton has committed to reducing greenhouse gas emissions in operations by 5% in 2007.

²² BHP 2006 Annual Report p. 8.

²³ BHP Mining Copper Mining Presentation. p 22.

BHP Billiton is responsible for environmental conditions at current and former mining and drilling operations. Environmental responsibility is linked to the key strategic driver of license to operate. During 2006, the company allocated over \$2.8b for reclamation and decommissioning costs and this figure was estimated to increase by another 25%.²⁴

2.2.6 Legal Factors

Legal factors are an important risk factor for BHP Billiton. The company has faced legal liabilities in the rulings for causing environmental damage at the Southwest Copper operations in Arizona which impacts financial performance. BHP lost an important Federal Court Decision in Australia pertaining to rail infrastructure access for two Western Australia iron ore mines. This lawsuit was originally brought in the Australian Competitive Tribunal by Fortescue Metals Group, which is a smaller iron ore competitor to BHP in the Pilbara Region. BHP Billiton stated that the ruling will have an impact on the production of iron ore and delay future investment decisions.²⁵ The Western Australia Pilbara Region is one of the most significant areas of growth for BHP and it provides export income of \$5.5b AUD and jobs for over 7,000 individuals.²⁶

2.2.7 PESTEL Analysis Conclusions

The Pestel Analysis has served the purpose of identifying key factors that impact the company as part of the external operations. These areas of risk within the external operation are omni present during company operations. The factors have a financial and time cost and in many cases they are being identified and addressed by BHP as part of the company mission to provide innovative customer and market focused solutions.

²⁴ BHP Billiton 2006 Annual Report p. 48.

²⁵ 'Federal Court Decision Threatens Australian Exports'. www.bhpbilliton.com Investors section.

²⁶ 'Federal Court Decision Threatens Australian Exports'. www.bhpbilliton.com Investors section.

2.3 Porter Five Forces Analysis

The Porter Five Forces Analysis offers a strategic view of the competitive external environment facing BHP Billiton. It enables the opportunity to assess the sources; strength and impact of the competitive forces and the affect each of these have on achieving company goals and objectives.

2.3.1 Bargaining Power of Buyers

The bargaining power of buyers is moderate to low. In many of the product lines that BHP Billiton markets, the company is able to pass along price increases for shipping and increased production and labor costs. This is due to low supply and the strong demand for natural resources including metals, coal, petroleum, diamonds and uranium. In many cases there are not alternative sources of supply (substitutes) in large enough quantities. This has reduced the bargaining power of buyers. The company is dependent on long term relationships with customers; however, the impact of price increases has been reduced by the strong company focus on customer service.

2.3.2 Bargaining Power of Suppliers

BHP Billiton has been impacted to a high degree by the bargaining power of suppliers in labor, materials, shipping and energy costs. As the activity of the firm has increased to reduce capacity, the overall costs from suppliers have increased as well. In these categories, there are few if any substitutes and this enhances the strong bargaining power of suppliers. For example, the mining industry has been faced with increased costs for replacement parts for mining equipment including a severe shortage of large tires for equipment. Labor costs for exploration and mining have increased and this has had an impact on the feasibility of new projects in the Pilbara Western Australia mining region. The company is in a weak position to counter the competitive pressure and bargaining power of suppliers.

2.3.3 Threat of New Entrants

The threat of new entrants is moderate to low. Today there is either simply a shortage or very little idle capacity and supply available in the world wide natural resources markets including oil. These factors cause significant barriers to entry. Chinese firms have formed joint venture alliances with other Western Australia mining companies; however the impact of these will only be felt in the long term. Furthermore, the quality and location of the iron ore and minerals is inferior compared to the BHP Billiton assets. It will take a long time for new companies to upgrade infrastructure, hire and train staff and bring new supply on the market. This is true not only in Australia but also in other markets such as Africa. China and India have made extensive moves in the Africa markets for natural resources but the threat of these countries and the affiliated companies remains moderate to low.

2.3.4 Threat of Substitutes

The threat of substitutes is low. It is not a significant challenge posed to BHP Billiton because there are not many substitutes for raw materials products. BHP Billiton has a broad, diversified portfolio of natural resources assets and it is one of the largest natural resources companies in the world. The company is in a strong position to counter any threats of substitutes due to the portfolio and reserves.

2.3.5 Rivalry among Competing Sellers

The rivalry among competing sellers is strong. This is due to the fact that mining and oil companies are competing for access to natural resources across several Continents. The competitor key facts table indicates a geographic overlap in most areas of worldwide mining operations. There is competition for qualified mining staff. Increased staffing costs are having an inflationary impact on labor wages. There is competitive rivalry in securing access to transportation infrastructure and construction staff for the building of new development projects. The competing sellers have not had an impact on lowering pricing for natural

resources as with a few exceptions pricing power for mining and oil companies has remained strong with very little competitive pricing rivalry among sellers. Despite the rivalries among competing sellers, the appeal of the industry remains attractive due to strong profit potential.

Most recently, Alcoa (AA) which is a competitor to BHP Billiton in the aluminum mining sector announced a hostile takeover offer for Alcan, Inc. which is another aluminum production company. The bid reflected a 20% premium to the share price.²⁷ There have been other takeovers rumors in the natural resources industry which either postulates that Rio Tinto or BHP Billiton could buy Alcoa or a private equity consortium take over BHP Billiton. In 2005, BHP purchased WMC Resources of Australia during a takeover battle. The company as a result has the largest uranium reserves in the world and secured a major source of future growth.

Table 2: Competitor Key Facts

Company	Sales	Empl.	Regions	Products
BHP Billiton (BHP)	\$32.153B	33,184	Africa, Europe, North & South America, Australia, Asia.	Petroleum, Aluminum, Base Metals, Carbon Steel Materials, Diamonds and Specialty Products, Energy Coal, and Stainless Steel Materials.
Rio Tinto (RTP)	\$19.033B	31,854	North America, Europe, Asia, Australia, New Zealand	Energy, Aluminum, Copper, Diamonds, Coal and Uranium; Gold; industrial minerals
Anglo American (AAUK)	\$33.072B	162,000	Africa, Europe, North & South America, Australia, Asia.	Gold, platinum, diamonds, coal, ferrous & base metals, industrial minerals, paper packaging
Companhia Vale do Rio Doce (RIO)	\$19.651B	30,538	Africa, Australia, Asia, South America	Mining, Non Ferrous Metals, Copper, Nickel, Coal, Energy, Aluminum, Steel.
Alcoa (AA)	\$30.379B	123,000	North America, South America, Australia, Africa, Asia	Aluminum

Source: Dow Jones & Company, Inc.

²⁷ 'Alcoa Launches Hostile offer for Alcan valued at 26.9 Billion' 7/5/07 Wall Street Journal.com

2.3.6 Porter Five Forces Analysis Conclusions

On the surface there is a lively and active competition among sellers in the global bulk commodities industry. BHP is positioned near the top as a market leader and one of the largest natural resources companies in the competitive field based on the value of sales, number of employees, scope of products and global reach. The company is a dominant competitor with a broad and extremely large global portfolio of natural resources assets.

As an integral part of the Five Forces model, the bargaining power of suppliers has one of the biggest impacts on the enterprise. Inflation in labor and transportation costs is a key driver and the bargaining power of suppliers has negatively impacted the company through rising costs and this remains an area of uncertainty for all competitors.

2.4 Key Success Factors Analysis

Evaluation of the competitive external environment points to three important Key Success Factors (KSFs) for BHP Billiton. BHP is dependent on the achievement of these KSFs for the ongoing company success and performance.

Key Success Factor	Explanation
Exploration & Development	Build & manage a world class commodities product portfolio; successfully extract, transport and market bulk commodities.
Skill & Capability	Execute primary and secondary value chain activities cost effectively and efficiently.
Sustainable Development	Do no harm to the environment; be an employer of choice in the mining industry; manage stakeholder relationships.

Exploration and development is a KSF because customers demand the efficient, timely and cost effective supply and delivery of quality commodities products with a high degree of customer expertise and service.

As part of skill and capability, investors in BHP Billiton demand strong company leadership which relies on management to achieve strategic goals, objectives and growth while delivering superior risk adjusted financial performance.

The third KSF is sustainable development. Government, citizens and community stakeholders demand a high degree of environmental responsibility. The costs in money, time reputation and goodwill for environmental responsibility and sustainable development are simply too great to ignore. The company is dependent on attracting and retaining employees across all markets. Therefore it is imperative to be considered 'the employer of choice' among natural resource companies.

2.5 Conclusion for External Analysis

Completion of the external analysis of BHP Billiton is an important step in analyzing the positioning of the firm. The issues raised as part of the external analysis will be focused on as part of the SWOT Analysis and finally part of the strategic issues. It is necessary to move to an internal analysis so that additional strategic issues and options can be formulated, planned and executed for the company.

3. Positioning- Internal Analysis

The internal analysis of the company is driven by analyzing the value chain, financial results and offering a conclusion via a SWOT analysis before moving to the formulation of the strategic issues.

3.1 Company Value Chain

BHP Billiton is engaged in the five **value chain primary activities** which are *supply chain management, operations, distribution, sales and marketing, and service*. These value chain activities are executed by the workers of BHP according to 'The BHP Billiton Way'.

Supply chain management is one of the largest cost drivers for the business and inventory management is a key function of the enterprise. Through the company size, it is able to be active in bulk freight and achieve delivery efficiency; however transportation costs have risen dramatically due to the high cost of petroleum. Freight operations represent 20% of total costs, which is shared for the largest cost category with contract manufacturing of 20%, which is part of operations.

As part of the operations value chain, the company is heavily invested in creating the final products which are bulk commodities. The mining foot print is global and the geographic location of the operations is primarily centered on Continents in the Southern Hemisphere with customers located in the Northern Hemisphere. BHP Billiton works to achieve sustainable development in operations including the health and safety of workers and the community. Employees are trained to be aware of safety standards in operations to work according to the purpose to cause 'zero harm' to the environment. The biggest risk in the primary value chain areas is cost containment. Another example of rising costs includes mining operations in the Australian Ravensthorpe Nickel project which have experienced increased capital costs due to lower labor productivity.²⁸ An emerging part of

²⁸ BHP Billiton Company website. www.bhpbilliton.com

BHP Billiton located within the operations value chain is the emissions credits business and power trading operations business. These operations could become areas of future growth or competitive advantage for the company.

Distribution is an essential function in the value chain for BHP. As such, the company is one of the largest bulk shipping seaborne freight carriers in the world. Distribution makes up one of the primary cost drivers in the value chain.

The company is divided into seven customer service groups based on main products lines that are strategically positioned in markets throughout the world. The sales and marketing value chain activities are managed according to a matrix structure with the main reporting centered at the global headquarters in Melbourne, Australia. The company employs a 'customer centric' marketing function which includes the stated value chain structure of people, processes and knowledge networks as part of the company internal operations.²⁹

The five **value chain support activities** of *product R&D, technology, systems development, human resources management* and *general administration* are essential parts of the internal operations of the company. Company management is in the position of allocating resources for development projects and managing the company for financial performance and staff performance.

As part of human resources management, the company has come under severe pressure to find skilled workers for mining operations in Western Australia. The company has sought to work with the Western Australia Government to increase government initiatives for new mining worker training. Despite these efforts, labor costs have been rising due to the persistent shortage of skilled mining workers.

As part of the support activities, the company has a human resources management succession issue with the announced retirement of the CEO, Chip Goodyear on February 7, 2007 to be effective by December 31, 2007. Mr.

²⁹ BHP Billiton Company website. www.bhpbilliton.com

Goodyear, age 49, after 9 years as CEO, did not give a detailed explanation only to remark that “it is appropriate for the organization to transition to the next generation of leadership and that this is part of corporate life.” Resolution of this issue is very important to the strength of the company operations. Chip Goodyear has delivered solid financial leadership during his tenure with the help of very strong commodities markets. The next leader for BHP Billiton will have to be adept at leadership, financial management and execution of the numerous capital projects.

BHP Billiton can become stronger in corporate communications. A review of the company website indicated only average financial and marketing presentations to customers. Communication with investors could be more interactive and information based besides simple power points. BHP is a large global corporate citizen and as such the company profile needs to be enhanced. The company needs to promote and have an agenda for becoming the employer of choice, so that potential employees are made aware of the value and benefit of working for BHP Billiton. There are not any messages from senior management which reinforce effectively the mission and vision of the company. This needs to be done on a frequent base over a variety of mediums including the internet. Public relations is the responsibility of general administration in internal value chain activities and this is an area for improvement as the excellent results that the company is achieving need to be more widely understood by stakeholders. As a natural resources company BHP is the focus of environmental groups. While the company sustainable development policy is clear, more work can be done in public relations to build a stronger case for BHP corporate citizenship.

3.2 Current Financial Results

BHP Billiton announced positive financial results for the last six months of 2006. In these results, the company reported an increase in profit of 41% to \$6.2B and earnings per share increase 44%.³⁰ The EBIT of \$9.1B increased 36.9% compared to the preceding 6 month period and the EBIT margins rose to 47.4% from 41.9% during the same six month comparison period. The dividend of \$.20 per share reflected an annual increase of 14%. The company reported record mining results for aluminum, alumina, copper, iron ore, manganese ore, and molybdenum. The company was the recipient of higher prices for all products except metallurgical coal and manganese ore. The company announced a moderate 5.1% increase in labor, contractors, raw materials, and fuel and energy costs as part of operations.

At the same time of announcing record financial results, the company reported a large \$17.5B project pipeline of 29 projects that are either in the execution or feasibility phase.³¹ The company maintained that the majority of the projects remain on cost and on schedule despite the increases labor and mining costs. Despite these positive statements by company management in regulatory filings, the actual results for these projects will not be known for several years.

Since November 2004, BHP Billiton has repurchased \$17B worth of shares in open market and off market share buy back programs, which represents 16.9% of the company shares.³² The company has made commitments to complete additional share buy backs as part of the company capital management program until mid 2008. The company has focused on increasing shareholder value which has made the stock an attractive investment candidate for shareholders.

³⁰ BHP Billiton News Release 7/2/07, www.bhpbilliton.com

³¹ BHP Billiton News Release 7/2/07, www.bhpbilliton.com

³² BHP Billiton News Release 7/2/07, www.bhpbilliton.com

The share price traded recently for \$53.41 at a 52 week high reached for the stock. BHP Billiton has had a very strong share price performance over the past 1 to 5 year period as enclosed share price charts indicate.

Chart 1: Annual Share Price

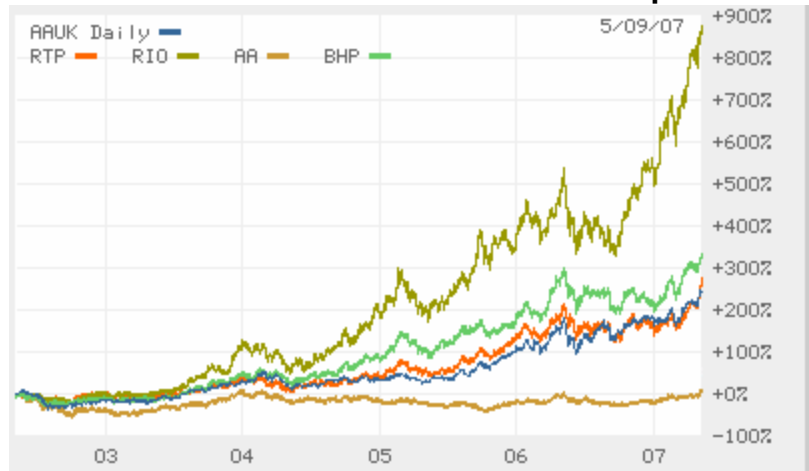


Source: Big Charts.com

Share Price Performance

BHP Billiton is near the top in performance during the past five years as the long term share price chart indicates.

Chart 2: Share Price Performance vs. Competitors



Source: Reuters

3.3 Key Financial Results Analysis

The key financial results and related comments in the enclosed table represent a strong performance for BHP Billiton. The company is an attractive investment that has delivered superior financial returns for investors.

Table 3: Financial Ratio Analysis

Quick Ratio	.83	3 year average reflects a strong comparison of cash and short term investments to short term financial liabilities.
Current Ratio	.99	The ratio is close to 1 which means that the company's long term debt and equity are equal.
Gross Margin	30.32	This margin compares favorable with the 5 year average of 26.04%.
Profit Margin	45.63	This is very strong.
Net Margin	32.76	The company is performing strongly with this return on sales figure which reflects strong income after taxes.
Return on Assets	20.58	This figure is strong and represents the how well the company management has used assets to generate profits
Dividend Payout Ratio	20.79	This high figure represents the percentage of earnings that have been paid to shareholders as cash dividends

Source: Reuters Fundamentals

The superior five year average of revenue and net income growth rates have positioned BHP Billiton as one of the best natural resources companies in the world.

The analysis of the financial ratios comparison and competitor financial performance indicates that BHP Billiton has room to improve in the area of increasing gross margin on a short and long term basis. One of the reasons for the lower gross margin has been the costs of acquisitions. While the majority of the financial management and financial results have been superior, the company needs to improve the long term return on equity to be closer in line with competitors. The company has allocated significant investments to capital spending and these need to be leveraged effectively so contribute positively to long term financial results.

Completion of the internal analysis has revealed a company that is achieving excellent financial results while executing company functions according to the value chain.

3.4 Financial Ratios Comparison

Annual Ratios

Ratios	BHP	RTP	AAUK	RIO	AA
Gross Margin	30.32	33.11	38.59	48.36	23.24
Operating Margin	45.63	37.54	23.81	38.86	11.3
Net Profit Margin	32.76	28.89	20.93	32.55	8.55
Return on Equity	46.82	44.83	25.83	52.44	15.48
Current Ratio	0.99	1.18	1.35	1.77	1.26
Quick Ratio	0.68	0.76	1.01	1.29	0.74
Debt to Equity	0.37	0.19	0.26	1.14	0.49
Dividend Yield	1.4	0.9	2.65	0.6	1.8
Price/Earning Ratio	13.07	13.33	14.34	16.43	15.28
Dividend Payout Ratio	19	94	26	14	24

Source: Reuters

5 Year Avg. Ratios

Ratios	BHP	RTP	AAUK	RIO	AA
Gross Margin	26.04	77.02	31.97	48.29	20.83
Operating Margin	29.05	21.86	18.16	38.54	8.57
Net Profit Margin	20.91	21	15.36	30.61	6.44
Return on Equity	18.63	24.32	16.15	51.04	10.36

Source: Reuters

5 Year Avg. Growth Rates

Ratios	BHP	RTP	AAUK	RIO	AA
Revenue	23	19.3	17.47	37.94	6.12
Net Income	64.18	33.16	14.93	38.37	19.07
Earnings per share	48.81	33.23	14.76	37.12	18.84
Dividend	23.46	27	28.99	n.a.	0
Capital Spending	36.61	23.83	14.77	49.42	22.18
Gross Margin	11.03	4.72	7.02	2.73	1.11
Cash Flow	45.14	22.3	13.25	36.02	10.55

Source: Reuters

Note:

BHP= BHP Billiton, **RTP**= RIO Tinto, **AA**= Alcoa

RIO= Companhia Vale do Rio Doce

3.5 SWOT Analysis

The objective of the SWOT analysis is to highlight the key strengths, weaknesses, opportunities and threats from the completed external and internal analysis. This SWOT analysis will translate conclusions into strategic actions so that the company can execute opportunities and defend against threats.³³

3.5.1 Strengths

BHP Billiton is a world class natural resources company with a diversified portfolio of assets. It remains in a strong market position. The company is one of the largest suppliers of uranium (Olympic Dam Mine in Australia), copper, silver, and lead (Cannington Mine in Australia is the world's largest single of silver and lead). BHP owns the world's largest source of copper with the Escondida mine in Chile. BHP is the third largest nickel producer in the world. BHP is the sixth largest world aluminum producer. BHP is one of the largest producers of iron ore, metallurgical coal and manganese as part of operations in Australia, Brazil and South Africa. The same is true about the Energy Coal customer sector group. It is one of the largest operations in the world and it is strategically positioned to deliver products from operations in Australia, Asia, North America, South America and South Africa.

BHP has delivered superior financial returns over the past five year period. The company through an aggressive share buy back program has returned capital to investors. The company has increased dividends over the past 10 successive periods. The company has a strong A credit rating and is able to raise money in global capital markets. The company has successfully managed the company financially while integrating the costs of the strategic WMC Resources acquisition.

The company is able to operate with a dedicated customer service component across the product portfolio and at the same time pass along price increases to

³³ Crafting and Executing Strategy. Thompson, Strickland, Gamble. McGraw Hill 2007. p. 107.

customers. This is due to a strong market where there are often no reasonably priced substitute commodities due to supply constraints.

BHP is a powerful global operator focused on sustainable development with a solid track record without incurring noteworthy downside negative brand awareness, due to problems with stakeholders.

3.5.2 Weaknesses

The company can improve the measures of gross margin and the long term financial return on equity to be closer in line with competitors. The company is operating with several human resources issues including finding a new CEO and hiring and training additional mining staff. There are not enough qualified staff and this is hurting operations, so staff training, recruitment and development is an area of weakness. The company is weak in corporate communications as there are no proactive corporate responses using new media or effective group communication to the investors and stakeholders using new media. Furthermore, the company mission, vision, values and strategic drivers need to be more clearly explained to the world at large. The CEO does not reinforce these messages beyond making the obligatory statements in company materials. The mission and complete values, strategic drivers need to be related to the enterprise through more thoughtful communication and corporate leadership, while involving every segment of the operation. Political lobbying is another weakness for the company. BHP has not effectively defended their position on infrastructure access and lined up the proper public support by public relations and political lobbying.

3.5.3 Opportunities

BHP Billiton has a project pipeline in the execution or feasibility phase of 29 projects totaling \$17.5B in investment. This should become a significant source of revenue during the 2008-2010 period provided the company executes cost effectively and profitably and there is a strong commodities market. BHP can

further execute innovative marketing solutions by being a proactive promoter of the enterprise by using new media tools and customer outreach while marketing natural resources from the company's extensive assets. This means extending the brand into creating customer awareness of the company strengths and operations.

BHP Billiton has committed to a reduction of 5% in greenhouse gas emissions. This program if managed properly can become a positive source for environmental responsibility and sustainable development. The company has an energy trading and transportation division. Being that BHP is a significant source for energy commodities there are opportunities to further integrate into the supply chain and operations of transportation companies and utility companies to capture additional profit margin and lower costs further. The oil and natural gas values are extremely high and the BHP portfolio is positioned mostly in Australia and the US which are stable, democratic countries. BHP as needed can selectively sell off energy assets at a premium if there is a need to do this in the future.

3.5.4 Threats

Rising costs from suppliers (energy, shipping and contract labor), inflation and labor staffing issues are the principal threats facing BHP at the current stage of company growth and development. The company has undertaken exploration and development projects in Africa and this activity will require the company to proceed carefully due to heightened political risks that could affect profitability in these markets. In the home market of Australia, the company has received an unfavorable ruling from the government regarding infrastructure access and the political dynamics of being on the 'right side' of issues cannot be underestimated. A strong lobbying presence is needed to counter political opposition. Global operations are threatened generally by environmental interests and the company must focus on sustainable development and positive interaction with stakeholders so that the operations can avoid delays or public relations damage

caused by environmental interests. The company is heavily dependent on China demand for natural resources and any global slowdown in world markets could impact the sales and profitability of BHP. The company must work to fulfill demand yet remain financially disciplined to achieve increasing levels of profitability along with growth in shipments of natural resources commodities. Since BHP is a profitable and growing company, it has caught the attention of private equity firms who if given the opportunity would like to take over the firm to capture the strong sources of cash flow. The company must be vigilant against mergers and acquisitions threats and not fall victim of being acquired or taking on extra debt to acquire another enterprise at a high multiple just as a defensive measure.

4. Formulation of Strategic Issues

The critical issues that are facing BHP Billiton relate to corporate structure, the execution of growth plans, communication with stakeholders and leadership. Formulation of the strategic issues is the result of the SWOT analysis preceded by the external and internal analysis. Formulation of the strategic issues is an important step which leads to prioritization and focus on the several strategic options.

We have seen a company that has executed very well and delivered superior financial performance in the reality of a commodities bull market; the current high prices for natural resources commodities have not been reached in several decades.

The principal issue for BHP is cost containment. Managing costs has a direct impact on profitability and the successful growth of the company operations. The company must mount a concerted effort to manage costs while achieving growth objectives. The company must execute value chain activities at a lower cost multiple than competitors in order to maintain leadership in natural resources and achieve commensurate financial returns. The company has been the beneficiary of a multi-year bull market in commodities demand. Markets are cyclical and the company must become a cost leader in order to compete effectively in the event that markets turn down and the pricing becomes more competitive. Cost structure needs to become an area of competitive advantage for BHP instead of a weakness or liability as it is now when the company has to fight against inflation and rising costs at all levels of the enterprise.

Effective cost containment rides parallel along with effective staff recruitment and retention as not having enough qualified staff impacts the execution of corporate growth plans. BHP must do more to win the strategic issue of being the 'employer of choice in Australia'. This means putting forth innovative programs that go beyond financial rewards for performance. Employees need to feel a

sense of belonging and contributing to results and enhancing the company position in world markets. The mission and seven strategic growth drivers of the enterprise need to be effectively translated and experienced by every member of BHP Billiton from the lowest to the highest corporate levels. The strategic drivers can be enhanced and made simpler by focusing on 'quality' which will have the dual effect of helping to increase efficiency, and radically reduce costs which will enhance and solidify the company position.

Effective corporate leadership is paramount in order for the company to continue to grow and fully develop the sources of supply in the large development project portfolio. BHP as the world's largest natural resources company is 'public enemy number one' because they contribute to global warming. Sustainable development at every level of the enterprise is necessary in order to meet the increasing global standards for stakeholders about curbing environmental pollution. Giving back to the community and being a proactive force against climate change must become a responsibility of the company otherwise change will be mandated by others in the political process. Stakeholder outreach through effective corporate leadership and communication by using all effective media and building 'mindshare' is needed and is a top strategic issue for the company.

How to make the corporate structure more effective is a strategic issue for the firm. Investors and stakeholders need to see a more active presence of the company in global media. Too often the company reaction in the press is 'one dimensional' by just issuing a press release which most of the time does not answer important questions or comment on the issue whether it is related to the reason for management change and succession or difficulties that the company is having securing long term, affordable infrastructure access. Key issues must be commented on thoughtfully by company leaders and they cannot be avoided hoping they will go away. Corporate responsibility begins with leadership and company management needs to empower a wider group of leaders who can comment on the issues and put a human dimension on the issues. Otherwise the

company is just perceived as behaving according to corporate greed and less concerned with the community and stakeholders.

The corporate future of BHP Billiton is vulnerable if the company becomes the target of private equity predators. Survival is a strategic issue while there is too much capital chasing too few deals that could be ultimately unwound with broken companies being left with too much debt on the balance sheet and expired promises about 'financial synergy'. BHP is a mining and natural resources company with an extremely valuable world class portfolio of assets that needs to be protected. The senior management and board of directors need to be vigilant about warding off unfriendly corporate raiders or making a stupid acquisition at high prices. More damage can be done in lost time due to management focus on external distractions instead of focusing on the business plan and being an effective operation.

5. Formulation of Strategic Options

In order to protect the value of the enterprise and ward against becoming the victim of a hostile take over, the company can sell off the oil and natural gas properties. This will generate an enormous amount of cash that can be either reinvested in operations or simply saved to use as currency for future acquisitions if the market valuations become attractive due to down turn. Private equity buyers will be driven away when they know that company leadership has a plan of attack to defend against unwanted acquirers. Secondly, BHP Billiton has the option to take the oil and gas properties public and set up a separate class of stock for these properties that could garner a higher company valuation. This stock could be used as currency for other acquisitions or as a vehicle to generate higher share holder returns through dividends. The oil and gas properties are expensive to operate due to high exploration costs. The third strategic option is to form a joint venture with an energy company who can share the costs of development and share some of the profit upside. BHP will be a winner in the short term by taking some chips off the table (locking in profits at a high valuation) and forming a defensive strategy by becoming aligned with a well capitalized synergistic partner.

The corporate structure of BHP Billiton has been weakened by poor corporate leadership on key issues of the environment that affect global stakeholders because the company has not mounted an effective public relations strategy. The senior corporate management and leadership can be given more powers to speak out in the media and forge public alliances with stakeholders. The leadership must start a visibility campaign that dovetails with specific corporate objectives to increase 'mind share' in the marketplace, organization and global community. Related to the corporate structure is changing the company mission, vision and strategy drivers. The strategic drivers need to reflect a cost focus and creating value through achieving quality at every level of the enterprise. Today the message is lost because it is not being communicated clearly and reinforced

by company leadership in marketing materials and corporate communications. The firm must be aligned according to achieving goals and objectives and this function is not being met effectively. Having the company commit to the noble goal of 5% reduction in greenhouse emissions is hollow if it does not become specific, measurable, time based and related to every individual in the enterprise.

The option for becoming more competitive as a corporation is to focus on quality objectives. Profits increase dramatically when quality is focused on at every level of the corporate operations. Causing the decrease in waste and measuring the effects will go a long way to empowering workers to make a difference and this will translate into superior financial results. It has been proven that companies set and achieve ambitious quality objectives achieve superior financial results. Delivering quality translates into every segment of the organization from external dealings to executing the value chain. Sustainable development, staff recruiting and training, transportation costs, manufacturing costs all will be improved and enhanced with repositioning the BHP Billiton organization as focused on quality.

Analysis of the external environment revealed potential risk areas of development projects in Africa. We suggest that portions of these risky projects can be sold to minority joint venture financial partners in Japan. BHP Billiton has the expertise and staying power to execute these projects; however, it makes sense to diversify and spread out the financial risks. Politics, war and wildly uncertain political dealings have been a characteristic of Africa for some time and since the future is unknowable, it makes sense to share in the risk and potential for increase development costs.

BHP Billiton has one of the largest bulk freight shipping operations in the world. A strategic option is to integrate further into the shipping supply chain by purchasing a cargo shipping company. In this way cost saving could possibly be realized as well as control of valuable vessels.

BHP Billiton can consider the strategic option to expand the company by purchasing several junior mining companies. This will allow BHP to lock in potential future new sources of supply while deploying excess cash that is generated from operations. Once likely acquisition target is the Fortescue Metals Group based in Australia.

The last option to consider is to set up a holding company to diversify some of the wealth and profits that are being created by the enterprise. There are financial instruments and investment opportunities that can be made that are unrelated to natural resources. This could help the company as for example investing in commercial real estate will allow the company to generate returns and have a relatively safe storehouse for the capital. The company could invest in real estate development projects in North Africa and the Middle East or even South America and these efforts could enhance the corporate profile of BHP as the company would be perceived as giving back to the community while generating corporate profits.

6. Recommendations

BHP Billiton has an opportunity to fine tune the company operations over the next 18 month period by implementing our recommendations. BHP Billiton must work to achieve an effective 'best cost' generic competitive strategy. Customers will increase the size and frequency of orders when the prices are made more affordable through providing the value chain activities more cost effectively than competitors.

6.1 Core Recommendations

1. Cost Containment
 - Execute value chain activities at lower cost multiple than competitors.
 - Make cost structure an area of competitive advantage for BHP.
2. Human Resources
 - Create staff recruitment program.
 - Set up staff training program with Government.
 - Create innovative programs to reward employee contributions to reduce costs.
3. Quality
 - Set up firm wide total quality management program.
 - Implement in phases.
 - Integrate with suppliers.
 - Make quality part of new company strategic drivers and mission.
4. Corporate Communications
 - Create active global presence in new media by using new tools.
 - Involve company managers in media presentations.
 - Clearly explain (new) company mission, vision, goals and values to all stakeholders via communications and corporate leadership.
5. Sustainable Development
 - Set up public relations plan and stakeholder outreach.
 - Set up SMART objectives for 5% greenhouse gas reduction plan.
6. Joint Ventures
 - Set up joint ventures in select Africa development projects as part of risk mitigation.
7. Management
 - Hire new CEO.
 - Set up political lobbying task force within BHP.

6.2 Recommendations Decided Against

1. Mergers and Acquisitions
 - The multiple for acquisitions is too high.
 - Management time distraction.
 - Will make the company more vulnerable to private equity predators.
2. Sell Oil and Gas Assets
 - The company does not need the extra cash.
 - The company would lose a key source of revenue and diversification.
3. Backward Integration into Supply Chain
 - Company must focus on core business and value chain.
 - Purchasing a shipping company adds to management distraction.
4. Diversification
 - Adds to distraction of management and employees.
 - There are great financial opportunities within natural resources that company can execute and therefore does not need to diversify.

7. Implementation

BHP will need to make changes in how the company is structured in order to implement the list of strategic programs. Compensation of managers will need to reflect the new emphasis on quality and eliminating waste throughout the value chain activities. The leadership starts at the top and the board of directors must make sure that the new CEO specifically focuses on making these changes across the silos and throughout the matrix management structure. Corporate communications and human resources need to be unified so that leaders are effectively trained on how to implement the new media strategies. These communications plans need to be synchronized with the company operations through human resources involvement. Human resources also needs to be at the forefront of implementing the quality program as well as setting quality objectives and making sure all of the corporate areas are aligned with the corporate objectives.

We recommend starting a detailed budget review plan so that the strategic objectives can be authorized by the board of directors and funded fully within the next 90 -150 days.

In order for effective strategic change to take place, there must be a top down commitment from the board of directors to the CEO and then all key managers to focus on implementing and operating the programs and objectives. Employees need to become aware and empowered to help the company reach important quality goals as these are essential to operating a competitive value chain.

We purposefully chose options that are cost effective to implement, yet they require management attention, which is an investment of time and energy.

BHP must exercise corporate leadership as the marketplace and stakeholders demand strategic focus and implementation on the core issues outlined in this analysis.