Australia: Industry Analysis

Industry Analysis

According to the classification by IBISWorld (2020), FMG mainly operates in the industry of iron ore mining in Australia. The main business activities of the industry firms include to extract iron ore and iron ore sands, and to undertaker the beneficiation process. according to IBISWorld (2020), the industry had a total revenue of $83.48 billion in the financial year 2019, with a very high-profit margin of 45.2%. Also, the industry has created over 29,000 employment for the country, particularly in rural and remote areas. Furthermore, the economic importance of the iron ore mining industry is also prominent in Australia's international trade. According to ABS (2020), the export of iron ore and other minerals accounted for approximately 40% of Australia's total export in July 2020. As such, the iron ore mining industry is undoubtedly a pillar industry in the Australian economy. The iron ore mining industry is considered a stable industry with high barriers to entry. However, the industry's revenue is not always stable; it is highly affected by the international price for iron ore, which is heavily affected by the global economy (IBISWorld 2020). For example, in 2015 and 2016 when iron price was low, the industry suffered a contraction (UNCTAD 2015). IBISWorld (2020) suggests that the growth in the industry is closely related to steel production and infrastructure investment in China. However, since China's economic transition in 2016 under Xi's administration, the country has re-focused on environmental production and virtually suppressed the steel production industry by cutting the "excessive production capacity" (Beresford, Pettit & Liu 2011). This factor has been a key reason underlying the industry's slowed-down growth in the past five years. Nonetheless, the iron ore mining industry in Australia is relatively resilient, mainly because of the low extraction costs of Australian iron ore resources and Australia's geographical proximity to main iron ore consuming countries like China and India (Potter et al. 2011). As a result, Australian iron ore mining firms are generally able to leverage on their economies of scale and survive a relative long period of low iron ore price (Stadler et al. 2014).

According to IBISWorld (2020), there are currently 64 businesses in the industry. The market concentration is high, with the largest four mining companies accounting for approximately 87% market share. As indicated by IBISWorld (2020), these four companies (and their market share) are Rio Tinto (33.7%), BHP Billiton (26.3%), Fortescue (15.9%) and Hancock Prospecting (10.9%). Among these four major firms, the former three are listed public companies, while Hancock Prospecting remains a proprietary company. Besides, Rio Tinto and BHP are both multinational companies who have a diverse mining business lines and many international operations. Hancock Prospecting is also moderately diversified as it has also established strong presence in the agricultural sector. In comparison, Fortescue is relatively less diversified in terms of both business lines and geographical presence. Nonetheless, by specializing in iron ore mining, Fortescue could establish a stronger set of industry-specific knowledge.

Company strategy analysis: prepare company brief, outlining the short history, core activities, competitive situation, the markets they operate, major risk factors and how the company respond to them. Please clarify the company's business strategy

Company strategy analysis

Being the third largest iron ore miners in Australia, Fortescue apparently has its own unique corporate strategy that has consistently driven its growth. The company was founded in 2003 by Andrew Forrest who discovered major iron ore deposits in the Pilbara region of Western Australia. although Fortescue's history is not very long, it has become the world's fourth-largest iron ore miner in just 17 years and achieved a revenue over $17.62 billion in FY2020 (FMG 2020). The company currently has headquarters in Perth with over 11,000 employees nationwide.

As mentioned, Fortescue operates in the Australian iron ore mining industry. In Australian, the company faces fierce competition from the other three major competitors, namely Rio Tinto, BHP and Hancock Prospecting. However, in the international iron ore market, Fortescue also faces competition from international mining companies, such as Vale. Major risk factors faced by the company mainly include the highly volatile international price for iron ore, which is largely driven by global economic conditions as well as economic policies of major iron ore-consuming countries like China. The ongoing COVID-19 pandemic has posed significant uncertainty to the company, as the world economy is likely to go deeper into the recession in the next few months, which would further reduce world demand for iron ore and thus driving down iron ore price and the company's revenue (Forster 2020). Another source of risk to Fortescue is the competition from competitors. In the past, when world price for iron ore dropped (such as in 2015 and 2016), the competitors were reluctant to collectively cut their supply; instead, they even increased supply in order to "squeeze out" small competitors out of the market (Chandran 2016). Therefore, in the future, it is likely that major competitors may initiate a price war again, and this would place further pressure on Fortescue's profitability.

To cope with these risk factors, Fortescue's focused on its own businesses, rather than using financial hedging. Fortescue's strategy mainly has two pillars: domestic expansion in mining operations and international development for sales channels. On one hand, since 2003, the company has developed a number of mining operations across Australia through either direct investment, joint venture or licensing. For example, in 2010, the company invested $8.5 billion to expand its Pilbara iron ore operations; in 2013, the company organized a $1.15 billion joint venture with Formosa to develop the FMG Iron Bridge Project; in 2014, the company obtained an exclusive license to explore for minerals within the West Angelas Tenements in Western Australia. Moreover, other than developing its mining capacity, Fortescue has been actively cutting its cost through developing economies of scale by investing in mining infrastructure and national networks, such as power stations and railway infrastructure (IBISWorld 2019).

On the other hand, Fortescue has been forming long-term sales and distribution partnership with international partners to facilitate the sale of its iron ores. For example, in 2009, the company signed an agreement with Hunan Valin Iron and Steel Group, a Chinese Steel production company to improve is sales to China (IBISWorld 2019). Such strategies helped to promote the stability of the company's revenue. However, it must be noted that Fortescue has not yet invested in any mining operations in countries other than Australia. As such, it is clear that the company's strategy has two focuses: increasing specialization and economies of scale domestically, and securing international customers. This means that Fortescue's production activity will be only exposed to risk factors in Australia, while its revenue is exposed to risk factors worldwide.

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