



Vertical Supply Chain

By CK Wong 2006.01.12

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Introduction

A company has to manage the financial in two ways: increase the top line and cut the expense. A technique to cut the expense is to reduce the cost of the material and utility. This is through the methodology of supply chain management. If you could cut the cost of the material, the variable per unit cost can be lowered. It is a very difficult task. To measure the quality of the efficiency of a company, we can examine its supply chain strategy.

In this piece, we are going to examine some of the visible measures Newmont used to control the cost.

Find the leak

To control the cost is just like to find the leak. You have to recognize it as a leak then you can plug it. If you do not believe it is a leak but think it is what it should be. There is nothing you going to do it. A strong management team will not have the ego to accept the status quo and leaves no stone unturned. The blind spot exists and could grow when we stop expanding our vision.

Find the leak is the first step. Plugging it is the second step. It is also not a easy take. The usual barrier is the business boundary and lack of vision.

There is a very vivid example which is a TV advertisement to illustrate finding the leak and stopping it. The scene has a couple in a rolling boat. Suddenly a leak appeared. The man gazing the lady and could not see the leak (blind spot because of distraction). The lady sees it and told the man. The man starts to panic and tries to find something to stop the leak. The lady watches the man search but the situation intensify. So she takes out a tampon and sticks it to the hole. Problem solved.

Newmont

Newmont is a gold and base metal (as a by-product) producer. The first problem to reduce the cost is the raw material. If there is no ore, the cost would mean you have to get it from primary source. You could use the supply contract to control the price but the long run you are in underhand. The important is to find multiple sources. A worldwide location is a good strategy. Of course you have to find high quality mine. Many gold producers have mine at multiple locations.

Mining and refining uses a horrendous amount of energy. When the cheap oil is running out and the oil price has double in 2004, Newmont bought a sizeable stake of Alberta's Canadian Oil Sand Trust. The doubling and tripling in the value adds value to the asset

which reduces the cost of credit. The Canadian Oil Sand Trust also provides an income that could offset the increase in energy cost. Consider the will power to convince the board and shareholder to have a limb out to own unrelated asset is a brave action.

Hedging has been a de facto practice in the gold producer for decade due to the low gold price. You sell the future gold in a higher price for capital reinvestment. Newmont has got out of that mode. Now the company can enjoy the value of every oz it produces. This is call guts.

Other than buying the Canadian Oil Sand Trust, for specific location, Newmont cuts the energy cost directly. Newmont builds a power generator at Nevada to supply its electricity demand. If it builds and runs it by itself, it would be less smart. You do not need to build the in-house expertise; you use the hired gun while you still have the ownership. The power plant is designed with surplus capacity to handle the future demand but could sell the surplus to the neighbor today. It is the same story for the smelters.

Shareholders feel good because the board doing things for the shareholder.

Vertical

To own the company which supplies you along the supply chain is called vertical supply chain management. The car manufacturers started this practice at the beginning of the 20th Century. It peaked at the '70. Then it becomes a squeezing game. You cannot squeeze your own peer so divestiture happens. The divested company merged to avoid the squeeze. The advantages of vertical management and divestiture both disappeared.

Toyota does not do the vertical supply chain management to take advantage of the choice of best supplier. The suppliers do not merge because they are not squeezed but rewarded if their quality meets the standard and keep the price low. The East's philosophy of harmony shares the profit rather than aggressiveness and confrontation has shown a better approach than the West.

Disclaimer

This is not a stock recommendation but an academic discussion.