CORPORATE BIGNESS - OPPORTUNITY OR LIMITATION?

By J.F. Rich

(Mr. Rich, Executive General Manager - Finance of Broken Hill Proprietary Co. Ltd., delivered this address to a luncheon meeting of The Securities Institute of Australia in Sydney on 14 March 1972.)

It is some time now since I accepted your invitation to speak at this luncheon, to the suggested title of:

"Corporate bigness: opportunity or limitation".

The trend of recent events, of course, has had a direct bearing on this subject, but I don't know that there is any great difference in what I propose to say today to what, perhaps, I might have said two or three months ago. On the other hand, every experience yields some lesson for the future, and at BHP, we have certainly been piling up experience in recent years. My talk to you will suggest some of the lessons we have been learning...... learning, some of you may think, the hard way.

Business and economics libraries these days are rich in texts dealing with the big corporation. From Alfred Sloan to Kenneth Galbraith, and a host of others in between, life inside the company and outside has been analysed and dissected, and
heroes and villians created according to whether you have been reading one or the other.

But it seems to me that a whole new relationship is developing between the big corporation and the community it serves, and that the implications of this relationship may have very far-reaching effects. The implications for people in your industry, in particular, may be of vital importance. So let me proceed with my argument.

My first point is that a corporation may often have little option in the matter of whether it becomes big, in relation to the economic environment in which it operates. Bigness is often not a matter of choice, but of necessity.

The classic conglomerate of the United States, that expands sideways because presumably, the Department of Justice discourages it from takeovers in its original industry, is at least acting from some free will. It does not have to grow bigger. It does so because the entrepreneurial spirit creates a desire to expand.

But without any wish at all to become a monopoly as a matter of deliberate intent, many companies in the basic industries and natural resource fields have powerful technological influences at work, driving them into large scale operations in order to achieve reasonable economies of scale.

The metals industries and the heavy chemical industries are cases in point; take steel, for instance, about which I know most. If steel is to remain competitive in price with other alternative materials it will do so largely as a result of economies of scale resulting from very large units of plant. Probably the key to productivity in a steel plant is the blast furnace which produces pig iron and determines the level of steelmaking and thus finished products. Blast furnaces these days are absolute monsters - producing from two to three million tons a year.

If you are thinking of starting a new steel plant on a green fields site, you don't build just one blast furnace. This means that almost the minimum size for an integrated steelworks these days, that is to hold its own in a competitive market, is something in the order of four to six million tons a year in output. In investment terms, this represents something like one thousand million dollars or more, and that is just for starting.

Even in the case of additions to existing steel plants where many of the services required are already available, the cost of new plant is very large. Take, for example, the new No.5 Blast Furnace at Port Kembla which was lit up yesterday at a capital cost of $50 million and a capacity of two million tons of pig iron per annum.

The point I would particularly like to make is that this is the scale that is necessary to provide a competitive industry. Certainly, you can start at a lower level of output; but if you do, you will certainly be establishing a plant that will be inherently uneconomic in world terms, always in need of a tariff or some protection, and never able to export its product in straight competition on world markets.

The pursuit of efficiency, therefore, in the case of most basic material producers, inevitably leads to the corporations concerned becoming big, whether they like it or not. It follows, in fact, that most basic resource companies are big. Many problems flow from that simple fact.

If we lived in a world in which every citizen had the capacity and desire to look at things objectively, perhaps things would be simpler for us as managers. Because, it seems to me, very few people seem to be able to consider corporate dynamics without getting caught up in emotional reactions. Special social pressures are generated. At BHP, for instance, we make no secret of the fact that we think our earning rate is too low. But to say
this publicly is often to be accused of crying poor-mouth, simply because the scale of our operation involves us in dealing in very large figures. Speaking to you, no doubt, I am preaching to the converted.

Because the basic material companies are big, and because they are based on natural resources, they usually find themselves having to accept special conditions in their capital investment policies. The sort of thing I have in mind is the provision of infrastructure facilities at a mine site, or a port, under an agreement with a government or a state authority. Alternatively, the company may have to accept a location which, to put it mildly, is less than optimal by pure management standards.

By reason of their size, and the nature of their operation, the same companies may, and usually do, find themselves involved in special arrangements to establish a labour force....migration agreements, housing, training.......particularly the last-named.

For BHP, because we want a deeper harbour at Port Kembla, (and it is a vital matter to us that we have one there) then it is necessary that we make some substantial contribution to the cost. In fact, we are providing funds to the New South Wales Government for the project, in the form of a loan covering about half the cost. At the mining town of Newman, in the Pilbara, the Mt. Newman partners provide everything including the police station and the kindergarten. The apprentice training shops at our steel plants represent a large investment, and one we have been pleased to make.

At this stage of Australia's development and with such demands on Government spending, there is probably no other way to get these large-scale projects going than by some such form of co-operation between industry on the one hand and governments and the community generally. However, one should keep in mind, that a great many of these facilities provided by industry to the community do not necessarily enhance the balance sheet, and this aspect may have to be given more consideration in the future.

In practice, as a manager of one of these large concerns operating on a big scale because this is the only way you can operate, you may find yourself caught in the classic squeeze. The social restraints to which I have referred may inhibit your freedom to earn a reasonable return on your funds.......or at any rate, what you regard as a reasonable return. You will find yourself urged to maintain employment policies which commit you to some inflexibility, as compared with the smaller workshop or the textile factory down the street. And all the time, on every side, you are being urged to maintain a high rate of investment.

Now it may be possible for a government to put all these notions into an act of parliament establishing a central bank, but you can take it from me that it is pretty difficult to run a business on such principles.

I have already indicated that, in BHP's case, at any rate, bigness is more or less inevitable. The sheer technology of the steel industry means that you either get big or you go under. Perhaps I should say, at this point, that there are many consequent advantages.

I think you would all agree with me that size is an inherent advantage in approaching the capital market. We have recently been able to make a large public loan issue on satisfactory terms, and we have also been able to negotiate private loans overseas. I am sure that size assists us in arranging even short term financing.

Scale of operation and the size of the management pool go hand in hand. BHP in particular has great strength in its professional and management staff, mainly by reason of its long-established training scheme, with the result that we have been able to find people largely from our own organisation to carry through the
considerable expansion plans in which we have been involved. The large company, also, is able to develop a range of management services which benefit its work enormously.

With regard to manpower generally, the large company does not have to regard the existence or otherwise of a source of labour as a fixed constraint. When BHP proved large-scale manganese deposits on Groote Eylandt, the establishment of a whole new society on the island was an inevitable and accepted aspect of the project. When oil exploration in Bass Strait provided promising results, we had to look not only for money, but also for skills of very high order. This sort of thing is done more readily when the scale of the project is large.

International standing is a subtle influence, but one of considerable importance. There is emerging, whether we like it or not, a group of large, multi-national companies whose activities are on a global scale. These organisations readily accept massive commitments, and, to put it bluntly, you have to be in the big league to keep up with them.

Research and development programmes, increasingly, can be supported only by corporations with big budgets available. There was a time when a man could sit in a back room and think, or a lone prospector go out into the bush with a geologist's hammer. Such things are still done, and there will always be a place for individual genius, but it must be said that the advantages are all with the organisation making full use of all the physical sciences, and with access to all the modern equipment.

Overall, then, the marshalling of financial and management resources on a large scale undoubtedly brings benefits in itself. At the same time there are many problems in managing a large organisation, not the least being the danger of bureaucracy centralising decision-making, stifling incentives and depressing innovation and individual enterprise. We are confident that the intelligent use of modern management techniques can overcome these problems. These are problems, the very identification of which, goes far towards solving. That this has been recognised in BHP is evidenced by the almost continuing process of change in our management and organisation over the past five years.

At BHP, we see our role as that of committal to the principle of corporate bigness; it is this thought that has caused the Board to resist suggestions to hive off the oil and gas interests into a separate organisation. Rather, we say that, given that by the end of the century as has been forecast, some 200 multi-national companies will be the most important economic forces in the world we are determined that Australia will have at least one member of that group.

Today, in Australia, we have a special problem, and that is an understanding of the role of profit. The difficulties that arise from this are proving formidable indeed, and now there is a special aspect that gives cause for concern.

There has been a great deal written by sociologists and economists on Australian attitudes to business; history back to the days of the convict colonies, the role of the great shearers' strike, the relatively short duration of our industrial development all these things have been invested with significance. One is less interested in the reason than in the reality; the fact is that it is dangerously easy in Australia to make profit a four-letter word.

You can say that this is simply a matter of public relations, but the chief point I want to make is that it may be much more than that.

In the last two or three years, we have seen a growing willingness on the part of governments to undertake some type of incomes policy with something short of full price control. President Kennedy's confrontation with U.S. Steel some years ago was perhaps
the best publicised model. President Nixon's new economic policy has elements of the same situation in it.

My concern is not so much the very general question of whether incomes policies can be made to work, but rather with the fact that, in practice, it is the large, basic material manufacturer that is expected to become the cornerstone of a system of economic regulation in the community.

In the last few weeks you have seen clearly the contention put to us at BHP that we should hold the line, that we are big enough to hold off increasing prices, that the ordinary rules of commercial behaviour should not be followed.

To a very large extent, this is put to us just because we are big. And quite frankly, as things stand at present, this is an attitude that we find difficult to accept.

The suspicion which appears to surround all profit and which is particularly evident in Australia is greatly magnified if the profit is large. Mere disapproval turns into outraged indignation and there is an immediate demand for controls to limit what is assumed to be exploitation. In many quarters there is a complete unwillingness to recognise that large profits require very large investment of funds. In BHP's case this is certainly true and, although our profit is large in absolute figures, it is certainly not large in relation to the amount of money which has to be invested. This particularly applies to the iron and steelmaking side of our activities which must be recognised as a quite separate segment of our business and one which must stand on its own feet in relation to earnings rate on funds.

Yet, as I said earlier, BHP is expected to act differently to all other companies in Australia, whether large or small. The full impact of economic decisions taken in the community fall with just as much intensity on us as anywhere else - we are just as much affected by wage increases, materials increases, Government and semi-Government charges and the multitude of items incurred in carrying on business. But now it is being argued, in effect, that the ordinary rules do not apply, and that we must play a special part in national economic management at the expense if necessary, of our already low earning rate.

Consider the consequences of persistent low earnings for a company such as BHP. Continued investment must seriously be questioned. It matters little whether the actual investment is from new funds taken from the market, or from retained profits; unless the return is there, the project cannot be justified. We estimate that Australia will need a steel capacity of about 12 million tons per annum by the end of the decade, and that an investment of about one thousand million dollars will be needed to provide this extra capacity. Surely we are not to get to the stage of having Australian manufacturing industry rely on imported steel, because the community will not tolerate the profit margins needed to have the Australian industry develop?

In BHP's case any objection to the size of profits amounts to an objection to the size of the company itself. Certainly, in the Australian context, BHP is a large company but, as I have already explained, the kind of things BHP is doing can only be done by companies with very large resources, both financially and in technological skills. If you look at the large scale mining and industrial developments over the past decade you cannot, of course, fail to see the prominent part played by overseas companies. If you accept that it needs large companies to undertake such developments you must then consider whether it is acceptable that all the big companies in Australia are to be owned overseas.

Whilst BHP is the largest company in Australia and makes the largest profits (in absolute terms), keep in mind that the next five largest profit earners in Australia are all overseas
controlled. It is a peculiar situation that, in knocking BHP our critics are knocking one of the few Australian companies that can compete, in terms of size, with overseas companies who have the technical and financial capacity to undertake major developments in this country.

But there are other consequences: BHP is beneficially owned preponderantly in Australia. Nearly eighty per cent of our 180,000 shareholders own fewer than 500 shares, and of the very large number of shares held by companies, many, if not most, are held by pension funds and life houses. These are the fixed-income groups in the community, by and large, and they can little afford any further inroads into their savings that would be the inevitable result of a sustained pressure on BHP's earnings.

Now, what am I trying to say?

First, we are not claiming exemption from any of the ordinary rules of economic prudence. We do not seek licence to act as though we had only ourselves to think of.

Second, we think that our current reported profit position shows that we have been exercising considerable restraint. We aim to relate our pricing policy strictly to manufacturing costs, and our steel profit has been showing a serious decline, as you all know.

Third, we think that any move to apply an incomes policy approach to particular companies must have social consequences which would make the policy self-defeating. The control of inflation, surely, calls for measures across the whole economic spectrum. If special penalties are placed on the big companies, a whole new set of rules will have to be worked out, both on the stock exchange, and for the community as a whole.

Now let me sum up, and in the course of doing so, put a BHP point of view on bigness.

The basic materials industries, upon which much of our economic development depends, produce many (if not most) of the giant corporations of our day. There are sound technological reasons why this is so, and the bigness is a normal, healthy symptom rather than the effect of anti-social trends or opportunistic monopoly. The bigness that arises in these circumstances provides as many advantages as limitations, when you consider the role that such companies play. And it can be argued that Australia needs at least one entrant in this competition for global importance.

Because these companies are conspicuous there is a tendency to cast them in the role of economic villains in an inflationary situation, although in fact, inflationary pressures are usually more evident in the tertiary sector. If this temptation results in the big resource companies being used as instruments of national economic policy in such a way as to depress profit levels, the consequences must be inequitable to today's investors, and unfortunate for those who have looked forward to tomorrow's development.

At BHP, we hope that this won't happen; indeed, we assume it won't. We can surely offer no better evidence of our faith in this country's future than to undertake the big new expansion programme at our Newcastle Steel Plant, which was recently announced, with confidence that the trading difficulties now facing us are short term in nature and in the belief that in the long term policies of investment discouragement will not be tolerated.

In the longer term, Australia's resource pattern, our social structure, and our place in world markets provide an opportunity in which BHP will continue to play a constructive and imaginative role.