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Tracking the trends 2022

Redefining mining

Deloitte’s Global Energy, Resources & Industrials specialists provide comprehensive, integrated solutions to all segments of the Oil, Gas & Chemicals, Power & Utilities, Mining & Metals, and Industrial Products & Construction sectors by offering clients deep industry knowledge and a global network.

Introduction

Redefining mining

What will successful mining and metals companies look like in a low-carbon, low-waste, purpose-driven future?

The beauty of this question is that there is no definitive answer. While the core objective of the mining industry remains unchanged going forward: to extract and provide metals and minerals to downstream sectors, many of the factors that have influenced how mining companies should look, feel, and act in the past, have shifted in recent years.

The way in which companies fulfil this mission is now open to interpretation. And today, there is a rare opportunity for leaders to reorganize, generate new value, and forge partnerships to create a more responsible and attractive future for the industry.

While some early movers saw the need for change coming 10, 15, even 20 years ago and have been redefining their organizations and operations accordingly, for many firms, the necessity for fundamental change only really hit home in 2020-21. The convergence of factors including the ongoing effects of the COVID-19 pandemic on the world of work, continued drive towards digitization, the growing need to integrate ESG commitments with central business functions, and the need to pivot in response to fast-moving business and operating environments, has opened many choices for companies.

Of course, the biggest underlying driver and opportunity for transformation lies in the green energy transition. The 2021 United Nations Climate Change Conference (COP26) held in Glasgow in November, highlighted the mining industry's integral role in supplying the metals and materials critical for a low-carbon future[1]. The way in which mining companies position themselves today in preparation for this change, will determine their sustainability, and could make or break their competitive advantage over the next decade.

Change on this scale is undoubtably daunting, which is why in this, its 14th year, Tracking the trends has focused on effecting transformation. The following 10 trends provide a toolkit to help mining companies start thinking through, and moving towards, their vision of future success.

In them, our global team of experts share insights and case studies designed to get ideas flowing. We explore how to evolve traditional mining and metals businesses through new business models, capital allocation, agile work practices, and data-driven technologies to create organizations fit for the 21st century; ones that can not only survive but profit from whatever the future might throw at them and leave a positive social impact in their wake.

The next decade will be one of the most exciting and transformative in the mining industry's history. We look forward to discussing the trends with you and supporting your company on its journey. Thank you for your ongoing support.

Endnote:

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Trend 3

Operating in the new super-cycle

Navigating the post-COVID regulatory and tax environment

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For the mining and metals industry, 2021 was defined by soaring commodity prices and the prospect of a new supercycle.

By June 2021, metal prices had risen 72% relative to their pre-pandemic levels,[1] with many, such as aluminum, copper, iron ore and nickel, going on to reach multi-year highs in Q3.[2] Sustained demand for critical metals fueled by the transition to green energy caused a number of analysts to declare the start of a new supercycle—a period where commodity prices rise above their long-term trend for between 10 and 35 years.[3]

This is good news for miners, although it is not without its challenges. With cyclical highs come government demands for a greater share of mineral wealth.[4] As many countries began to recover from recession following COVID-19, the mining industry saw a raft of regulatory measures proposed and imposed for the period from 2020 to 2021, as well as various forms of resource nationalism.

The rise of resource nationalism

Resource nationalism can take many forms—some obvious, others more subtle. Traditional measures range from the expropriation and nationalization of strategic assets to states interjecting in operations by reviewing pre-agreed terms and implementing new forms of taxation.[5]

The direct expropriation of the Kumtor gold mine in Kyrgyzstan from Canada-based Centerra Gold[6] demonstrates how these types of measures can create significant operational risk, as well as financial difficulties. In September 2021, Centerra applied for urgent interim measures in its international arbitration against the government of the Kyrgyz Republic and shareholder Kyrgyzaltyn JSC, citing deviation from the approved mine plan in ways that could cause "irreversible damage".[7]

According to Verisk Maplecroft's 2021 Political Risk Outlook,[8] 34 countries, including key copper producers, such as Zambia and the Democratic Republic of Congo, witnessed a significant increase in risk during 2020 due to resource nationalism.

The firm expects this threat to grow over the next 12 months, with the mining industry bearing the brunt of new measures as governments attempt to recuperate financial losses inflicted by the pandemic.

Roman Webber—Mining & Metals Leader, Deloitte North South Europe: UK, explains, "In the past, resource nationalism has mainly taken the form of direct or indirect expropriation of assets. This time, we're seeing more sophisticated methods, and mineral taxation is one way that host governments are looking to exert more control or gain better returns on their resources."

He continues: "In many cases, the mining sector will be a key source of tax revenues for countries going forward. So, it's unsurprising that we've seen local governments, for example, Chile and Peru are looking to increase tax on these companies specifically."

In Chile, under a proposed bill, investors could face a tax burden of 82% in royalties and taxes on sales exceeding 12,000 tons annually of copper and 50,000 tons per year of lithium, up from 40.3%.[9] Beyond changing tax regimes, we are also seeing other forms of state intervention, such as that currently being debated in Mexico. There, the government is considering legislation that would limit private participation in lithium production[10] but could also be extended into other minerals key to the energy transition. Many of these issues are being driven by concerns around security of supply.

Decisions like these are often driven by politics rather than economics, and the danger is that, if the proposed rates of taxation are too high, or if legislation limits wider industry participation, then they could potentially be counter-productive, lower long-term competitiveness, and limit mining activity in that region or country.

Valeria Vazquez—Mining & Metals, Deloitte Mexico, adds, "Fiscal measures enforced without proper industry consultation could also impact mergers and acquisitions; one of the consequences of elevated risk ratings is that investors will lean toward safer jurisdictions which carry less risk of disruption."

Future tax reforms

An additional challenge is that the international tax system is currently under reform. The OECD estimates that domestic tax-base erosion and profit shifting (BEPS) practices cost countries across the globe US$100-240 billion in lost revenue each year (the equivalent to 4-10% of global corporate income-tax revenue).[11] Developing countries which often have a higher reliance on corporate income tax are disproportionately affected by this.

In October 2021, using the OECD/G20 Inclusive Framework on BEPS, 136 countries and jurisdictions agreed to implement a two-pillar plan to tackle tax avoidance, improve the coherence of international tax rules, ensure a more transparent tax environment, and address the tax challenges arising from the digitalization of the economy. The new minimum corporate tax rate of 15% applied to companies with revenue above EUR750 million (approximately US$873 million) is expected to generate around US$150 billion in additional global tax revenues annually.[12]

Countries are aiming to sign a multilateral convention during 2022, with effective implementation in 2023,[13] and mining companies must be ready for this.

As key players in the green-energy transition, mining and metals organizations must also have one eye on carbon taxes which could increase as countries look to incentivize decarbonization. For example, the South African Carbon Tax, which was introduced in 2019,[14] has proven weighty on mining companies. The first phase only applies to Scope 1 emitters, but the second phase, which is currently under review and will be implemented in 2023, will be more expansive and could include changes to rates and tax-free thresholds.[15]

Vazquez adds: "I think we'll see more of these types of measures introduced as the energy transition accelerates. There will be unpredictable and substantial changes in mineral taxation and/or regulation of assets over the next decade, and mining and metals companies will need to prepare for and adapt to these as best they can."

Future bites

Resource nationalism is borne out of a desire to protect a country's resources through ownership and tax revenues. New models based around circularity could potentially help to overcome this issue.

For example, if a state or nation owns metals as they move through the value chain, and mining and metals companies extract, process, and trade them as a service, then that could help to ease ownership concerns for governments and allow mining companies to be more agile.

It could also lead to greater governance surrounding metal circularity, because the state would be responsible for and incentivized (through royalties or returns) to ensure metals are recycled each time a product comes to the end of its life.

Building flexibility and resilience in the face of regulatory uncertainty

- **Seek partnerships and consultation with authorities:** Many organizations' current relationship with governments and tax authorities is dictated by past experience, whether good or bad. Some companies actively seek to create an open and engaging dialogue with authorities while, for others, a lack of trust is the defining factor in the relationship. Neither approach is right or wrong but, as in so many matters, it is best to have a seat at the table, if not a voice, wherever possible.

  Being part of the consultation process for potential tax reforms brings a level of predictability that will be useful in future strategy development. Greater transparency around tax planning and through public disclosure will also help to build trust where it is lacking.
- **Demonstrate value beyond tax:** Companies should lean on their environmental, social, and governance (ESG) efforts to better explain their value to governments, not just through economic returns but also through environmental and social-impact initiatives.
- **Increase organizational agility:** Even when operating in jurisdictions that have relatively stable fiscal regimes, mining and metals companies need to factor a certain level of flexibility into their strategies so that they can adapt to and take advantage of changes in the political and economic environment.
- **Embed the use of scenarios in strategic planning:** Use long-range scenario planning tools to consider different regulatory regimes in geographies in which you operate and plan for possible responses.
- **Diversify portfolios and supply chains:** Aim to spread investments across jurisdictions with a range of risk ratings to reduce overall exposure to risk.

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