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China's Coal Industry Consolidation: Is Bigger Better?

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It's common knowledge that China's economy is heavily reliant on coal. However the "golden age" of coal business in China is coming to an end. The slowdown of the national economy and sluggish demand, mining overcapacity and expensive transportation, rising labor costs and environmental constraints have led to China's coal industry significant profit decline.

The change of the industry and economic landscape has fostered implementation of structural reforms aimed at industry consolidation. 12^{th} Coal Industry Development Plan suggests promotion of major industry reorganization through coal enterprises' mergers and acquisitions, as well as integration with electricity and heavy (e.g. metallurgical and chemical) industries. According to the plan, by 2015 there should be created 20 large coal groups; average year output of all mining companies should reach at least 1 mln tonnes. These measures are coupled with an ongoing shutdown of small, unlicensed and inefficient operators.

A good example of how coal sector is expected to evolve is Shandong Energy. The new giant coal group was established in 2011 as a merger of 6 local coal companies. Today it has a diversified portfolio dominated by coal mining as a major business and coupled with oil shale extraction, electricity generation, equipment manufacturing and R
D centers. In 2012 it became the largest coal producer in Shandong province, the 7^{th} largest in China and one of Fortune-500.

But is bigger really better? Medium and especially small enterprises are characterized by low cost efficiency, poor safety, outdated technological processes and significant emissions of greenhouse gases and coal particles. On the contrary, bigger companies with longer supply chains and more diversified portfolios benefit from economy of scale, as well as cost and energy efficiency. Unlike small mines they have better access to capital, which allows them to acquire new technologies and equipment in order to make mining safer and more eco-friendly. They can also become new energy innovation centers in China. Finally, they are a lot more competitive in a global coal market than their smaller counterparts.

Industry restructuring however may create a less competitive national coal market and give more power to state-owned majors (SOE). It is not clear how mining giants will deal with inevitable job destruction. It also remains to be seen how they will be affected by the recently proposed economic reforms aimed at SOEs and whether these reforms will result in coal supply disruptions.

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