Goodbye London, hello Gaborone: De Beers sales head to Africa

LONDON (Reuters) - In a spartan office in the London headquarters of De Beers, Elliot Tannenbaum holds a cloudless stone the size and shape of a domino to the light: a rough diamond worth millions, even before it is cut and polished.

Diamond buyer Elliot Tannenbaum, from the Leo Schachter Diamond Group, holds an uncut diamond at a sightholders week at De Beers offices in central London August 29, 2013. REUTERS/Olivia Harris

A veteran diamantaire, Tannenbaum's family firm is one of some 80 buyers handpicked by the diamond giant to buy rough gems from its mines, under an arcane system of pre-determined allocations and regular sales meetings known as "sights".

"I have been coming here some ten times a year for 35 years, I have missed only two or three sights. It is part of our routine," says Tannenbaum, whose Leo Schachter group, founded in New York and now headquartered in Israel, is a major manufacturer of polished diamonds.

But this week's sight is De Beers' last in London. From now on, the action will be in Gaborone, dusty capital of Botswana.

The office allocated to Tannenbaum's firm, his dedicated De Beers contacts and the black-and-yellow attache case stacked with clear plastic bags of diamonds will move south along with the whole of the company's sales operation - 85 out of 300 London-based De Beers employees.

The 2011 decision to move - which will cost more than $120 million, including shiny new offices in Gaborone - follows years of negotiations between Anglo-American-owned De Beers and Botswana, the largest producer of gem diamonds and home to mines like Jwaneng, the world's richest.

The move secured a new 10-year contract for the sorting, valuing and sales of diamonds from the Botswana mines run by Debswana, a 50:50 joint venture between De Beers and the southern African country's government - the longest sales contract agreed to date between the two sides.

It will shift more than $6 billion of annual rough diamond sales from an international financial centre to a comparative backwater with a population of 230,000, in one of the most dramatic examples of a producing country battling successfully to keep value and profits from the raw materials at home.

The change will test Botswana's ability to develop skills and services, lower an unemployment rate stuck at roughly 18 percent and diversify an economy still dependent on diamonds for more than 80 percent of exports.

By separating sales from corporate headquarters, the move is also arguably the biggest challenge De Beers has faced to the way it does business since the current sales model was set up nearly a century ago to secure its then-dominant position.

END OF AN ERA

The shift south, long expected in one form or another, raises practical questions - visa difficulties, a lack of direct flights and suitable hotels - but has also sparked a debate around the future of De Beers and its role in the gem market.

Still the world's largest producer by value, De Beers was taken over by Anglo American in a deal completed last year which bought out the Oppenheimer family, cutting direct links to the dynasty that ran the firm for almost a century.

"It is what you would call the end of an era, but it should not be seen as a negative, it should be seen as the natural progression of the industry," Kieron Hodgson, an equity analyst at Charles Stanley in London.

Others are less sanguine.

"I don't think any of them really want to be (in Gaborone), but they don't have a choice as the diamonds are in the ground there," said RBC Capital Markets analyst Des Kilalea.

"It is akin to saying we won't have an London Metal Exchange, you'll have to go to Chile to get your copper. It is blatantly inefficient - though in terms of politics and development, if I were president I'd do the same."

De Beers has already moved its diamond sorting and aggregation businesses - the operations that sift through the production from each mine and bring the gems together before they are allocated to buyers - to Gaborone.

It has also been supporting cutting and polishing operations by making more diamonds available locally - encouraging international firms like Tannenbaum's to grow there. The Leo Schachter group now employs some 300 people in Botswana.

Slideshow (7 images)

A TIGHT GRIP

De Beers' London sights date back to the 1930s, when it set up what became the Diamond Trading Company to control supply, secure demand and tighten its grip on the market in rough diamonds, of which it held some 80 percent at its peak in the 1980s and 90s.

Gems from all mines were aggregated and quantities for customers were agreed in advance. Buyers were vetted and could not refuse gems in their allocation without risking future supply. In exchange, they were assured a predictable, consistent quality and supply.

Until this month, the London sales meetings were interrupted only by the heavy bombing during the Blitz.

But times have changed. De Beers has been battling lower production and challenges to its sales model for years, in part thanks the collapse of the Soviet Union and the emergence of mines in Australia and Canada outside the firm's influence.

Its share of rough diamond sales dropped to under 50 percent in 2006 and to 37 percent in 2012, according to consultancy Bain. In 2009, it was overtaken in carat terms by Russia's Alrosa.

De Beers says the move to Gaborone was partly motivated by wanting to keep alive the sights system, which still sells to buyers like jewellers Tiffany & Co and China's Chow Tai Fook, and Indian family firms.

"The Botswana government did not come to De Beers and say please transfer your business. The Botswana government said we would like you to sell the Botswana diamonds here," said Varda Shine, who runs De Beers' Global Sightholder Sales.

“We believe our business model is quite strong and provides value for De Beers and its shareholders - so we came up with the idea of moving the whole business.”

But some in the industry say it presents challenges that the model may not survive.

De Beers already sells 10 percent of its production through auction as opposed to via sights, and according to the 2011 deal, the Botswana government will be able to sell a portion of local production through state-owned Okavango that will rise to 15 percent.

De Beers says the auctions provide a guide price for sightholders, but others only see competition.

“There is a direct challenge to the De Beers sightholders system taking place,” says diamond entrepreneur Martin Rapaport, whose own group operates rough and polished diamond tenders.

There are also questions about the wisdom of separating De Beers’ management, which will remain headquartered in London, from its sales and the expertise that has underpinned the group.

“The diamond end of the business is going to become divorced from the corporate end of the business, and the corporate end of the business has already been largely denuded of diamond expertise,” said Brian Menell, whose family sold a stake in the Venetia mine to De Beers a decade ago and now has mining interests across Africa as head of the private Kemet group.

He also pointed out the move brings De Beers closer to just one of its producing nations, which could arguably skew its views. Botswana accounts for almost three-quarters of De Beers production, but it also has mines in Namibia, South Africa and Canada.

ANTWERP, DUBAI, GABORONE?

For its part, Botswana - long hailed as an African success story - is hoping the De Beers shift will help it boost skills and develop as a diamond hub that will attract a growing traffic of buyers across Africa.

While it may never outshine Antwerp, Dubai or Tel Aviv, Gaborone hopes it can carve out its own niche.

Many question whether it can really change the structure of an industry where most of the resources are in Africa but most of the value is generated elsewhere, and whether its strategy is good preparation for life after diamonds, as the mines age.

Thanks to improvements in technology used in cutting and polishing and increased efficiency, Botswana has lowered its costs to compete, for larger stones at least, with India.

But Tannenbaum says productivity still lags behind, making margins difficult for smaller gems, where the cost of cutting and polishing can make up a larger percentage of the final price.

“It will take time for the more difficult material - it took India 40 years,” he said.

The country also still lacks the financial and other infrastructure of, say, Dubai.

Razia Khan, Africa analyst at Standard Chartered in London, said Botswana was being given a golden opportunity.

“The big win for Botswana would be if it could put in place micro level reforms that result in an improvement in the business climate,” Khan said.

“If it doesn’t do that it loses an all-important opportunity to expand its economy, to expand its export base, to provide a driver for GDP growth.”

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