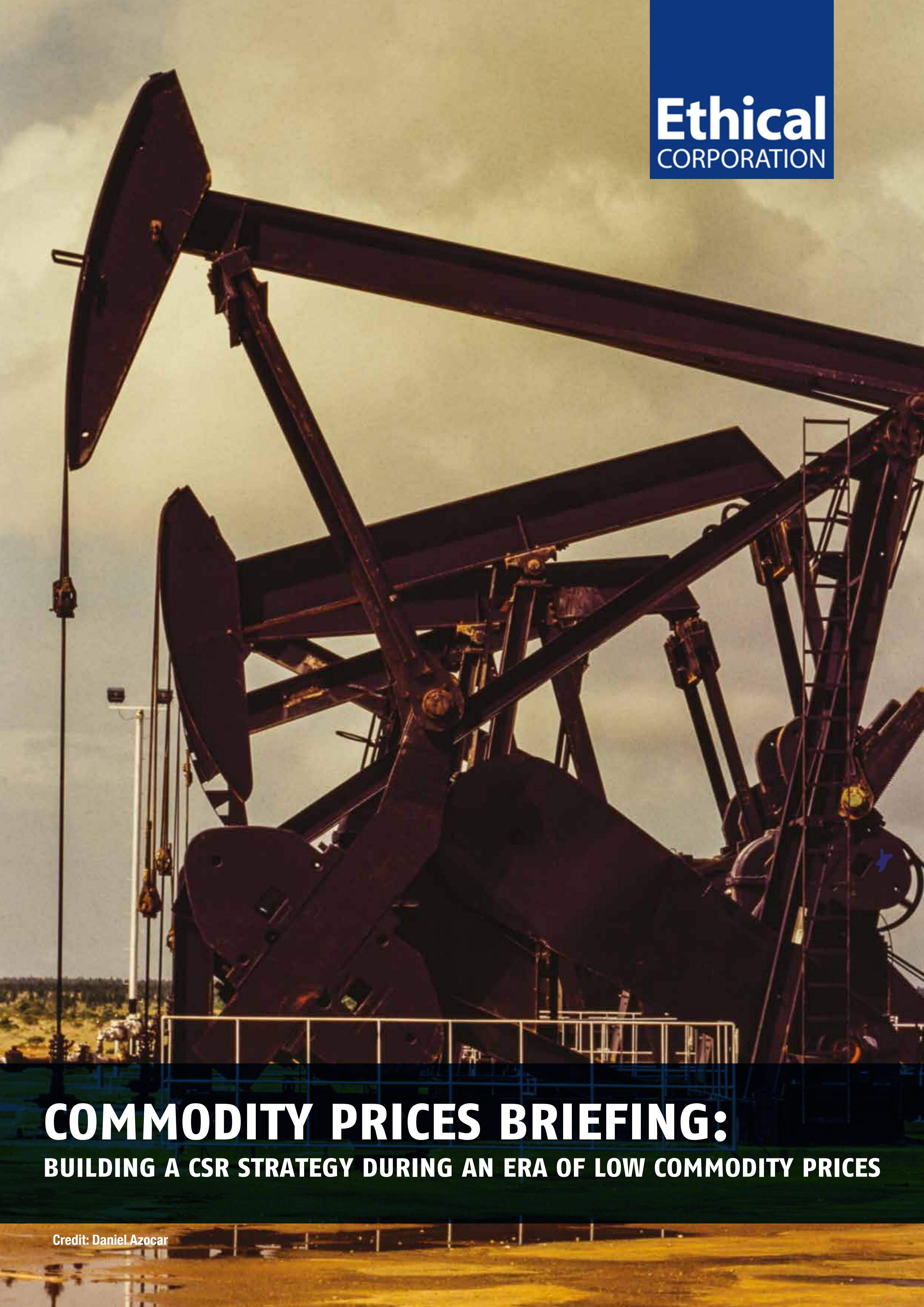


COMMODITY PRICES BRIEFING:

BUILDING A CSR STRATEGY DURING AN ERA OF LOW COMMODITY PRICES

Credit: Daniel Azocar

Credit: Justin Sullivan

Commodity prices raise CSR concerns

By Sam Phipps

Will sharp price falls and squeezed margins in oil and gold affect producers' CSR strategies? The picture is mixed, analysts say, with risk mitigation and resource scarcity still concentrating minds across extractive industries

Corporate social responsibility is integral when predicting and minimizing non-technical risks to extractive operations

By December 2014, oil had hit a five-year low of around $64 a barrel and gold a four-year low of $1,200 an ounce. For crude, this represented a 40% drop since June this year and for the precious metal, a 30% fall in the past three years. The outlook for both commodities remains weak, at least in the medium term, and this is likely to weigh other minerals down too. Morgan Stanley has predicted oil could fall to as low as $43 a barrel in 2015 – this month, the bank cut its average Brent base-case forecast by $28 to $70 per barrel and by $14 to $88 in 2016.

Such predictions raise the question of whether extractives companies are likely to shift their thinking on corporate social responsibility (CSR) issues and perhaps cut budgets. If revenue is falling, the logic goes, savings must be made and CSR could be a prime contender. However, oil and gold executives have told Ethical Corp not only that the industries take a longer term view that builds in varying degrees of resistance to price fluctuations but also that CSR is increasingly embedded at an early stage of planning. Therefore, it has become integral to operations – in some cases.

In other words, CSR is becoming more of a core function than an add-on, particularly for major extractive companies. The need to mitigate non-technical risk will therefore continue to hold sway, albeit on a scale that varies from company to company and sector to sector. In general, smaller companies are seen as more likely to cut CSR spend if prices extend their falls over the coming months. Some freelance consultants have already reported a drop-off in interest.

CSR has become integral to Operational performance | Credit: slovegrove

And the plunge in prices might already be affecting the more traditional philanthropic side of CSR, in the form of lower donations, according to some sources. However, the memory of wild swings in oil and gold prices going back decades will help underpin the broad commitment to CSR, analysts say.

A long term approach to social performance must be adopted

Long view

Tamara Bekefi, founder and principal of Daedalus Strategic Advising, based in Brookline, Massachusetts, says it's impossible to "successfully predict what will happen to [oil and gold] prices".

"Despite all the talk of potential agreement on a climate deal, nobody is saying global oil demand will shrink all of a sudden," she explains, in reference to international climate change talks held in Peru earlier this month and others scheduled for 2015 throughout Europe.

"I would not foresee a big shift based on commodity prices, particularly as more and more companies see many of these CSR measures as risk mitigation on issues such as worker rights, human rights and the environment – it's something they have to do and have to think about as a matter of course.

"They are very unlikely to pull the plug just because oil prices drop for six months. That said, if it was a five-year dip, there might be deeper thinking about where to spend those dollars." But state-run companies that have so far avoided investing heavily in CSR are unlikely to start doing so in the current climate, Bekefi adds, citing a number of Chinese extractive operations in parts of Africa.

"In these cases, the shrinking returns on investment make it hard to justify adopting something outside their norm," she explains. "Yet for others already engaged, including most private companies and certainly majors, it's very expensive to cancel a programme midway: the monetary and reputational cost is high."

Price trends are unpredictable | Credit: Spencer Platt

Likewise, many of the companies most committed to CSR see the clear business rationale. Shrinking margins can serve as an incentive "to do more with less", executives say, and this covers everything from project planning onwards. "It can be hugely expensive to ignore problems that could lead to conflict or stoppages," says Bekefi. "A three-day stoppage caused by community issues, for instance, could cost a company millions of dollars if all upstream and downstream effects are calculated."

Community related delays in production results in $20m per week loss of value

Costs of Company-Community Conflict in the Extractive Sector, a 2014 report by the Corporate Social Responsibility Initiative (CSRI) at Harvard Kennedy School, concluded that the net value of major, world-class mining projects with capital expenditures of between $3bn and $5bn will fall up to $20m for each week of delayed production.

Careful decisions

Silvana Costa, senior advisor, environment and social responsibility at New Gold – which is based in Canada and produces silver and copper as well as gold – says, "Changes in market prices haven't really impacted our social responsibility operational budget. As an intermediate mining company, we've always been very lean, very aware of our resources, and [we] carefully make decisions on expenditures.

"The only area where low metal prices might have a direct impact on our budgets would be the donations or sponsorships budget – those discretionary expenses we make to support local organisations where we operate." But Costa says such spending is only a very small part of the company's social responsibility efforts. "We are aware of our impacts and work to address those and we have to be very careful about how we support communities, in such a way that they keep independent from us," Costa says. "These things are built into our operational programme. We have developed our own community engagement and development standards and the funds necessary to implement these remain in place."

The outcome from climate talks remains uncertain | Credit: Peter Macdiarmid

All of New Gold's sites – it has four producing assets and three development projects in Canada, the US, Australia and Mexico – have to devise their own systems that meet the company's responsibilities: reducing environmental footprint, contributing to community development, ensuring the health and safety of employees and so on. The aim is to standardise the way the company manages its relationships with local communities, and how it contributes to their sustainability, Costa says.

"These standards include several processes such as planning and monitoring, the assignment of roles and responsibilities and making sure people have appropriate training on social responsibility issues."

New Gold's approach to its local community, or First Nations partners, in British Columbia has generated unexpected benefits, Costa says. "The work with indigenous people at our New Afton mine has not only been of value to that operation, [but] it turned out to be a really good investment, because we were able to leverage that work for another project," she says. "We could connect our SSN [Stk'emlúpsemc te Secwépemc Nation] partners with the indigenous groups neighbouring our new project, which is going through permitting right now. They were able to have open discussions and this reference has proven to be a very valuable one for New Gold."

The company has been recognised for excellence in relations with indigenous groups and as an advocate for entrepreneurship and economic development within them, Costa says. "Some mining companies have had serious challenges in permitting mines in First Nations asserted territories in British Columbia. We're very fortunate that we have been able to work through First Nations' concerns and arrive at solutions together. We're a fairly young company and the good reputation built by these efforts is invaluable to us."

This view is backed up by Tam Robert Nguyen, global head of sustainability at Bechtel Corporation. "In ongoing projects, the decline in prices may not have a significant impact especially if CSR-related activities are essential to maintaining positive community relations during construction or operations."

Extractive projects lose millions from delayed production | Credit: mladensky

Under pressure

However, the picture is mixed. Atma Khalsa, environmental and social risk management consultant at Acorn International, based in Jefferson, Massachusetts, says that "in an ideal world" commodity prices would have no effect on CSR spend. The importance of CSR should remain constant irrespective of price, with companies linking outlay to strategic business objectives that are also material to their stakeholders, he says.

"In reality, however, many companies allocate CSR spend on an ad hoc basis because that's what's expected, and for these players CSR spend will likely decrease," Khalsa explains. "Even though an increasing number of companies are integrating non-technical risks early in the planning cycle into pre-investment decision making – and even though CSR issues are gaining more attention with executives and key decision makers – ultimately, potential cost impacts are often dwarfed by economic or geologic factors. But that's to be expected."

Smaller companies, and those closely tied to less economic extractive prospects (ie unconventional plays), are likely to feel the most pressure to cut CSR spending, Khalsa says. "However, I have seen a number of small companies spend quite aggressively on CSR – but these may be outliers." Community investment budgets vary significantly by company, project context (i.e. level of country risk), and the lifecycle stage, Khalsa says.

Exploration budgets tend to be the most volatile given the short-term nature of the activities, whereas projects that are in operation and have a life cycle of 20 to 30 years tend to have a more stable funding. "Nevertheless, the drop in commodity prices will surely put pressure on companies to cut back in all areas, including CSR," Khalsa says.

Christelle Faivre, founder of jobcsr.com and former business development director at Boréalis – which specialises in CSR software for the extractive industry – said many consulting jobs in mining, and more recently oil and gas, had already been cut. "There has been a lot of internal restructuring and a drive to make efficiencies," she says.

A fall in prices will likely decrease spend and many jobs have already been cut

Working with local indigenous people can be good investment | Credit: ClaudineVM

Strategic gap

The need to access resources far outweighs price pressures

One oil executive with 10 years' experience in East Africa says resource scarcity, and the need to drill or mine in places that would previously have been deemed inaccessible or uneconomic (mostly non-OPEC, non-OECD countries), will continue to drive CSR investment.

"It's a case of each barrel counts, rather than any link to the oil price," she says. "CSR has become very important for reputation and social licence to operate. Stakeholders are expecting a lot. That's why my feeling is that majors, in particular, are not going to cut corners on CSR."

The executive believes there should be a greater focus on strategy and alignment. She says, "It's not so much a question of increasing resources but the way CSR is handled. You see managers externalising their relationships with stakeholders but this has to be a top-to-bottom ethos, right through the organisation and culture."

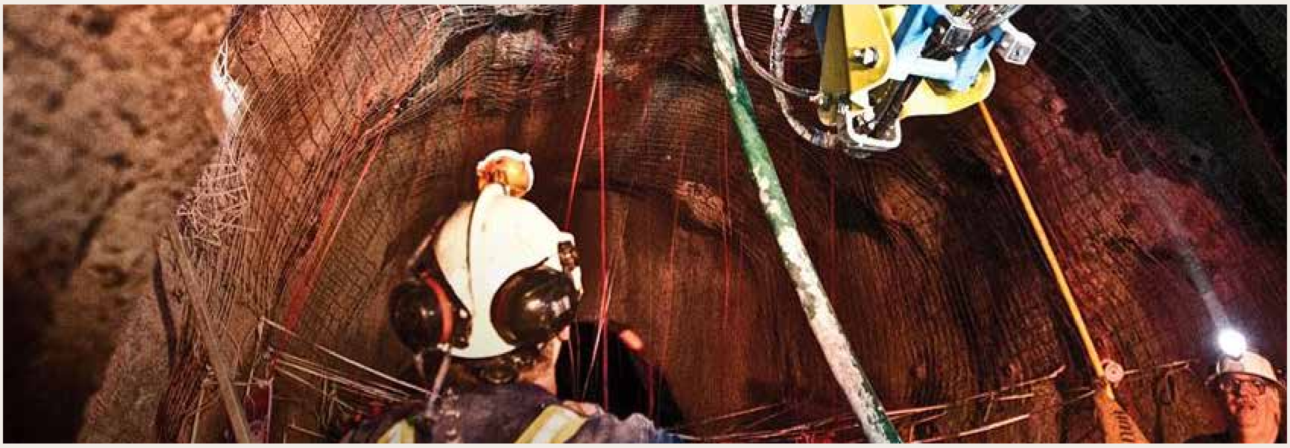
An example, she says, would be the way several oil companies in a particular field often fail to align compensation, which spreads discord and suspicion and a "divide-and-rule" policy within a local community. Or different majors might have different ideas of what constitutes suitable social investment, including local infrastructure: "Sometimes the goal is to buy social peace in the short term by means of a highly visible project, without thinking: what's the exit strategy? How is this sustainable?

"This is an area where CSR is often badly managed – and with a high level of expenditure. But it has to be a non-competitive space because if one company messes up on, say, the environment, or human rights, the whole industry suffers." Extracting with Purpose, a report published by the Shared Value Initiative in October 2014, emphasises this point.

Investing in CSR minimizes the risk of costly disruptions | Credit: chokchaipoomichaiya

"The amount of money spent often serves as the only measure for all parties to value social investments," the report states. "As a result, companies find themselves forced to spend more every year on efforts that may or may not improve the communities and countries in which they operate." In short, margins might be under threat from falling commodity prices but extractive companies can hardly afford to ignore CSR.

Collaborate: The actions of one company can impact the entire industry



23% of employees at The New Afton Mine are indigenous people | Credit: NewGold

Case study 1
New Gold's collaborative approach

New Gold runs the New Afton Mine in Canada, Mesquite in the US, Peak Mines in Australia and Mexico's Cerro San Pedro. It also owns the Rainy River and Blackwater projects in its native Canada, as well as 30% of the El Morro Mine in Chile.

In 2013, the company's revenue was $780m, having produced 397,688 ounces of gold, 85.4m pounds of copper and 1.6m ounces of silver. The New Afton copper-gold mine, in British Columbia, is located within the asserted traditional territories of the Tk'emlúps and Skeetchestn bands. These bands are part of the larger cultural group known as the Secwepemc or Shuswap First Nation.

A participation agreement, signed in 2008 and amended in 2011, ensures preferential treatment for business owners from the bands. Considered best practice in Canada, the agreement guides discussion and provides input and oversight on environmental stewardship, business opportunities, employment, education and training, and socio-economics.

A collaborative, multitiered approach ensures that the communities within the agreement benefit economically, while safe guarding their environmental and cultural interests. To ensure First Nations participation, and provide feedback, an environmental monitoring board made up of First Nations partners and regulators was also established.

New Gold has trained local people to work at New Afton, and currently about 23% of its employees are indigenous people. "We hired a First Nations coordinator to make sure that these conditions would be implemented not just to the letter but also to the spirit/intent," a company spokeswoman says. "We will look for opportunities and solutions to any problems and have brought in a mediator when we needed that third party to assist us to resolve issues."

New Gold regularly provides funding for community groups, as well as scholarships and donations to the Tk'emlúps and Skeetchestn bands.

Source: NewGold

Social risk planning for new operations may pay off | Credit: Muhannad Fala'ah

Casestudy 2
PRE's water shortage solution

Pacific Rubiales Energy (PRE), the largest independent oil and gas exploration and production company in Colombia, has adopted a Shared Value Initiative for water usage. Water shortages are a serious problem in Colombia: the water consumption of its agricultural sector is expected to double between 2008 and 2019. Oil extraction, meanwhile, produces an abundance of water, which comes to the surface with the hydrocarbons and must be separated. The water produced is usually in an unusable state, and disposing of it cheaply, efficiently and responsibly is a real business need.

Traditionally, PRE disposed of residual water through a process of "reinjection" into wells, at an average cost of 22 cents per barrel of water. The company recently developed Agrocascada, an entity to manage its water treatment process. Together with several partners, Agrocascada treats water to a standard at which it can be used safely and productively to irrigate biofuel crops around PRE's operations.

It is estimated that water treated through the programme will cut reinjection costs by more than 20%, or $400m over the next 15 years. The social return is also expected to be significant.

As well as addressing the ongoing water shortages in the south-east plains of Colombia, Agrocascada has the potential to create an estimated 2,000 jobs. Given that most of PRE's operations are in places of water scarcity, this initiative could be scaled to deliver benefits to other agricultural communities.

Source: Shared Value Initiative

The cost of community conflict

The direct cost of community conflict in the extractives industry is high, according to a 2014 report by the Corporate Social Responsibility Initiative (CSRI) at Harvard Kennedy School. One conflict led to stoppages that cost a project $100m in a single year. In another case, a conflict that shut down power lines caused an entire operation to halt at a cost of $750,000 a day.

In the case of initial mineral exploration (early reconnaissance work), interviewees estimated that $10,000 is lost for every day of delay – through lost wages and the costs of maintaining an exploration camp. For advanced exploration, involving drilling and delineation of ore-bearing rocks, up to $50,000 a day can be lost if programmes are placed on standby.

For one company, the working assumption is that 5% of an asset manager's time should be spent managing social risk. Yet for one of its subsidiaries in an African country, it is in fact 10% to 15%, and in one Asia-Pacific country, it is 35% to 50%. Company staff successfully used these figures to make the case to management for upfront social risk planning in a new operation the company was developing in the Middle East and North Africa region.

A former senior manager of one extractives operation estimated he spent only a third of his time "actually doing my job", with the rest spent managing internal staff and external community issues arising from conflict.

Source: Harvard Kennedy School

PQ1: Oil could fall to as low as $43 a barrel in 2015

PQ2: Smaller companies are more likely to cut CSR spend if prices continue to fall

PQ3: State-run companies that have so far avoided investing heavily in CSR are unlikely to start doing so in the current climate

PQ4: A three-day stoppage caused by community issues could cost a company millions of dollars

PQ5: New Gold has been recognised for excellence in relations with indigenous groups

PQ6: The drop in commodity prices will put pressure on companies to cut back in all areas, including CSR

PQ7: CSR has become very important for reputation and social licence to operate

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