Mining Company Investment In Community Social Economic Environmental Development (SEED)

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1. Context

Mining companies are well practiced in analysing the value of capital investments which occur "inside" the mining lease boundary to deliver commodity output, but the case for investment "outside" the fence in community social, economic and environmental development (SEED) is less clear.

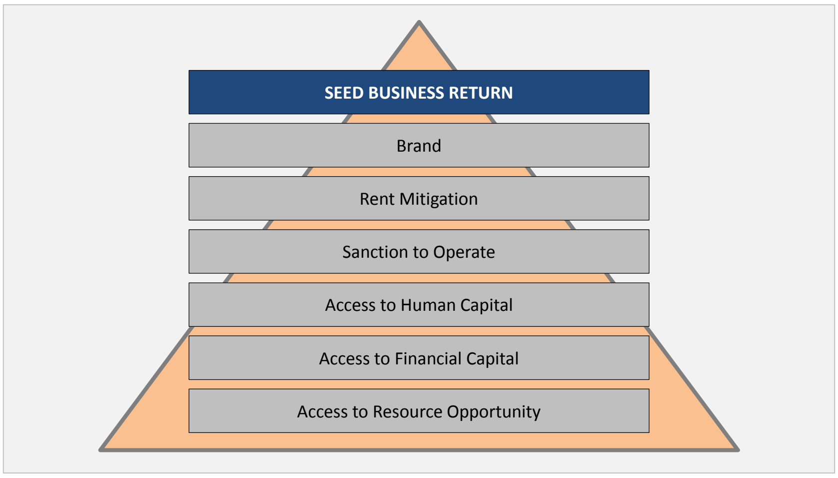
This lack of clarity arises principally from the difficulty in drawing a direct linkage between investment and business return, or where return is clearly envisaged, the inability to practically deliver strategic objectives. Consequently while mining executives intuitively understand the need for SEED investment, they are circumspect about committing to expenditure beyond that which is essentially becomes a sub-component of the public relations strategy.

This paper will argue that, notwithstanding execution risks, SEED expenditure should be treated as a core component of project development investment and that the investment can be rationally analysed in terms of its return.

2. Objectives

The source of business return resulting from effective SEED investment is well founded (Figure 1). In its simplest form, a mining company's most important value creating activity is gain preferential access to high quality resources. If it is not successful in this endeavour, it has no business. Once it has secured resources, it cannot extract foreseen value without access to financial and human capital, and without securing revenue flows by insuring against interruption and unforeseen rent extraction. Effective SEED investment is critical to each of these criteria, as outlined below.

Figure 1: Sources of SEED business return



2.1 Access to Resource Opportunity

Mining company reputation for leadership in SEED will increase access to resource opportunities through several routes. In seeking development partners and in assigning mining leases, Governments will favour companies who can deliver the largest net return in terms of economic and social development to local communities, as delivering these dividends (real and perceived) is the ultimate basis of sustaining their own power.

Junior explorers will also choose development partners which yield the highest return, which in turn is linked to the ability to rapidly achieve government approvals and funding. A leading record with SEED is likely to enhance both of these parameters.

2.2 Access to Financial Capital

Financiers are increasingly applying SEED outcome filters on applications for capital. Sovereign risk is high on the financiers risk agenda for mining projects, and SEED performance is one of the primary levers used to reduce this risk.

Figure 2: NGO's are pressuring financiers for SEED consideration in investment

Banks and finance houses who invest in projects that are seen as detrimental to local SEED objectives are increasingly being targeted by NGO's (Figure 2), risking reputational damage.

2.3 Access to Human Capital

The resources industry is facing a shortage of capability, driven by two important factors. Firstly, the industry curtailed investment in people through the two decades of unattractive returns prior to the early 2000's, and is now in the midst of rapid expansion driven by demand from China. Consequently the existing pipeline of skilled people is inadequate. Secondly, capable people are drawn to industries and businesses which will enhance their own reputation, self-actualization and skill set, which by definition means choosing businesses which have high standing in the community. This cannot be said of Mining in the broadest sense. Therefore, mining companies must not only redress past underinvestment, but they must achieve a reputation in the community which means that they preferentially attract capable people. Leading SEED performance is critical in this respect.

2.4 Sanction to Operate

Governments and local communities which are dissatisfied with a mining companies contribution to, and impact on the local community can, and have, resorted to imposing temporary or permanent closure on projects. Grievances can be real or perceived, and are often wide ranging including, perceptions of economic return, environmental impact, or cultural insensitivity. Even if SEED performance is sound, if community relationships are not built effectively, sanction to operate can be at risk.

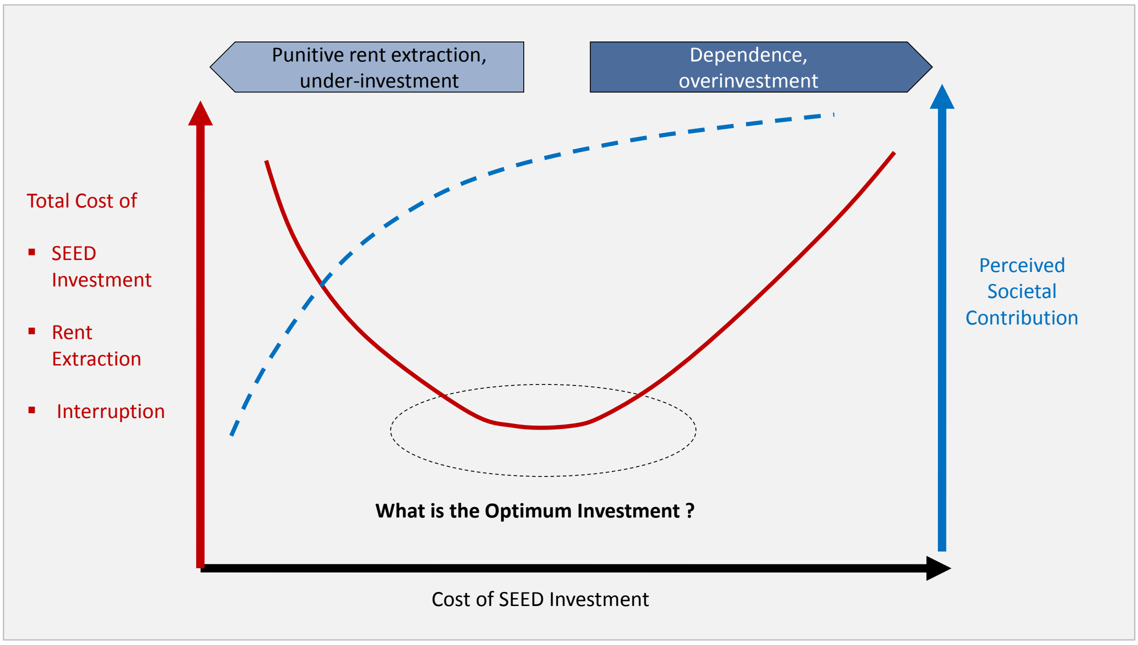
2.5 Rent Mitigation

Rent in the form of royalties, licences, taxes etc. can be decisive in terms of investment decisions. In many respects, certainty of rent extraction is as important as the assumed absolute proportions.

In effect, pro-active SEED investment is a "pre-emptive" form of rent payment. The intent is that by achieving effective outcomes, punitive rent extraction will not be levied as both governments and communities realise the value in mining development partnerships and seek to attract and retain developers through moderating rent extraction. Importantly a track record of SEED performance can reduce rent extraction uncertainty.

Getting the balance right in SEED investment is not easy (Figure 3). Too little, and the consequential societal impact can be seen as insufficient, resulting in putative impost by governments, while too much can result in inefficient dependency where-by governments do not assume their rightful obligations. Getting the balance right between long and short term investment is also important, in particular careful planning of investments in parallel to the life of mine plan. It is also noted that a "Pan state" perspective needs to be taken, as governments and communities are increasingly working together to ensure the same standards and outcomes are achieved across national borders.

Figure 3: Balancing SEED investment



2.6 Brand Capital

Brand is a manifestation of reputation (Figure 4), and reputation translates directly into value through the mechanisms outlined above, not least of which is the contribution to enabling sustained access to resources.

A sustained effective Brand cannot be achieved in mining without demonstrable performance in SEED, where the impacts are real and measurable. However, SEED investment alone is not sufficient, and a company's brand must deliberately be managed.

Figure 4: The importance of brand

Golden Rules

1. If you don't manage your brand someone else will
2. You must deliver to have a sustainable brand, but delivery is not enough

Brand = Reputation

Reputation = Value

3. The Current State

In world class companies there is a strong recognition of the need for a responsible approach to environmental impact and community relationships as a minimal condition for sanction to operate. This recognition drives the typical approach of compliance with statutory and explicit government expectation, coupled with community relations programs.

However, mining companies remain much more cautious about investing broadly to catalyse SEED as a mechanism for delivering competitive advantage through opportunity generation and risk mitigation. This caution is derived from a wide range of factors including:

- The underlying belief that Governments are responsible for SEED, not businesses. If anything this belief has strengthened in decades with the ascendency of free-market approaches in recent decades.
- The propensity for federal governments to increase rent extraction, both in developed and developing countries, irrespective of SEED investment and performance at the local community level. That is, miners are seen as soft target "cash cows".
- The instability of governments in regions where SEED investment is in most need, meaning that sovereign risk is beyond an acceptable base threshold.
- The risk of SEED investment building community dependence, rather than self-sustaining economic and social entities.
- The track poor track record of "planned" approaches to SEED, compared with natural market forces.
- The extractive nature of mining means that NGO's base position is one of negativity, irrespective of positive SEED impact.
- The fundamentally non-sustainability of mining activities.

From an opportunity assessment perspective, mining companies and financial institution still tend to view sovereign risk as more of an absolute than a parameter which can be managed to enhance investment outcomes. Consequently, perceived high risk areas with compelling opportunities tend to be avoided, rather than using SEED as one component of strategy to mitigate risk.

In terms of brand management, some companies bias towards maintaining a low media profile, with the belief that this will minimise the risk of raising unwanted attention. This strategy is losing currency as detractors fill the void left through the "small target strategy".

4. The Case For Change

Pressure is building for a new approach to Social and Economic Development. Companies which take a minimalist approach, and do not embrace thinking through the impact of SEED strategy as a core component of their investment portfolio are likely to lag in future.

Specific drivers for change include:

- **Access to resources in developing world.** Mining companies must go where the economic resources are and, high prospectively very often does not coincide with perceptions of low sovereign risk or with local communities with high levels of economic development. Mining companies which do not build the technical and socio-economic development competencies to profitably develop resources in challenging regions will see their growth stagnate as others who can meet the risk challenges flourish.
- **Increasing "sovereignisation" of resources.** With resources in high demand due to development of China and broad global economic convergence, governments are increasingly exercising their sovereign rights over mineral resources and increasing rent extraction. If resources businesses operate under the simplistic notion that they own the mineral rights, and are not obliged to assume significant responsibility for mineral wealth positively impacting communities, then they will potentially either be excluded from access, or subject to punitive rent extraction.
- **The developed world is no-longer a low sovereign risk refuge.** The strategy of biasing business towards developed nations because of their perceived low sovereign risk is no-longer a valid strategy. Increasingly because of developed world debt, high resource demand and the poor brand perception of resource companies in advanced economies, developed world governments see the resource industry as a high priority target for increased rent extraction and regulation.
- **State backed companies are changing the game.** Companies backed by their governments (in particular China) are playing a different game in securing resources than are the typical large listed Western Companies. These state backed companies are more willing to invest in community projects with the aim of influencing governments to secure access.
- **Societal expectations.** Societal expectation of businesses social responsibilities continues to build. This is evident through the extent of increasing regulation, NGO's activity, and the number of global companies across all industries strengthening their social charters. Progress in SEED performance is an inevitable requirement of resource businesses.

5. A Strategic Framework For SEED

A framework for developing the Mining companies SEED business strategy is outlined in Figure 5, with elements being discussed below.

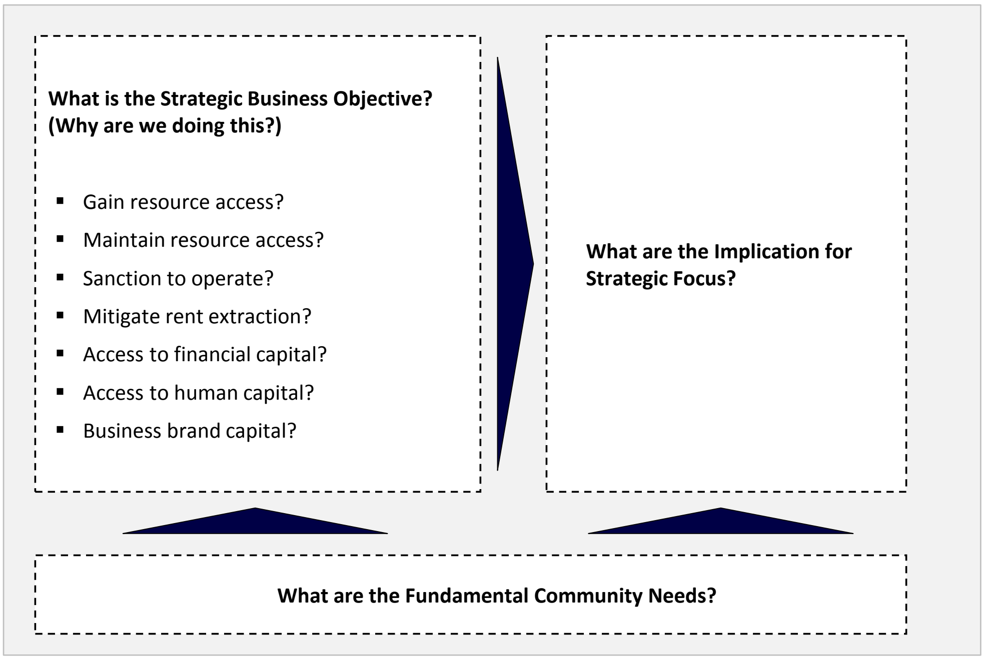
Figure 5: Framework for developing SEED strategy

1. **Define the strategic business objective and scope** of SEED investment
2. **Specify development outcomes** that will ensure the business objectives are achieved
3. **Pre-emptively influence government and communities** to manage expectations
4. **Catalyse partnerships** to deliver SEED outcomes
5. Deliberately leverage and **manage the business brand**
6. **Define an integrated deployment strategy** including mine design, SEED, brand and governance
7. **Deploy the right capability, structure** and necessary capital

5.1 Defining the Strategic Business Objective

This step is focussed on answering the basic question of where the value lies in investing in SEED. That is what is the near and longer term business return in making the investment.

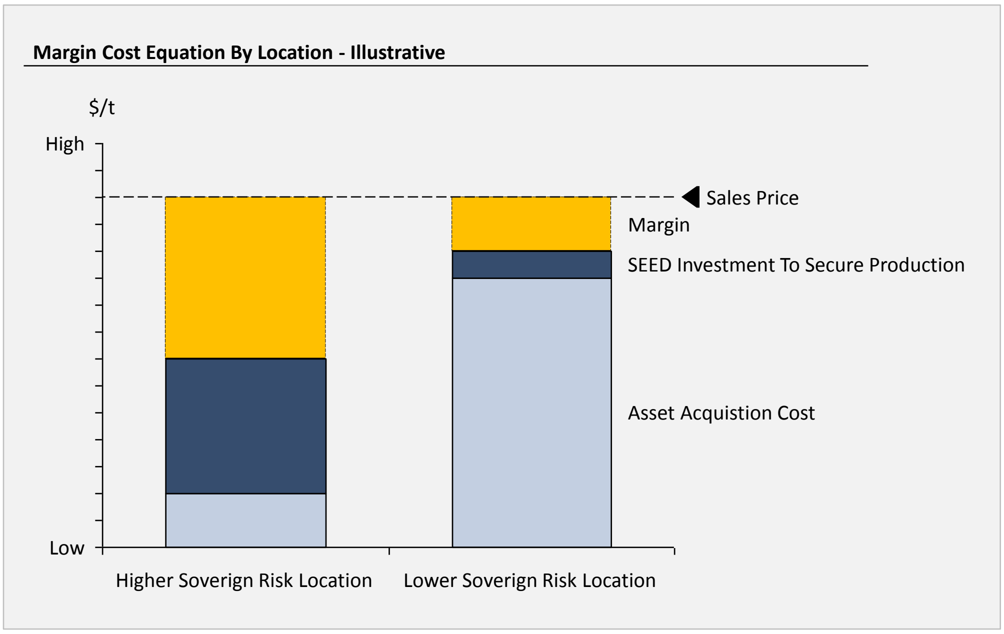
Figure 6: Defining the strategic business objective



The answer to this question will likely lie in the value objectives described in section 2, and will be founded on a deep understanding of the community's current and future needs.

The Strategic Business Objective will likely be directly linked to the relationship between investment capital required to deliver a productive asset (via acquisition or development), sovereign risk, and value potential (Figure 7). Acquisition costs in higher sovereign risk regions tend to be lower and therefore these assets can rightfully sustain a more sophisticated investment approach to SEED as it relates to risk reduction.

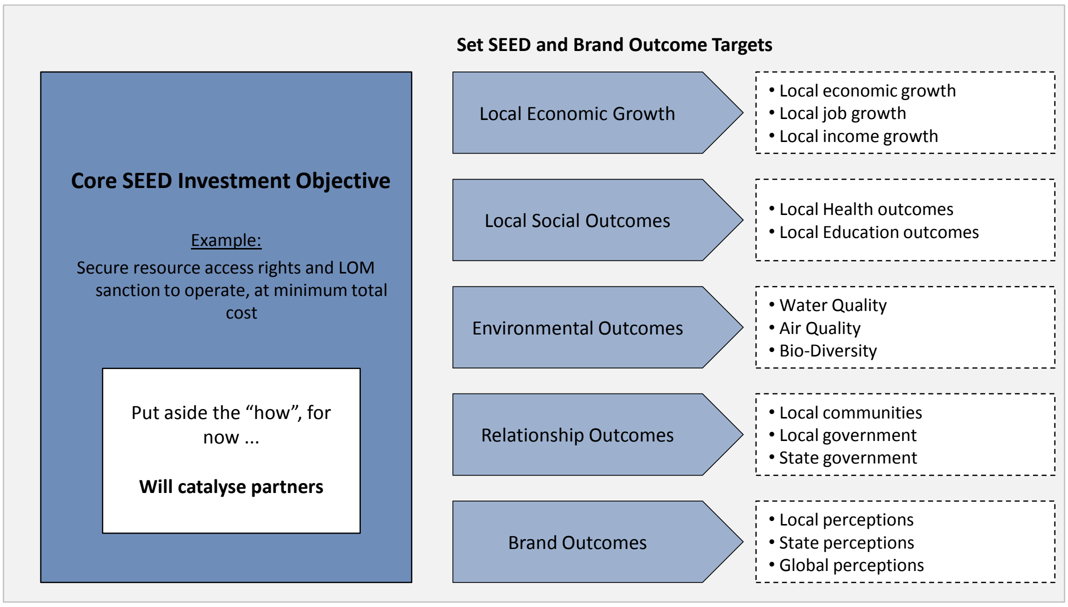
Figure 7: SEED Investment scope depends on profit potential and asset class



5.2 Specify the Development Outcomes

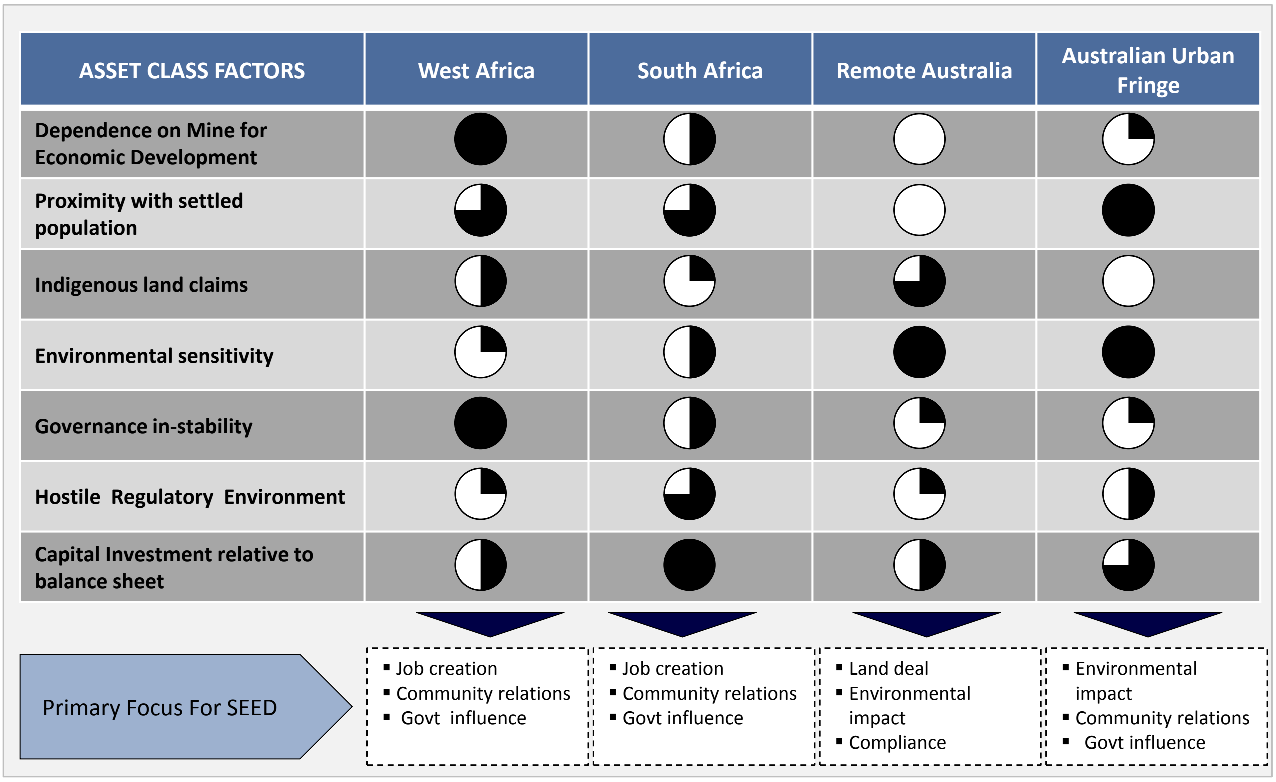
It is important to take an objective driven approach to defining the development outcomes that are most likely to deliver the strategic business outcomes sought (Figure 8). Clearly defining outcomes upfront ensures that development objectives are directly linked to business objectives. It also prevents the development objectives from being constrained by the company's existing internal delivery capability. Delivery is best approached on a partnership basis (refer point 4), and the partnership coalition can be constructed on the basis of the capability required to deliver pre-defined outcomes.

Figure 8: Determine SEED and brand Outcomes that will deliver strategic objectives



The development outcomes chosen will be directly linked to the Asset Class (Figure 9). For example, SEED investment associated with a mine in West Africa in some of the poorest nations in the world would have a primary emphasis on sustainable job creation as a means of wealth creation, and development of strong community relations as one means of mitigating volatile state government control. This can be contrasted with remote Australia, where relatively, the reliance on the individual project for economic development is marginal, and community expectations tend more to a share of wealth generated through land deals, while ensuring strict compliance with environmental expectations.

Figure 9: Asset class and SEED focus



5.3 Pre-emptively influence Government and Communities

Government impact on potential business outcomes is potentially as high as any technical or capability driver, and can be highly unpredictable. For example, it was estimated that the original resource rent tax proposed by Australian Government in mid 2010, would have a value impact in the Australian Iron Ore majors of 10's of billions of dollars and was announced without consultation. In West Africa in 2008, half of Rio Tinto's Simandou lease was rescinded and re-allocated by the Guinean government.

Strong relationships capable of influencing governments, and protecting value positions, can only be built with substantial continuous effort, and should be built well ahead of the project need arising. The need will be ongoing, given the propensity for governments and communities to increase expectations from the most recent benchmarks. It is important that expectations are continuously managed.

One of the key difficulties facing industry in building strong relationships capable of protecting value is the strategic thinking and proactive gaming required to build and leverage the network. Current approaches are typically either reactionary (putting companies on the back foot) or involve random interactions in the hope that this will create a positive outcome when something does go wrong (further reinforcing a reactionary approach). One of the key challenges the industry as a whole is facing is that Governments (and other external stakeholders) are working together and leveraging this united approach with a divided and uncoordinated industry group.

The strength of Government and community relationships can rightfully be considered a competitive advantage, given the lead time required for development, the intricacies of networks, and the non-transferability of relationships. That is it is a capability not readily replicated.

5.4 Catalyse Partnerships

The case for using partnerships to catalyse social and economic development, as opposed to the mining corporation developing and managing programs in house is compelling.

- Partnerships will enable expansion of the **vision and ambition**. For example, the mining company will tend to set modest job growth targets it knows it can deliver, not the objective targets the local community required.
- The challenges faced in creating sustainable economic growth are more complex than any of the technical mining challenges faced given their unbounded nature. Meeting these challenges will require step change **innovation**. Innovation occurs most effectively across functional and corporate boundaries, suggesting partnerships should be leveraged.
- SEED impact requires a high level **specialist capability**. This is not a core competency in large mining corporations, which are mostly oriented towards operating excellence in their field. The level of specialist capability required to develop the policies, initiatives and businesses to drive economic growth outside the mining operation, will not normally reside within the organisation.
- Partnerships can expand both the **funding** pool, and limit the risk associated with individual participant investments. International aid capital is not in short supply for effective programs, particularly in poor countries.
- Using partnerships in the development process to assist in **capacity building**. This is a key ingredient of sustainability, and is a typical requirement in developing country mining charters.
- One of the greatest risks in mining companies engaging in SEED program is the development of a dependence culture. Partnerships are one means of mitigating this undesirable outcome, and in providing an early mechanism for the **transfer of accountability** to the state and broader community.
- The track record of highly planned and controlled interventions in the broader economic and social fabric is not good. The **natural "economic and social ecosystem"** should be as far as possible leveraged in any programs, which necessitates the adoption of partnerships.

5.5 Leverage the Business Brand

The mining companies Brand is its reputation. It is the perception that others have of the business in respect of how they see the company behaving in certain circumstances. In turn, it will determine how others act towards the mining company under certain circumstances. In this respect brand perception is in fact reality.

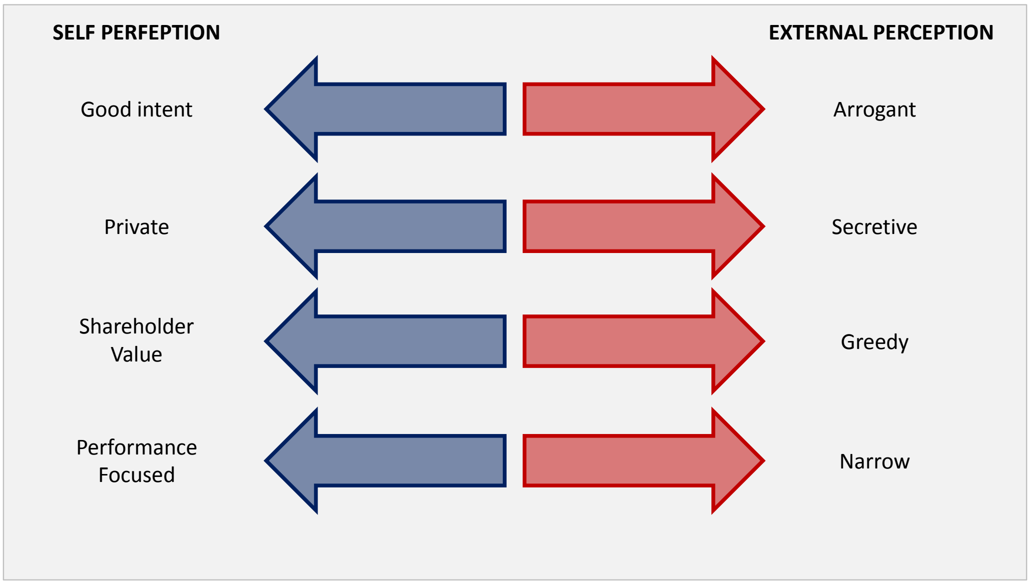
Brand perceptions will determine whether governments act supportively or punitively, it will determine whether investors feel confident in allocating funds, it will determine whether capable people join or not, it will determine if exploration companies give preferential access to resources in development deals. That is, brand = reputation = value.

Effective performance is a pre-requisite to a valuable brand, but its not sufficient. There are many organisations which deliberately focus on brand building but avoid the investments required for effective real performance. While such reputations built on fragile foundations may not last, they will in-fact deprive the organisation who performs well, but which keeps a low profile, of brand capital.

Good businesses need to deliberately leverage as much reputation value as possible from its SEED initiatives. This process should be designed as an integrate part of programs, and not as a consequential event. This will shape how the mining corporation seeking to maximise brand capital constructs the partnerships used to catalyse and progress development.

Maintaining a low profile is not an answer, it creates a vacuum, and nature abhors a vacuum, creating only suspicion (Figure 10). At an industry level, the Australian mining industry and the proposed resource rent tax in 2010 is a good example of underinvestment in brand. Perhaps if the industry had created a more visible profile in the populous Eastern States, based on its value contribution to society, then the Government of the day would not have felt that it could have introduced the proposed tax and sell it to the public using the argument that the mining industry is not "paying its way".

Figure 10: Potential Reputational Result of Maintaining A Low Profile



5.6 Integrated Deployment Strategy

For the SEED strategy to be effective, its design and deployment plan must be both comprehensive and integrated.

Key dimensions which would ideally be directly considered and addressed in the SEED strategy would include:

- **Influencing change in regulations** to promote industry best practice, while aligning internal governance systems to exceed both government expectations and competitor performance.
- Using **integrated mine design** to achieve step change improvement in productivity, environmental impact, and local economic development outcomes. It is believed that the most sustainable outcomes will be those that embrace (not eschew) high levels of technology minimising mine footprint and direct labour, while promoting sustainable economic growth beyond the core production process.
- **Catalysing economic development** for community to achieve self-sufficiency beyond the mine. This will mitigate security risk, and re-enforce company “bona fides” as a preferred operator.

- Enable the **community to take accountability** for developing its economic and social infrastructure, through catalysing strategy and capability, while building deep trust between the corporation and community.
- Adhering to **statutory regulations**, while achieving step change improvement in **community and environmental impact** as part of driving operations productivity.
- **Addressing environmental legacy** issues as part of economic development and productivity initiatives.
- Developing **company and community capability** to deliver strategic, operational and collaborative objectives.
- Ensuring that strategies are achieving the intended **quality of life outcomes**, which is an ultimate measure of success
- Ensuring the corporation attains **recognition** as a pre-eminent mining company, based on its leading impact on the local community's socio economic environment and quality of life.

5.7 Capability

Conceiving the SEED strategy at a level that adds real strategic value, and managing implementation which involves a wide range of external partnerships is very complex work. In terms of Jacques' levels, this is solid level 7/6 work, and likely to be well beyond the level at which it is allocated in the typical Mining Corporation hierarchy (normally level 4, or even 3 within a broad 4 domain). The complexity of the work is also very often compounded by the lack of a clear corporate business model in terms of how it will use SEED as a core component in its strategy, and in particular, what role it will take in seeking to influence societal development as part of its business strategy. Resolving this challenge is level 7 work.

Figure 11: Levels of Work

VII (> 20 years)	I get work done through framing / influencing the fit between the corporation and the world
VI (20 years)	I get work done through capturing external variables and introducing them into the corporation
V (10 years)	I get work done through framing the industry and asset game
IV (5 years)	I get work done through leveraging other peoples' ideas
III (3 years)	I get work done through leveraging systems
II (1 year)	I get work done through other people
I (3 months)	I do work

In addition to the complexity challenge the nature of the specialist work involved in SEED, is very different from the operating core-competency which dominates most large mining corporations.

The twin challenges of complexity and speciality suggest that approaches beyond the currently typical structures where single point hierarchical accountability for operations dominates. Consideration should be given to:

- Using the most senior executive team to collectively develop the SEED strategy, rather than delegating to a single ExCo member.
- Adopting a board structure, combining mining corporation executives and external people of high level capability and requisite experience to direct this strategy.
- At an operational level potentially separating the accountabilities for operations, and community economic and social development, taking single point accountability to a higher level.
- Adopting more flexible approaches to inject specialist capability in to the development and execution of strategy. Most of the most suitable people will probably not be willing to accept the traditional hierarchical fixed salary employment conditions.
- Architecting knowledge hubs which cross organisational, geographic, and external boundaries.
- Using open systems and partnerships to continuously inject new thinking.

6. Questions and Uncertainties

While the case for investment focus in SEED is compelling, the pathway has been characterised by interventions not meeting initial expectations. There are important outstanding questions that require ongoing thought and consideration which could have a significant impact on future success in this domain. Some of these questions include:

- To what extent is the "Western Worlds" perspective on governance constraining potential approaches that could accelerate development of mineral resources and sustainable economic growth?
- What are we doing differently to ensure the failures of the past do not repeat, in particular, creation of dependency and failure of economic development programs to be sustainable?
- How can we better catalyse and leverage the natural economic and social economic eco-system to do its work, and not be overly deterministic in designing programs?
- How can we best build partnerships where incentives are mutually re-enforcing?
- What will it take for mining companies to move from a reactive stance in Social and Economic Development, to one where this is seen as a core leverage point in gaining preferential sustained access to high quality resources?
- How should technology to reduce labour be adopted in developing countries where job creation is paramount?
- At what point does a political instability, and disconnect of ruling parties with the welfare of their people, render SEED investment to minimise risk ineffective?
- What tools can be used to more clearly define and value risk mitigation through SEED investment?

7. Conclusion

This paper makes the case that the basic resource company business equation of needing to access high quality resources at reasonable rent, demands greater emphasis on Social and Economic Development strategies. Furthermore to conceive and implement these strategies, new business models and approached to capability will likely be required.

It is recognised that success in this path of successfully influencing societal and economic outcomes to underpin resource access is variable and uncertain. It is also noted that this form of uncertain is nearly always present when the rewards are the largest.

8. To Learn More

To learn more about how SEED could transform your organisation, please contact any one of the following VCI Global Partners:

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