

Extracting with Purpose

Creating Shared Value in the Oil and Gas
and Mining Sectors' Companies and Communities

EXECUTIVE SUMMARY

FOREWORD BY MICHAEL E. PORTER



ABOUT THE SHARED VALUE INITIATIVE

The Shared Value Initiative is a global community of practice to drive adoption and implementation of shared value strategies among leading companies, civil society, and government organizations. Operated by FSG with support from a network of funders, the Shared Value Initiative works with partners to curate sharedvalue.org, develops tools to guide shared value implementation, convenes practitioners to promote best practices, and expands the network of Affiliated Professional Services firms that aim to provide customized shared value strategy and support. Join the community at sharedvalue.org.



ABOUT FSG

FSG is a nonprofit consulting firm specializing in strategy, evaluation, and research. Our international teams work across all sectors by partnering with corporations, foundations, school systems, nonprofits, and governments in every region of the globe. Our goal is to help companies and organizations—individually and collectively—achieve greater social change. Working with many of the world's leading corporations, nonprofit organizations, and charitable foundations, FSG has completed more than 600 consulting engagements around the world, produced dozens of research reports, published influential articles in Harvard Business Review and Stanford Social Innovation Review, and has been featured in The New York Times, Wall Street Journal, Economist, Financial Times, BusinessWeek, Fast Company, Forbes, and on NPR, amongst others. Learn more about FSG at www.fsg.org.

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Foreword:

BY PROFESSOR MICHAEL E. PORTER

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Extractives companies are a major source of income and economic growth. Oil and gas and mining operators, suppliers, and related supporting industries represent an estimated five percent of global gross domestic product. Three of the world's ten largest companies are extractives companies. Although companies in this sector have had a decidedly mixed record on social and environmental issues, they have helped create more vibrant economic development, new businesses, new jobs and opportunities for professional growth, reductions in the disease burden, and more effective government. Close to four million people are employed by mining companies alone.

While the mining and oil and gas sectors differ in terms of their products and to some extent operations, their upstream activities – the focus of this report – face similar on-the-ground realities. Reserves are often found in remote areas with limited economic activity and major societal needs. Operations require massive inflows of capital that often dwarf local economies. Both sectors have a long-term horizon, with reserves depleted over several decades. Companies and suppliers inevitably have multiple points of interaction with local communities.

Yet the huge economic output of the extractives sectors, valued at \$3.5 trillion in 2012, has not always translated into improved social and environmental outcomes for the countries and communities where these companies operate. Among nations that depend most heavily on minerals and fuels, only two rank among the top 50 countries globally in the United Nations Development Program's Human Development Index (HDI). Nigeria is emblematic of this missed opportunity. Despite the

presence of major oil companies in Nigeria since the early 20th century, the country still ranks among the bottom 20 percent of countries in the HDI and its GDP per capita was 180th in the world in 2013.*

Extractives companies today are losing billions to community strife despite extensive community relations programs. In Nigeria, community disruptions to pipelines lowered oil production by 18 percent between 2005 and 2008. Strikes at platinum mines in South Africa in 2012 caused production to drop by 12 percent of the total annual global supply. New data from the International Council on Mining and Metals shows that reported conflicts with communities are increasing.

Companies have large community relations groups and sophisticated manuals for stakeholder engagement and impact mitigation. Yet the norm is to respond to conflicts by focusing on the visible causes of tension – protests, permit delays, negative media coverage, and demands from local influencers – so-called non-technical risk. Companies spend hundreds of millions on social

* On a purchasing power parity basis.

investment projects even though research shows little correlation between the amount of money spent and the success of company-community relations. Investments based on community wish lists and attempts to placate the loudest voices in a community have led to ever-shifting community requests, unilateral projects that have little impact, prioritizing image over outcomes, and missed opportunities for business and community alignment. Companies track dollars disbursed rather than societal outcomes. A “non-technical risk management approach,” the prevailing one in this field, is not an effective long-term community engagement strategy, nor does it deliver meaningful societal outcomes.

Aligning the business interests of extractives companies with community needs and priorities is the only real solution for companies and communities alike. The root causes of community strife are lack of economic opportunity, poor health, lack of effective local or national governments, and environmental degradation. These issues are fundamental to business success due in part to the very long time horizons of oil and gas and mining operations and the deficits in the regions where these companies operate. Companies must tie community prosperity to the present long-term needs of the business in areas such as a qualified labor pool, capable suppliers, and well-functioning community infrastructure.

This report offers a vision for extractives companies to approach communities based on **shared value**. Since the release of the article “Creating Shared Value” in *Harvard Business Review* in January 2011, companies in many industries are moving away from old mindsets that view social problems purely as risks. Few sectors have a more urgent need to recast a short-term community risk mindset into a shared value model. Maintaining the *status quo* is no longer an option as protests and disruptions mount, companies move into ever more remote locations, and governments seek partners with a shared value mindset with which to develop resources.

This report reviews the success of existing practices and describes why shared value is an imperative for extractives companies. It offers a blueprint for shared value in the sectors and ways that governments, local and international NGOs, and industry associations can accelerate long-term social outcome improvements

in the locations where resources are extracted. Some companies are already moving in this direction, and their examples are shared in this report. Obstacles to shared value, such as the legacy organizational structures and prevailing cultures in extractives companies, are described, as are ways to tackle them.

This study also enriches the concept of shared value. Although the end products are commodities and depleting natural resources and depending on fossil fuels are not sustainable strategies, extractives firms have clear shared value opportunities in the value chain through strengthening the workforce and improving the utilization of water, energy, and other resources in operations. Also, while their end products are commodities with limited local needs, extractives companies also produce intermediate products of extraction, such as drinking or irrigation water and electricity, that can be provided to the local community and can create enormous shared value, especially in remote regions.

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We find extractives companies moving to create shared value in two different ways. One is initiatives directly related to the companies’ businesses. BP’s enterprise development program, featured in the report, is a good example. However, we also see companies, in collaboration with others, playing critical roles in broad-based economic and community development. Many of the shared value investments relevant for extractives are more indirect and longer-term than in other sectors we have examined, and reflect the remote regions and very long time horizons of investments in these fields. Chevron’s Foundation for Partnership Initiatives in the Niger Delta is emblematic. The way in which leading extractives companies have approached these broadly

based investments carries important lessons for other sectors such as agriculture and telecommunications that are seeking to compete in frontier economies.

Aligning the business interests of extractives companies with community needs and priorities is the only real solution for companies and communities alike.

This report points the way toward a better future. Shared value cannot substitute for shoddy operational performance, environmental damage, or poor ethics, but it offers a shift in purpose for these companies in the places where the resources are extracted. When extractive companies take a shared value perspective, they are producing more than just oil, gas or minerals. They produce new businesses, more vibrant economic development, new opportunities for professional growth, reductions in the disease burden, and more effective government to facilitate the long-term development of the community in which the company operates.

It is becoming clear that some extractives companies are now recognizing that shared value is the next competitive advantage. Technical skills in project planning, exploration, and production are becoming table stakes. Companies that can develop unique strategies in creating shared value will become the partners of choice in the extractives sectors. We see a world in which competition in extractives will be increasingly determined by the ability to integrate economic and social factors.

This report is one of a series of studies examining shared value opportunities in particular sectors. The aim is to deepen the understanding of shared value for companies as well as their partners, including government, nongovernmental organizations, and other stakeholders. We hope this report will inform and trigger a new era of societal impact by the extractives sectors, and offer new perspectives for government and community organizations that will amplify their impact.

Executive Summary

The Case for Shared Value

This report highlights how companies in the oil and gas as well as mining and minerals fields can create shared value by pursuing opportunities that tie business success to the prosperity of host communities and countries, often working in collaboration with governments, multilateral institutions, nonprofit organizations, and even competitors. While the sectors' downstreamⁱ products and services create tremendous benefits for society, this report focuses on the upstream – the activities related to extraction – area of the business. This is an important area to investigate due to the magnitude of the opportunities for both business and society and the history of adversarial relationships that exists among companies, host communities and countries, and other stakeholders. For extractives companies, addressing this dynamic and becoming governments' and communities' partner of choice – for extraction and for societal development – will be the next competitive advantage.

Creating shared value in the extractives sectors is not a new concept, but current practices fall short of potential, and few companies have overarching shared value strategies. Even among the more enlightened companies, project execution is inconsistent. Companies need to change the existing mindset that sees projects in local communities only as a cost to the business. Rather, companies can start from the premise that there is real business value in solving societal needs. Otherwise, there is an immense opportunity lost – for both extractives companies and society.

Adopting shared value strategies in the sectors is challenging, and this report acknowledges several reasons for that. Change will take time and require stakeholders to reimagine how companies can generate value beyond what they extract. But the opportunity to raise millions out of poverty around the world while overcoming one of the biggest barriers to companies' economic success is too great to ignore.

Context

The stakes of strengthening the links between business and societal outcomes are rising. Extractives companies operate in some of the most underdeveloped regions on earth. Nearly 80 percent of countries whose economies depend on extractives operations have per capita income levels below the global average. Many of these nations also face significant challenges in health, education, economic development, and basic infrastructure. The extractives sectors are a critical source for economic and social development in many of these countries. Yet countries and communities have failed to fully capitalize on the societal opportunities created by the presence of oil and gas or mining companies. Among the 25 countries that depend most heavily on mineral and fuel production, only two – Brunei and Qatar – rank among the top-50 countries globally in the United Nations Development Program's Human Development Index.¹ This is critical: for some host countries, there is

i There is opportunity to continue to innovate and create shared value throughout the downstream activities of the industry, and many societal needs are associated with downstream products (e.g., access to energy, renewable energy). The focus of this report, however, is on upstream activities – that is, those that take place at or near the point of extraction.

ii United Nations Development Program. International Human Development Indicators. March 14, 2013. <http://hdr.undp.org/en/countries> (accessed May 10, 2014); Haglund, Dan. Blessing or curse? The rise of mineral dependence among low- and middle-income countries. Oxford Policy Management, 2011.

no path to development that does not involve leveraging the extractives sectors' contributions.

This failure to build human capital creates real business costs, some obvious (e.g., conflicts with local communities that see no benefits from resource extraction) and some subtler (e.g., the added costs of sourcing goods and services from uncompetitive local suppliers, employing an expatriate workforce at a premium due to lack of local talent). The lack of development in poor countries is not the sole responsibility of the sectors. As companies look to expand to more remote and underdeveloped areas, however, finding a way to improve dynamics between companies and host communities and nations has become a business imperative. Doing so is critical to mitigate risks and improve operational efficiency. Moreover, as technology becomes less of a differentiator among companies in the sectors, demonstrating the ability to address societal issues to host governments and communities will be critical to securing concessions.

Companies operate in extremely complex environments where many decisions involve tradeoffs among competing interests. They understand the importance of relations with host governments and communities. During the last several decades, many have invested in gaining a better understanding of the negative impact of their operations and improving both their and the host governments' abilities to address societal issues. They have invested in social and environmental engagement, developing toolkits, guidance, and processes to help improve

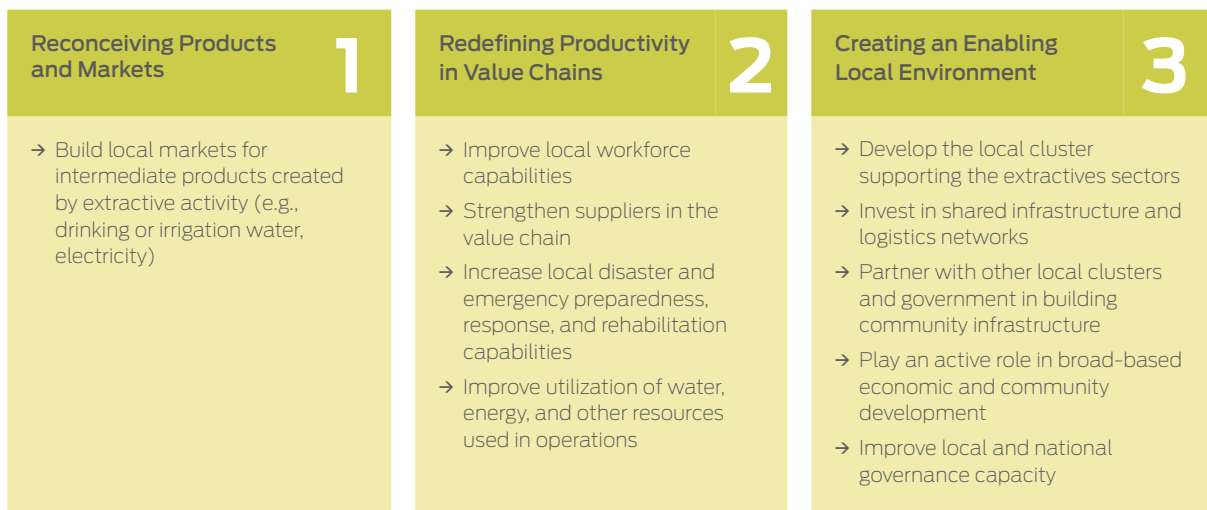
societal outcomes, prevent human rights violations, and improve accountability and revenue transparency. They have adopted performance standards on social and environmental issues with the aim of preventing harm in communities and countries with extractives operations.

Despite these investments, the relationship between companies and host nations and communities where companies extract subsoil assets is often transactional, if not adversarial. It typically focuses on what companies spend philanthropically and pay in taxes and revenue sharing in exchange for extracting resources. Companies react to community demands through social investments in attempts to secure company acceptance with little emphasis on delivering or measuring societal outcomes. The amount of money spent often serves as the only measure for all parties to value social investments. 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.

Shared value – defined as policies and activities that measurably improve socio-economic outcomes and improve related core business performance (e.g., decreased operational costs, enhanced productivity, and / or a predictable and stable business environment) – establishes a framework for identifying opportunities to address societal issues and deliver real business value.

Some extractives companies are already experimenting with a variety of shared value initiatives along the three levels of shared value. See chart below.

LEVELS OF SHARED VALUE CREATION FOR EXTRACTIVES COMPANIES



The menu of possibilities is substantial, and examples of success in creating shared value initiatives exist. Few companies, however, are developing company-wide shared value strategies. Most efforts are one-off projects that emerge serendipitously or through the dedicated efforts of a handful of individuals. Several obstacles are deterring companies from adopting shared value more explicitly as a strategy.

Overcoming the Obstacles to Creating Shared Value

Research for this report uncovered four critical challenges that impede the development of shared value strategies in the extractives sectors. Finding opportunities and implementing shared value strategies consistently hinges on commitment from companies and other stakeholders to overcoming these challenges via:

- **Removing Internal Barriers:** Companies have built-in organizational barriers that prevent shared value creation. These barriers manifest themselves in limited understanding of societal issues across the business and a lack of skills to address these issues, a perceived lack of rigor and measurement in social engagement functions, and incentive structures that do not reward strong performance against societal measures. To counter these barriers, companies can make operational changes, including integrating business and social functions, aligning societal and business reporting processes, and creating incentives for measurable improvements in host communities.
- **Measuring the Opportunity:** Companies do not size shared value opportunities accurately and underestimate the business benefits of shared value. The full upside of the opportunity is not captured, and the full costs of *not* investing in shared value strategies – e.g., paying a premium for local content or employing an expatriate workforce – are not measured. Approaches that capture the full financial impact, including both benefits and costs, of potential interventions can expose their materiality and thus justify more shared value activity.
- **Embracing Collaboration:** Collaboration often is seen as difficult, impractical, time-consuming, and at odds with reputational objectives. But the scale and range of the societal challenges that companies must tackle to create shared value requires collaboration

with a wide range of partners – even other extractives companies. Collaboration can make the difference between token actions with little impact and measurable societal change.

- **Aligning with Government:** Local, regional, and national governments can promote shared value effectively, but they often do not. While companies cannot and should not replace government, they can strengthen their own ability to create shared value by helping to build local, regional, and national capacity for effective governance.

Shared Value in the Broader Societal Engagement Agenda

Shared value is not the only way in which companies engage with society, nor should it be. Mitigating the societal impacts of projects, conducting effective community engagement and outreach, complying with – and in many cases going beyond – regulatory requirements, operating sustainably, and making charitable contributions in host communities all play a role in a company's contributions to society. But shared value can be a powerful, sustainable approach to building societal prosperity and creating value for the business simultaneously.

Recommendations for the Future

The opportunities for shared value creation are as challenging as they are significant. While some companies have already begun to craft shared value strategies, others are still in the exploratory stages. The following recommendations can accelerate progress towards shared value adoption.

Recommendations for Companies

To advance shared value, companies can adopt some of the same practices they use to make business investment decisions concerning projects in host communities and countries. Companies can take a long-term view toward solving societal issues to benefit the business, invest in improving business unit operations' knowledge of societal issues and vice-versa, measure societal outcomes and their impact on the business, and work with

other multinational companies in the extractives sectors, NGOs, and governments. These steps embed shared value into the way extractives companies operate.

Recommendations for Other Stakeholders in the Extractives Sectors

Governments can play a critical role in shaping the landscape of shared value opportunity by taking action to encourage shared value adoption (e.g., setting a clear national development agenda, incorporating shared value principles into concession agreements); improving policies that create barriers to shared value creation (e.g., regulations that require companies to make social investments in areas outside of the core business); and supporting cross-sector partnerships by sponsoring research, convening disparate stakeholders, helping to implement shared value strategies, and incentivizing shared value investments.

RECOMMENDATIONS FOR COMPANIES

	Recommendations for Action by Extractives Companies	Long-Term Success: Embedded Shared Value
Approach to Societal Issues	<ul style="list-style-type: none"> Take a long-term view toward solving societal issues to benefit the business 	Strategies to meet societal needs are embedded in the business
Removing Internal Barriers	<ul style="list-style-type: none"> Include societal issues in project planning Develop cross-functional teams with fluency in business & societal issues Incorporate societal metrics into incentives structures Develop competencies and skills in dealing with societal issues across the business 	Companies link societal outcomes to business success
Measuring the Opportunity	<ul style="list-style-type: none"> Properly account for the full benefits and costs of shared value initiatives 	Societal issues are integrated throughout the business; full impact to business is understood
Embracing Collaboration	<ul style="list-style-type: none"> Identify promising areas for pre-competitive collaboration Develop new collaborations based on shared goals 	Companies launch multi-sector partnerships to address societal issues
Aligning with Government	<ul style="list-style-type: none"> Offer support for capacity building Design programs that create business benefits in anticipation of regulations 	Governments partner with companies to create conditions for shared value

NGOs, multilateral aid organizations, and other stakeholders can support shared value by finding the intersection between their missions and company interests, partnering with companies to improve local conditions and increase prosperity in host communities and countries, and sharing their expertise in measuring societal outcomes.

Finally, investors and financial institutions can encourage companies to adopt shared value strategies by promoting the development and adoption of accounting practices that reflect the social, environmental, and economic risks that materially influence the extractives sectors. In addition, financial institutions can adopt valuation practices that account for the costs and benefits of a company's societal strategy. Using these additional data points will lead to a greater understanding of how positive changes in countries and communities in which companies operate drive returns for companies.



The Extractives Sectors and Society

Companies covered in the study profit from the extraction of a finite supply of natural resources. Despite the sectors' efforts to minimize their footprint, atmospheric emissions, water consumption, environmental impacts, and energy use are all realities. FSG recognizes that the world's reliance on fossil fuels merits public and political debate and that addressing climate change is one of today's more pressing societal issues. FSG also recognizes that the impacts of many extracting methods, such as hydraulic fracturing, merit careful investigation to avoid negative environmental consequences. Finally, we understand that some methods of extraction, such as those used in the oil sands, can have greater negative environmental impact than others.

As an organization that focuses on social impact, FSG does not take these issues lightly. We believe that climate change is an unprecedented problem that requires government, companies, civil society, and individuals to work together. As a start, oil and gas companies can do their part to reduce harmful environmental effects of extraction and invest more in the innovation of renewables to replace fossil fuels. This report does not dismiss these issues, but its focus is the sectors' upstream activities. We believe that this is the area where FSG can have the biggest impact and create positive change for both societal and business outcomes.

FSG also recognizes that extractive companies have a history of adverse environmental and social impact. These include incidents such as Ok Tedi, where mine pollution in Papua New Guinea negatively affect-

ed the lives of 50,000 local people;ⁱⁱⁱ the 11 million gallons spilled in Alaska by the tanker Exxon Valdez in 1989;^{iv} and the Deepwater Horizon explosion and oil spill, which killed 11 workers and caused severe environmental damage to the Gulf of Mexico in 2010. The unrest caused by wildcat strikes in South Africa has been ongoing since 2012, when police shot to death 34 striking workers at the Lonmin Marikana platinum mine.^v Employee safety issues also have been a recurring theme in the sectors, most recently demonstrated by the Turkish coal mine disaster in Soma, which claimed approximately 300 lives.^{vi} These episodes justifiably give communities cause for concern and vigilance.

This report assumes, however, that until society reaches consensus on how to reduce dependency on fossil fuels and transitions the global economy away from their use, an opportunity exists to improve the societal value of extraction activities in local communities and host nations. Demand remains for resources to feed society's growth and prosperity. The world's standard of living depends on the minerals, metals, and energy commodities that come from the extractives sectors, which are critical enablers of global prosperity through the products they create. As long as demand remains, the sectors will too. And as long as the sectors remain, the opportunity to build prosperity is too great to ignore. Through shared value, the extractives sectors have enormous potential to deliver these positive social outcomes by unlocking opportunities for economic and community development at scale.

iii World Resources Institute. "OK Tedi Mine: Unearthing Controversy" in *World Resources: 2002-2004*, 191. Washington, D.C.: World Resources Institute, 2002-2004.

iv National Oceanic and Atmospheric Administration. "Exxon Valdez Oil Spill." Office of Response and Restoration. n.d. <http://response.restoration.noaa.gov/oil-and-chemical-spills/significant-incidents/exxon-valdez-oil-spill/> (accessed July 8, 2014).

v Dolan, David, and Jon Herskovitz. "Wildcat Strikes up Stakes in South Africa." Reuters. October 7, 2012. <http://www.reuters.com/article/2012/10/07/us-safrica-unions-idUSBRE89607Y20121007> (accessed June 17, 2014).

vi Tuysuz, Gul, Ivan Watson, and Laura Smith-Spark. "Turkey Mine Search Ends with 301 Confirmed Victims of Fire." CNN World. May 17, 2014. <http://www.cnn.com/2014/05/17/world/europe/turkey-mine-accident/> (accessed July 9, 2014).

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CREATIVE COMMONS

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