TREND 5

ESG: Corporate governance adding to competitive advantage

EMERGING RISKS MANDATE GREATER OVERSIGHT

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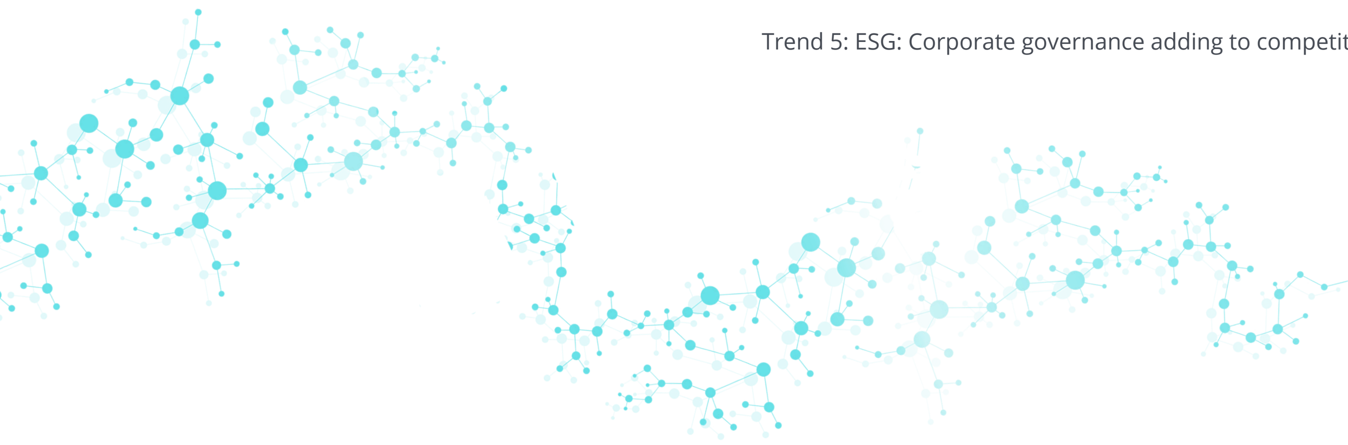

IN ADDRESSING THEIR environmental, social, and governance (ESG) responsibilities, many companies have relegated governance to a backstage role. This opens the door to potential missteps that could result in a widening trust deficit and irreparable reputational damage, but if managed correctly, it could also create a competitive advantage for companies. To do this, mining companies should strengthen their governance processes, particularly around rapidly shifting issues that have only recently begun making their way onto corporate agendas. This includes their approach to issues such as human rights, ethical conduct, diversity, cybersecurity, and evolving social norms.

Stakeholders have the power to change an industry's focus. That has certainly been the case for many mining companies that have changed direction in response to both investor and community pressures.

On the one hand, investor demands for improved environmental performance have seen mining companies restructuring their portfolios and committing to ambitious carbon reduction programs. On the other hand, community demands for improved social performance, supported by local governments, nongovernmental organizations, and socially conscious consumers, are spurring miners to provide shared value by creating social impact.

However, there is a third pillar of ESG that often gets short shrift—governance. It is frequently relegated to a backstage role, a practice that has the danger of backfiring.

Although most mining companies understand the imperative to put effective controls into place, weak governance can result in significant missteps, and potentially cause companies to unwittingly breach not only their regulatory mandates, but also their commitments to investors, communities, and other critical stakeholders. Beyond resulting in a loss of the social license to operate, this can lead to irreparable reputational damage, lawsuits, community unrest, and plummeting market values.

Shifting from downside risk to competitive advantage

Good governance is often seen as a way to protect against downside risk, but it can also be seen as adding to competitive advantage. Companies with strong governance systems make themselves more attractive to investors given ESG pressure, strengthen their attractiveness to host governments and communities, and also help to attract some of the best talent.

Therefore, what are these critical stakeholders—investors, governments, communities, and employees—focused on? Typically, they expect management and boards to strengthen their governance processes, particularly around rapidly shifting issues that have only recently begun to make their way onto corporate agendas. For instance, in the past few years, investors, customers, communities, and governments, not to mention media and watchdog organizations, have heightened their focus on a wide range of corporate behaviors, including those related to human rights, ethical conduct, cybersecurity, diversity, and even responses to changing social norms.

To develop appropriate controls, standards, and policies, it's important that companies understand the governance mandates associated with each of these areas.

Protecting human rights

Although human rights obligations were once considered the sole domain of the state, there are expectations today that companies share this responsibility.

According to the UN's Guiding Principles on Business and Human Rights,[1] published in 2011, business enterprises—regardless of their size, sector, operational context, ownership, and structure—are required to respect human rights at all stages of their operations. Beyond avoiding, causing, or contributing to human rights impacts, businesses are also expected to seek to prevent or mitigate those impacts directly linked to their operations, products, or services by their business relationships "... even if they have not contributed to those impacts."

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This can put a greater onus on companies to monitor their third-party relationships.

For example, after setting up a gold mine in Eritrea in partnership with the country's government, Nevsun Resources is alleged to have hired state-run contractors who used forced labor to build the mine's facilities. Although the company was not directly responsible for hiring these laborers, the Supreme Court of Canada recently ruled that the case by its former employees for breach of customary international law would proceed in the Canadian courts—requiring the company to answer for human rights abuses allegedly committed by a third-party contractor.[2] The case has subsequently been settled out of court.[3]

Similarly, in July 2020, a human rights organization in the United Kingdom is reported to have asked the London Bullion Market Association (LBMA) to decertify a mining company for failure to investigate allegations of human rights abuses at one of its source mines.[4]

The conduct of contractors, even when they're offsite, is also being called into question. "It's incumbent on mining companies to protect communities from the misbehavior of employees and contractors," says Patricia Muricy, Mining & Metals leader, Deloitte Brazil. "If a company brings outside workers into a vulnerable community, and one of those workers commits a crime, the company could be held responsible."

This makes it imperative for businesses to develop and embed appropriate policies, governance structures, and tools to mitigate human rights risks, both within their operations and across their supply chains. This could be doubly important for those miners that operate in regions with weaker human rights protections.

"By putting these human rights controls in place, companies can enhance and strengthen their reputations as valued and responsible partners in the regions in which they operate," says Patricia Muricy. "In addition to closing the trust deficit that the industry faces, this can serve to open up new opportunities and markets for miners looking to extend the life of mines, move into new jurisdictions, and seek new leases."

Ethical conduct

Similar issues can arise when it comes to ethical conduct, particularly in those cases where that conduct is backstopped by legislative guidelines. Enforcement action in both the United States and the United Kingdom makes it clear that companies can be brought to task for anti-corruption violations that may have occurred in foreign jurisdictions.[5]

The same is true when it comes to the management of so-called conflict minerals—mined in areas of armed conflict. In 2012, Section 1502 of the US Dodd-Frank Act came into effect, requiring all companies reporting to the Securities and Exchange Commission (SEC) to disclose if their products contain conflict minerals—such as tin, tantalum, tungsten, and gold—originating from the Democratic Republic of Congo (DRC) or its neighboring countries.[6] While enforcement of those audit requirements were suspended several years later, mineral provenance remains front and center for countless corporations. As tech giants, automotive manufacturers, and even major retailers become more vocal in their demands for ethically sourced minerals, mining companies are coming under growing pressure to improve their due diligence practices and transparency reporting.

With the European Union's (EU) Conflict Minerals Regulation coming into effect in January 2021, those obligations are expected to escalate. Under the guidelines, EU companies that import a range of minerals—including those frequently used to produce mobile phones, technological devices, automotive products, jewelry, and medical devices—will be required to conduct supply chain due diligence to disclose if those minerals originate (even potentially) from conflict-affected and high-risk areas.[7] As EU-based companies work to comply with these rules, they will unquestionably expect their suppliers to provide them with a wider range of disclosures as well.

The difficulty here is that many of the reporting obligations mining companies currently adhere to are reviewed at the corporate level, rather than at the asset level. While some emerging reporting frameworks, such as those outlined by the Initiative for Responsible Mining Assurance (IRMA), take an asset-based approach, that lens is not yet the norm.

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"It is these types of risks that proper governance is meant to stem," says Kevin Xu, Mining & Metals leader, Deloitte China. "Ultimately, management and the board must have a sufficient line of sight to the operational level, even at mines that operate in a decentralized fashion."

The impetus to adopt strong governance processes is growing stronger, particularly as more and more investment funds mandate adherence to ESG principles. By 2025, more than 57% of European investment funds are expected to track ESG performance.[8] In light of this imperative, companies that improve performance in this area stand to gain not only a competitive advantage but also an enhanced ability to potentially attract investment capital.

A look inside

While issues related to human rights, corruption, bribery, and provenance play out at a macro level across the mining sector, companies should ensure that their focus extends to the enterprise level as well.

For instance, while digitization and automation have opened up significant productivity possibilities for mining companies, they can also put companies at greater risk of cyberattacks and privacy breaches. The proliferation of social media also increases the potential for reputational damage. Within this shifting risk landscape, companies may need to modify their control frameworks to identify and manage the emerging risks associated with automation. On the plus side, those with strong governance controls and systems could more effectively navigate mounting levels of global uncertainty and volatility.

Culture, conduct, and reputation play a role in this as well. Any mistakes related to the deployment of new technologies could lead to operational, financial, technological, cyber, data privacy, regulatory, legal, sustainability, or third-party risks—resulting in reputational damage, particularly if management's response is perceived to be inadequate. This is no small matter for mining companies that are already frequently depicted negatively.

Reputational missteps are not confined to digitization and automation. When it comes to the image of mining, leading companies have recognized that they must walk the talk if they hope to rebuild and retain trust with employees, investors, communities, governments, and the public.

Similarly, as issues around employee health and safety, personal data privacy, and community impacts come into sharp relief, they will increasingly need to be integrated into corporate governance strategies rather than being relegated to a corporate social responsibility (CSR) function.

"The more rapidly the world alters, the more important it becomes for companies to adapt their behaviors. Many mining companies that have demonstrated a clear commitment to environmental and social performance are already seeing payoffs from these initiatives. The time has clearly come to add governance to that mix," Patricia Muricy adds.

So what will investors be looking for in future? Put simply, governance and control systems that can navigate this new uncertain landscape. Companies that get this right could be able to enhance not only operational stability and reliability, but also their brand reputation, through being able to focus on their positive actions rather than defending missteps.

"For a long time competitive advantage in mining has been about being the lowest cost producer," says Roman Webber, Mining & Metals leader, Deloitte UK. "But as global uncertainty rises and accountability expectations change, companies should think about how to use governance as a source of competitive advantage."

From good to great governance

- **Strengthen board composition.** As new, emerging, and unexpected risks continue to impact operational realities, boards should become more agile and responsive. In addition to bringing professional capital to the table—including functional and technical skills, sector experience, and governance knowledge—board members should also bring social capital (e.g., professional connections, relationships, and networking skills) and behavioral capital (e.g., diversity, emotional intelligence, listening skills) into the mix. This can be particularly vital in the mining industry related to workforce diversity and inclusion. As a Deloitte Insights publication recently noted, "By setting an example of inclusion in the boardroom, by advocating for an inclusive culture both internally and externally, and by holding management accountable for taking concrete measures to embed a culture of inclusion throughout the enterprise, boards can move a needle that's been advancing far too slowly for far too long."[9]
- **Assess third-party risks.** Rising regulatory expectations that hold companies responsible for the behavior of their external contractors heightens the need to conduct due diligence across the supply chain. Although onsite inspections and audits have become difficult while COVID-19 persists, businesses can use data-driven assessments to more closely monitor supplier risks. This could include assessing human rights, corruption, and/or bribery-related risks across a business's operations and its supply chain. It can also include developing policies and program governance around the conflict minerals supply chain. Either way, it remains important to develop and implement in-house policies and procedures, as well as training and support programs, to ensure compliance and proactive issue management.
- **Modify the risk framework as needed.** A company's risk management framework should be flexible enough to accommodate new and emerging risks (such as digital disruption, cognitive technology deployment, or even COVID-19) without a major overhaul. If a strong framework and infrastructure have been established, risk oversight becomes largely a matter of understanding the risks, knowing who is accountable for managing them, and confirming that they are measured, monitored, and addressed. Given the challenge of quantifying them, it would be easy to omit risks and initiatives from statements of risk appetite, risk profile, and risk tolerances. The board should see that management addresses these matters explicitly, taking a top-down approach that provides a broader perspective of risks across the organization and breaks down siloed thinking. If the risk governance framework and infrastructure are not flexible enough to accommodate these risks, then a broader review and an overhaul or expansion may be needed.[10]
- **Be aware of reputation risks.** Risks to brand and reputation, and thus to revenue and shareholder value, are of particular concern to boards. These risks can emanate from seemingly small decisions and can be difficult to measure and track in terms of likelihood and impact. Candid discussions of what can go wrong and of all the steps taken to monitor and respond to these risk events are strongly recommended.

ENDNOTES

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