



Valuing Returns on Sustainability Investments: Linking Local Impact and Business Value

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ABSTRACT

The Financial Valuation Tool for Sustainability Investments (FV Tool) estimates the financial return (NPV) on site-specific sustainability investments and the financial value of risks mitigated. The outputs will enable the justification and quantification of the business case for social investments, and provide a comparative analysis of social investment options. This kind of information helps to justify and stabilize the annual budget that companies devote to sustainability efforts. The tool was piloted with Newmont Ghana (gold mine project), Cairn India (oil and gas project) and Rio Tinto (copper-gold mine) to demonstrate the model's value-add, i.e. integration into risk management, strategic planning and project evaluation. The tool helps develop the business case for investing in sustainability. It helps change the incentive structure for companies to invest in sustainability and drives paradigm shifts in community investment. By providing sustainability professionals with the language to communicate the results and benefits of their work in financial terms, the tool also contributes to the professionalization of the sustainability field. The tool demonstrates that the return to a company from investments in health, education, workforce training, rural electrification and biodiversity is a function of local stakeholders' perception of benefit.

INTRODUCTION

Companies are spending millions of dollars in local communities to support sustainability – environmental, social and governance (ESG) – programs that develop infrastructure, provide vocational training and support a variety of local institutions and stakeholder groups. Measuring the real and perceived benefits to communities of sustainability programs is important for assuring positive outcomes. More specifically, business managers have known that investments in sustainability are key to protecting a company's social license to operate and managing social risks.

In addition to creating benefits for the local communities, sustainability investments also create significant business value for companies. Quantifying the value of these

investments and planning accordingly, however, has long posed a challenge for companies and community development practitioners. This inability to articulate its true value has kept sustainability investments outside the core of the project planning and budgeting process.

Intuitively, companies understand that there is a business case for being a good corporate citizen. Positive relationships with communities, civil society and governments help ensure that, among other things, production schedules are met, access to labor, land and resources are maintained, and reputations are kept intact. This is particularly true in emerging markets, where higher levels of operational risk require strong local environmental, social and governance (ESG) practices that engage local stakeholders. It is also most evident in high-impact sectors, like extractive industries, where companies are often operating in environments where local communities come face to face with foreign companies, sometimes without the presence of a strong central or local government or governance structure.

To address this gap, a multilateral partnership, including IFC CommDev, Rio Tinto, Deloitte, Newmont and MIGA with the support from the Government of Norway developed a **Financial Valuation Tool for Sustainability Investments (FV Tool)** which estimates the financial return (NPV) on site-specific sustainability investments and the financial value of risks mitigated. The outputs will enable the justification and quantification of the business case for social investments, and provide a comparative analysis of social investment options. This kind of information helps to justify and stabilize the annual budget that companies devote to sustainability efforts. It creates incentives, within companies, to invest in their communities. The FV Tool is a web-based, public good, available at www.fvtool.com.

This case study presents the methodology and lessons of experience from applying the FV Tool at Rio Tinto's greenfield investment in Sub-Saharan Africa, Newmont's Ahafo gold mine in Ghana and Cairn's oil pipeline in India. This study suggests that companies can develop metrics to guide their sustainability investments and translate local development outcomes into business value, in terms that are understood by the market – risk reduction, productivity gains, savings, return on investment, and enhanced reputation. An additional incentive is that high-performing environmental and social programs are increasingly seen as a proxy for effective business management. According to Multilateral Investment Guarantee Agency (MIGA), the World Bank political risk insurer, they would reduce insurance premiums for an operation that demonstrates rigorous risk management.

FINANCIAL VALUATION TOOL FOR SUSTAINABILITY INVESTMENTS – KEY CONCEPTS AND COMPONENTS

The FV Tool calculates a probable range for the net present value (NPV) return to the company from a portfolio of sustainability investments, including value protected through risks mitigated and value created through productivity gains or cash savings. The FV Tool is grounded in the assumption that a company's sustainability investments can improve the relationships between the company and its local partners - government, civil society and

communities – and, in turn, should reduce the likelihood of risk events and generate value back to the company.

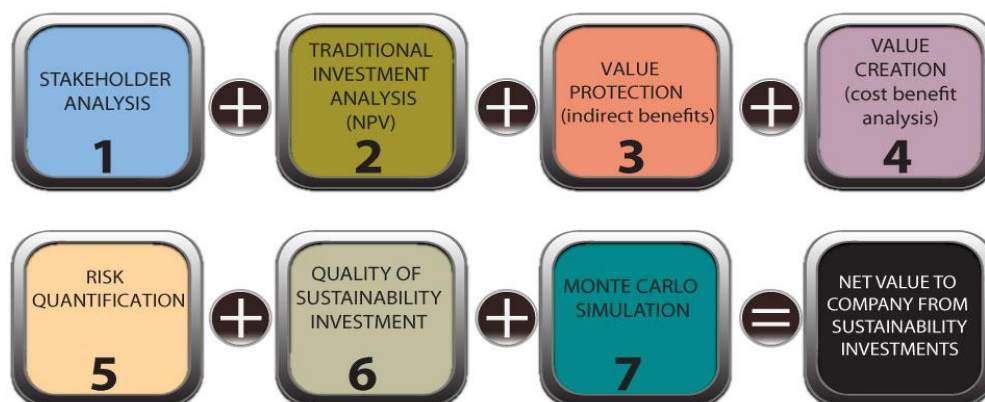
The tool is designed to supplement a company's traditional discounted cash flow valuation model. It compares different sustainability investment scenarios based on risks and opportunities faced by an asset/operation, such as a mine or pipeline, to help managers decide which scenario is likely to yield the most value for the company via creating a positive impact for surrounding communities. By comparing the financial value of two different sustainability investment portfolios, the tool helps determine what the value of making additional sustainability investments is, i.e. going above and beyond what a business is externally required to do.

The FV Tool and the implementation process provide a common platform and language (financial value) for many business functions, such as finance, risk, CSR, procurement and human resources, to holistically assess the returns from investing in sustainability. The process encourages the communication and coordination between business functions that traditionally don't act in synchronization to mitigate risks.

The FV Tool assesses *indirect value protection and direct value creation* potential of sustainability investments. These are two sides of the same coin. Direct value creation is direct cost-benefit analysis of sustainability investments, i.e. positive cash flow. It can be value from input savings or productivity gains, for example, local workforce training enabling the substitution of expensive expatriates with local hires. Indirect value protection, is the value saved by mitigating risks through sustainability investments. It is defined as the value of avoiding risks such as costly delays in planning, construction, operations, lawsuits or other unforeseen added costs, project cancellation or appropriation. Unlike value creation, value protection is not readily calculated. It requires thinking through how to put a dollar value on investments that contribute to social risk mitigation and increase trust, social cohesion, reputation, and good will, among other things.

The methodology underpinning the FV Tool includes several components. Stakeholder analysis and engagement are central to understanding site-level risks and opportunities to positively impact communities when deciding on an optimal portfolio of sustainability interventions. Assessing the quality of sustainability investment programs is also an important input to the overall methodology and related calculations. In addition, the methodology takes into account related project and country specific risks. The FV Tool subtracts the macro-level (country level) risks as assessed by MIGA and prompts the user to consider asset specific risks, using sector level data from historical database and risk register data, to determine the potential volume of risk that a given sustainability investment portfolio can manage.

Key Components of the Financial Valuation Tool



LESSONS LEARNED FROM RIO TINTO AND NEWMONT

The early development and application of the FV Tool was co-sponsored by Rio Tinto, one of the world's largest mining companies, which designed the tool to plan its sustainability portfolio for a greenfield investment in Sub-Saharan Africa. Building on that experience, IFC and Deloitte partnered with Newmont Mining Corporation (Newmont), one of the largest gold producers in the world, and Cairn Energy India, an oil and gas company, to field test, refine and demonstrate a proof of concept for the FV Tool in diverse contexts.

Companies used the FV Tool (both the software and the process) to evaluate the financial value-add of their community investments. This process revealed new perspectives to evaluate the drivers for value creation and value protection of social and sustainability program spending.¹

Rio Tinto's human capital analysis indicated that local capacities in terms of mining expertise and skills were very low. The company wanted to assess the costs and benefits of setting up training programs early to elevate skills levels and build a pool of local labour to run its operations in the near future. The FV Tool calculations showed that investing very early in local workforce development would bring high benefits in the later phases of life of the asset particularly since the specific asset was in a very remote area where local jobs were limited and the company might be dependent on expensive expatriate workers.

Newmont piloted the FV Tool at Ahafo gold mine in Ghana (Newmont Ghana Gold Limited). The company realized its community relations team had contributed to

¹ Quantitative data and NPV outputs are not included in this paper to maintain the confidentiality of company data.

substantial savings, calculated using the FV Tool, through its Land Access and Acquisition program improvements. In an effort to expand their operations, they streamlined their approach to land negotiations and conducted a more inclusive stakeholder engagement process. Newmont also dedicated stakeholder engagement/community specialists to the project engineering team negotiating land access and compensation rates. All this led to lower expenses for land compensation. Due to the involvement of the community relations team Newmont was able to build trust with communities by being perceived as a fair land and compensation negotiator. As a result, Newmont saved time and money in its second neighbouring catchment negotiations, thereby gaining access to the land earlier than planned for the project. These savings were quantified through the FV Tool pilot implementation. The financial benefits were not clearly understood and quantified prior to this exercise.² Newmont also realized that they were spending significantly less on security than other surrounding mines when the FV Tool process led them to conduct some simple benchmarking. This savings is partly attributed to the work of the Community Relations team.

Cairn realized a return on investment with a SMS text program for farmers. The pilot program, in partnership with Reuters, reached 10,000 farmer families along the longest heated pipeline in the world, enabled farmers to obtain information via mobile phones about market crop prices becoming more informed when selling to tradesmen or local markets. During the process of assessing the value creation and value protection potential of the SMS program, Cairn discovered that improved access to mobile phone technology enabled farmers to inform the company about cases of pipeline sabotage, leaks or maintenance issues. The SMS text program led to increased revenues for farmers, and early warning notification of pipeline security issues. Consequently, Cairn was able to react and avoid pipeline damage, which saved reparation costs to the company. Additionally, Cairn was able to utilize mobile technology for direct communication with farmers via text messaging, hence increasing the speed of communication and reducing costs and logistical challenges around convening rural communities along a 600 km plus pipeline.

These cases predicted a financial return far greater than the cost of local investments. They also illustrate the value of applying the FV Tool. Data collection from various departments and creative thinking about value creation and value protection potential of a community investment identified hidden value drivers.

The FV Tool encourages engagement and increased interaction between CSR and finance functions to discuss CSR in terms of concrete financial value to the company. Sustainability investments are evaluated using financial valuation methods that finance and management understands and which add to the rigor of the company's long-term

² *"The Financial Valuation Tool can be used to assist non-finance functions to improve understanding of community investment connection to financial drivers. It may assist company in communicating in more concrete terms the business case for community investment."*

Walter Richards, Regional Controller Africa, Newmont Ghana

"We now realize data points that we have but had not been capturing across the organization." Kojo Bedu-Addo, External Affairs Manager, Newmont Ghana

community investment strategy. It provides CSR managers financial value metrics to speak the same language as other business units and helps justify social spending.

CONCLUSION

The output of the tool enables managers to critically approach the portfolio of sustainability investments and to prioritize those that will yield most value to the company and to communities. The NPV output is not only driven by cost – benefit cash flow analysis, but also includes stakeholders' perceptions and risk mitigation potential of sustainability programs.

The FV Tool reinforces cross-functional alignment within a company and improves decision-making for sustainability investments at the asset/project level based on robust financial and risk analysis, stakeholder engagement and social development program design. This effective measurement tool should provide companies with an understanding of the impact their sustainability investments are having in financial terms; whether this impact is viewed positively or negatively by local communities; and how this translates into tangible business value.