THE BUSINESS CASE FOR TRANSPARENCY

June 2012

We present a two-part study, the purpose of which is to highlight that new disclosure initiatives such as oil and mineral tax payment disclosure as mandated under the Transparency Amendment [1] and as about to be mandated by the European Union[2], have a place in the investment world and an impact on investment decisions. The study identifies the listed companies that integrate the principle of disclosure of tax payments on a country-by-country basis into their reporting activity[3] and measures their financial performance as well as their performance with respect to human and environmental protection rights of the communities where they interact. This second type of performance is important from the investors' point of view since it is intimately related to political risk and the 'social license to operate'.

Both parts of the study find a positive correlation between transparency and the performance category. Although we recognize that we only have shown an association of results in this study and that transparency in its own right will not be a panacea to all investment - related worries, the results do provide support for a business case in favor of expanding on transparency measures within the extractive industry.

Only 17 transparent companies disclosing on a country-by-country basis

We surveyed 70 companies: all of the 57 Extractive Industry Transparency Initiative (EITI) supporting companies as of August 2011 as well as all of the extractive industry companies, non-EITI supporters, but which report along the Global Reporting Initiatives (GRI) framework guidelines (with the expectations that there could be transparent companies that do not support the EITI.) There were 13 companies in this situation.

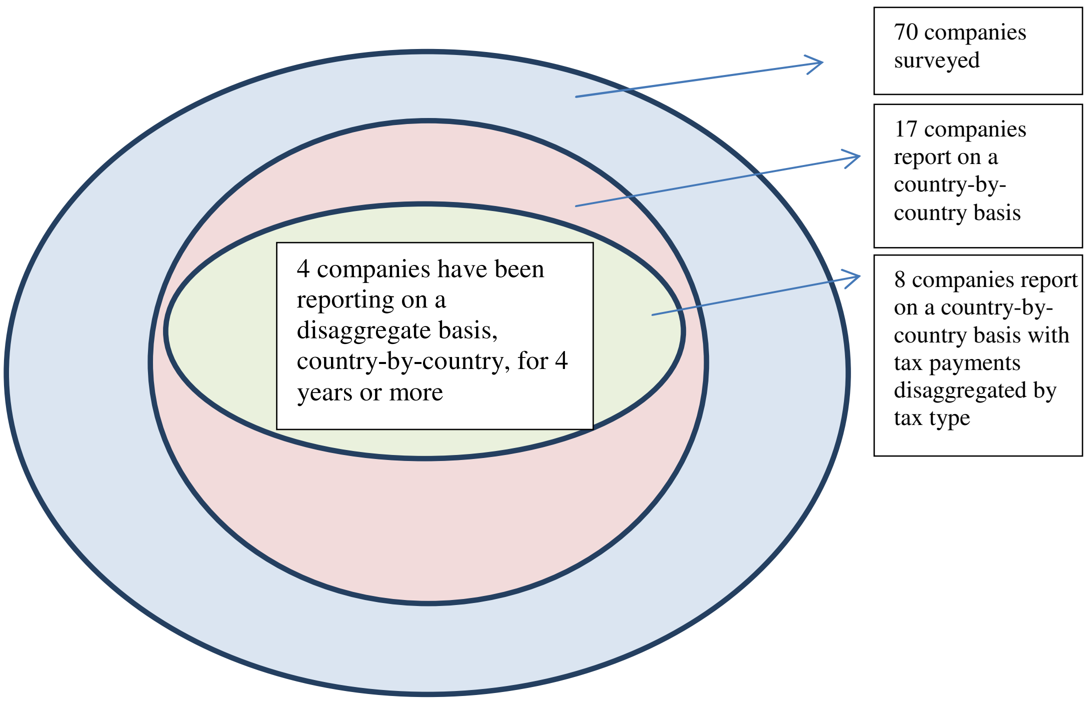
[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 1504, 2010 http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

[2] The European Commission issued its Proposal for Directive on transparency requirements, an amendment to the Transparency Directive (2004/109/EC, at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0038:EN:PDF), as part of its Responsible Business Initiative Package on October 25 2011.

[3] To shed more light on the potential impacts of the Transparency Amendment, ideally the project would have analyzed disclosure on a project-by-project basis. Unfortunately only 3 companies disclose on a project-by-project basis and among them, 2 disclose that way as a result of having one project by country. See the section describing the results for more information.

We opened all the sustainability reports starting with 2010 back to 2005 to find out about their disclosure policies. We found that only 17 companies disclosed their tax payments on a country-by country basis in 2010 and only 3 on a project-by-project basis. These are named 'Transparent Companies.' Among those 17 companies, 8 companies disclose their tax payments disaggregated by tax type (what we call here Advanced Transparent Companies). [4] Among those 8 companies, 4 companies have been diligent with tax payment disclosure for 4 years or more.

<u>Universe of extractive industry companies surveyed by this study</u>



[4] Meaning that among those 17 companies, 9 companies report on a country-by-country basis but with taxes aggregated.

<u>17 extractive industry companies disclosing on a country-by-country basis (including 8 companies disclosing their tax payments disaggregated by tax type)</u>

Company Name	EITI, GRI?	Disaggregation of tax payments?	First year of due disclosure
Anglo American	EITI,GRI	Disaggregated	2010 (2004 with taxes aggregated)
AngloGold Ashanti	EITI,GRI	Aggregated	2005
BHP Billiton	EITI,GRI	Aggregated	2010
Freeport McMoran	EITI,GRI	Disaggregated	2009 (aggregated 2008 - former reports not found)
Goldcorp	EITI,GRI	Aggregated	2005
Iamgold	GRI	Disaggregated	2009
Kinross Gold Corporation	GRI	Aggregated	2009
Lunding Mining	GRI	Aggregated	2010
Newmont	EITI,GRI	Disaggregated	2007 (former reports not found)
Norsk Hydro	EITI,GRI	Aggregated	2005
Oz Minerals (formerly Oxiana Limited)	EITI,GRI	Disaggregated	2006 (former report not found)
Repsol YPF	EITI,GRI	Aggregated	2010
Rio Tinto	EITI,GRI	Disaggregated	2010
Statoil	EITI,GRI	Disaggregated	2004
Talisman Energy	EITI,GRI	Disaggregated	2005
Teck	EITI,GRI	Aggregated	2006
Xstrata	EITI,GRI	Aggregated	2009

In this sample, only 3 companies disclose on a project-by-project basis:

- Iamgold, when the project is 100% owned by the company.
- Lundin and Oz Minerals, since they only have one project in each of the countries they operate as of December 2010.

DeBeers discloses on a country-by-country basis but is a private company so the company could not be included for the purpose of this analysis.

To match this sample of 'Transparent' companies, we identified 17 'Non-Transparent' companies (that do not disclose on a country-by-country basis) with similar characteristics: the ratio of EITI versus non-EITI companies and the ratio of large versus small companies are comparable in both samples with the caveat that oil companies are more heavily represented in the sample of non-transparent companies. This is not by choice but by circumstance: among the EITI supporting companies, the mining companies are more inclined to country-by-country tax payment disclosure than the oil companies although the EITI supporters are broken down in equivalent proportion between both sectors.

17 extractive industry companies not disclosing on a country-by-country basis and included in this study

Company Name	EITI, GRI?
African Rainbow Minerals	EITI,GRI
Anvil Mining	EITI,GRI
Arcelor Mittal	EITI,GRI
Barrick	EITI,GRI
BG Group	EITI,GRI
Chevron	EITI,GRI
Conoco Philips	EITI,GRI
Eni	EITI,GRI
Exxaro	GRI
Gem Diamonds	GRI
Gold Fields	GRI
Hess	EITI,GRI
Noble Energy	EITI
Shell	EITI,GRI
Tata Steel	EITI,GRI
Total	EITI,GRI
Vedanta Resources	GRI

We note that 3 EITI supporting companies were not included in any of the samples because their disclosure is done at the regional level: Vale, Glencore and JX Nippon. These companies are considered not transparent enough to enter the sample of transparent companies but more transparent than the sample of non-transparent companies.

Transparency is correlated with better financial results

Identifying the Variables of Financial Performance

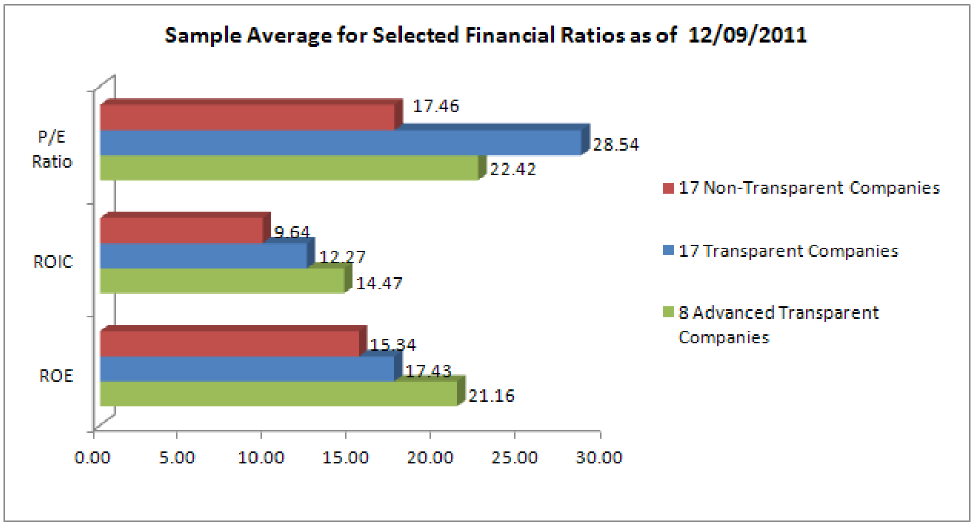
We selected 3 ratios that reflect the performance of the company in terms of profitability or efficiency and that are used by investors to compare a company to its peers within the same industry.

The Price-Earnings Ratio (P/E ratio): it shows how much investors are willing to pay per dollar of earnings.

Return on Equity (ROE): it measures a company's profitability by showing how much profit a company generates with the money shareholders have invested.

Return on Invested Capital (ROIC): it assesses a company's efficiency at allocating the capital under its control to profitable investment.

Results



Source: Bloomberg[5]

The results show that transparent companies are associated with a better performance along those ratios. *We are aware that these results only reveal correlation and association of results and do not claim to bring evidence of a causality effect.*

Transparency correlated with fewer cases of human and environmental rights violation

In this second part of the study, the purpose was to analyze the performance of extractive industry companies along the lines of reported cases of human rights violation and environmental damage.

Methodology

Reported cases were researched and analyzed for the calendar year 2011. The focus included disputes and allegations, which freshly arose during the period, or were long-standing and live disputes during the calendar year 2011. To categorize the cases, we built on the framework used by the International Council on Mining and Metals (ICMM) in its report to the Special Representative[6]

[5] Data is detailed in annex.
[6] His mandate ended in June 2011.

on Human Rights and Transnational Corporation and Other Business Enterprises[7], due to its comprehensive coverage of social, environmental and corporate governance issues specific to the Extractive Industry. The ICMM framework offers the issue categories, here below.

ISSUE CATEGORY[8]	DEFINITION USED
Civil conflict	Revenues, payments or other support from company allegedly used by government / state entity / rebel group to fuel conflict, or conflict between different groups over distribution of revenues.
Security	Security arrangements – alleged abusive actions of personnel guarding the mines / in region of mines.
Indigenous	Rights of indigenous peoples alleged to be infringed (i.e., group identified as 'indigenous' being allegedly harmed).
Resettlement and compensation	Resettlement alleged to have been undertaken unfairly, or perceived inadequate compensation for land / property.
ASM	Interests / position of traditional / artisanal or small-scale miners alleged to be undermined.
Health & Environment	Alleged / feared health and environment failures.
Safety	Alleged / feared safety failures.
Economic	Perceived negative economic impacts, or perceived insufficient local economic benefits, including negative impact on livelihoods.
Corporate power	Perceived undue political influence of company, including both (a) revenues and existence of company as investor allegedly helping to legitimize human rights abusing regime or (b) government allegedly bending to wishes of company.
Consultation	Alleged failure by company to consult meaningfully or secure consent.
Corruption	Alleged corruption or lack of fiscal transparency on part of company or government.
Labor	Alleged labor abuses, including forced labor, child labor, lack of freedom of association or union representation, racial or sexual discrimination, harassment or abuse.

[7] ICMM- Second submission to the UN Secretary General's Special Representative on Human Rights and Business - Mining and Human Rights: how the UN SRSG can help spread good practice and tackle critical issues - October 2006.
[8] Those issues and definitions are from the ICMM framework and haven't been amended by our study.

For each reporting case of irresponsible corporate behavior, up to two flashpoint issues, and as many other issues, were identified and tagged along the issue categories described above. A flashpoint issue is defined as the focal or primary issue in a dispute, whereas 'other issues' includes multiple facets connected or unconnected to the focal issue, but which were nonetheless observed in the context of the dispute. The analysis was conducted for each of the 34 sampled companies. The total issues were then compiled for each of the samples of transparent and non-transparent companies.

Data Collection

For the purpose of data collection, given the absence of a single comprehensive repository for world-wide data on the subject, the following three sources were researched:

- Proprietary data from OECD National Contact Points (NCPs)[9] that are mandated to receive and adjudicate cases of violations of OECD Guidelines on MNCs. NCPs receive complaints from NGOs and publish quarterly reports on statistics.
- Business and Human Rights website[10] - The repository includes cases raised in forums in diverse jurisdictions and legal settings. It also compiles data on cases, which might not necessarily have been or are being addressed in legal forums. The data was analyzed using individual companies as search criteria.
- Corpwatch[11] – The website aggregates newsfeed on communities' rights violations by corporations. Industry categories of Natural Resources, Oil and Energy were reviewed.

The results from these three sites were combined to give a final tally for each case category for the transparent and non-transparent sampled companies.

Results

From our analysis of disputes in 2011, we found that a total of 55 flashpoint issues and 19 additional issues could be traced for companies, which were not transparent about their tax payments in 2010. Similarly, for companies, which were transparent with their tax payments in 2010, there were a total of 32 flashpoint issues and 10 additional issues. The chart in Figure 1 below indicates that non-transparent companies reported 43% more issues than their more transparent counterparts.

[9] Http://www.oecd.org/document/3/0,3746,en_2649_34889_1933116_1_1_1_1,00.html.
[10] http://www.business-humanrights.org/.
[11] http://www.corpwatch.org/.

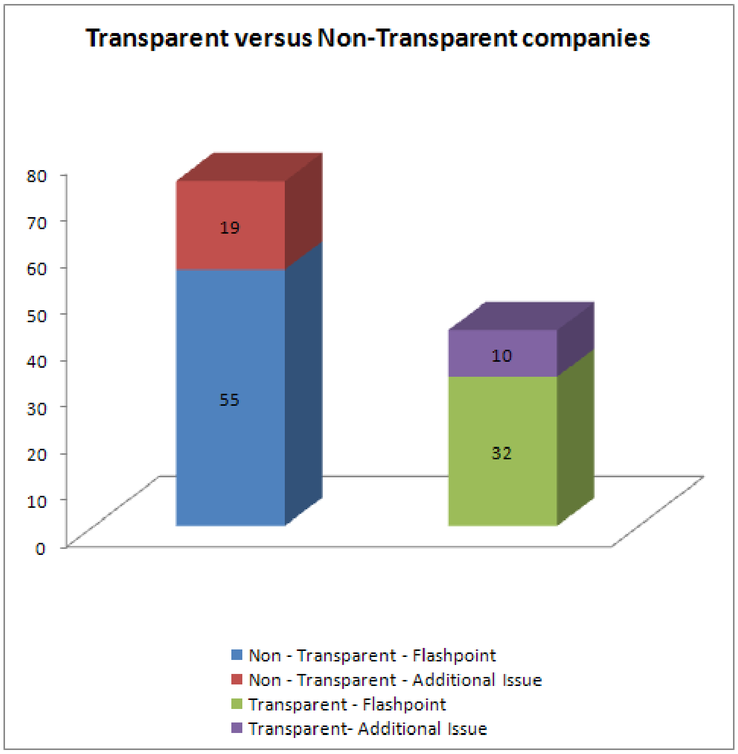


Figure 1

The results from a deeper analysis of issue distribution are indicated in Figure 2 below. In 7 out of 11 issue categories, non-transparent companies reflected a higher incidence of issues as compared to transparent companies. These categories include 'civil conflict', 'corporate power', 'corruption', 'economic', 'environment', 'compensation', and 'consultation'. The highest number of cases was reported for categories including 'environment', 'civil conflict', 'corporate power', 'corruption', and 'economic' collectively accounting for 77% of a total of 74 cases reported for non-transparent companies, and 54% of a total of 42 cases reported for transparent companies.

An analysis of divergence indicates that there is near competitive performance of the two samples in the 'environment', 'security', 'safety', 'indigenous', 'consultation', and 'labor' categories. Categories where the number of reporting cases of non-transparent companies drastically outnumbered that of transparent companies were observed in instances of corporate complicity in the perpetuation of 'civil conflict', 'corruption', and 'corporate power'. Interestingly those categories are the various facets of the resource curse. Non-transparent companies also display more reporting cases in the 'economic' and 'compensation' categories.

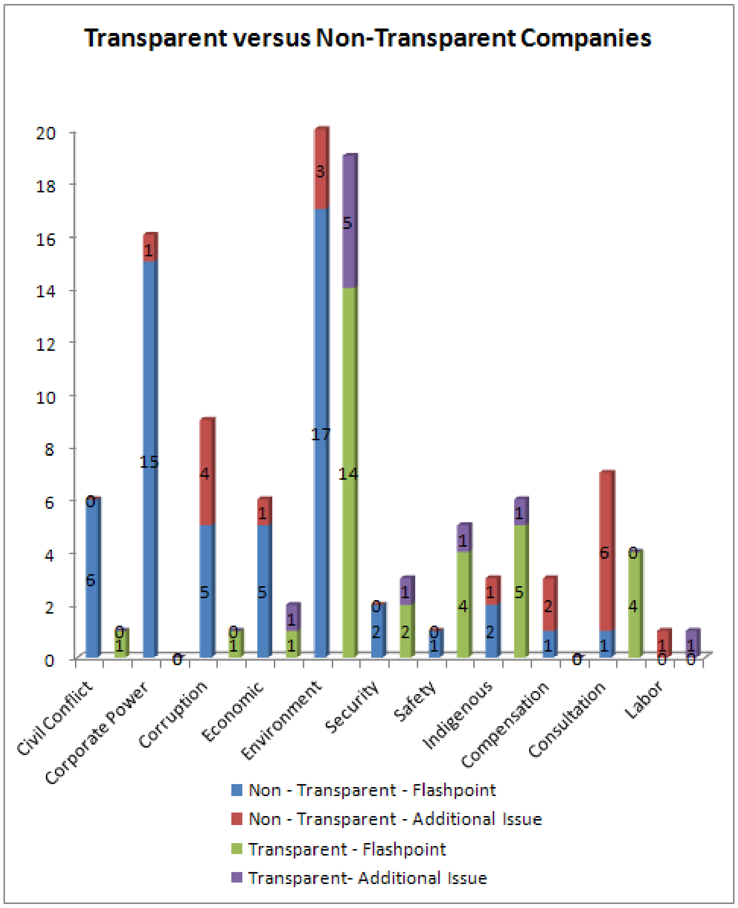


Figure 2

Overall, the results of this study leads us to believe that on average, transparency revealed in companies' willingness to disclose information about their tax payments in the countries where they operate is associated with less reported cases of corporate misbehavior. However the similar performance of both samples on certain indicators might indicate that transparency as currently handled by the sample of 'transparent companies' (country-by-country basis reporting, not always disaggregated by tax type) hasn't fully led yet to enshrining the fundamental values associated with transparency: accountability, fairness and sustainability. One could assume that increasing the level of disclosure to a project-by-project basis will increase the corporate standards since the company will be held accountable on a project-by-project basis or in other words on a community-by-community basis.

We conclude that this study lends support to the business case argument in favor of mandatory rules of disclosure, both through the positive association of results and through the interpretation of the need for a further push on transparency. A more rigorous transparency regime seems to have its place from a business perspective.

Perrine Toledano, Lead Economics and Policy Researcher[12]

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Annex – Table of Results – Source: Bloomberg as of 12/09/11

Transparent Companies:

Company Name	ROE	ROIC	PE RATIO
Anglo American	21.68	12.46	9.58
AngloGold Ashanti	2.67	3.33	126.22
BHP Billiton	44.92	34.74	10.93
Freeport-McMoran	45.58	29.02	12.97
Gold corp	8.82	4.90	33.93
Iamgold	10.78	8.81	23.80
Kinross Gold Corporation	8.14	6.01	32.79
Lundin Mining	10.43	6.80	14.60
Newmont	18.94	17.11	13.44
Norsk Hydro	3.69	3.94	32.03
OZ Minerals	20.05	14.77	10.00
Repsol YPF	23.40	14.21	5.43
Rio Tinto Plc	28.04	19.08	9.51
Statoil	18.23	11.78	11.58
Talisman Energy	6.00	2.73	88.48
Teck	12.18	8.22	35.31
Xstrata	12.75	10.60	14.57

Non-transparent Companies:

Company Name	ROE	ROIC	PE RATIO
African Rainbow Minerals	17.01	13.48	12.09
Anvil Mining	4.35	NA	67.38
Arcelor Mittal	4.72	NA	17.66
Barrick	19.19	12.76	16.74
BG Group	13.61	11.31	20.19
Chevron	19.31	12.72	9.76
Conoco Philips	17.4	7.3	11.5
Eni	12.99	9.03	9.39
Exxaro	34.33	12.98	9.11
Gem Diamonds	5.38	6.57	26.22
Gold Fields	8.77	6.58	23.12
Hess	14.13	10.09	14.89
Noble Energy	11.15	6.31	20.4
Shell	14.15	8.02	10.16
Tata Steel	30.76	8.03	6.28
Total	18.72	10.46	8.38
Vedanta Resources	14.88	8.92	13.5

[12] Many thanks to Nancy Siporin for her close review and to Julien Topal for his useful inputs.

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