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Assessing Business Development Impact

A Management Framework for Improved Economic and Socio-Economic Performance Reporting

Assessing Business Development Impact:
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This report updates an earlier ODI report 'Bridging the Economic Benefits Gap: A Management Framework for Improved Economic and Socio-Economic Performance Reporting by Energy Companies' by Dr Michael Warner, ODI, October 2004 and funded by BP plc

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Cover photographs: Gold mining at Siguiri Prefecture, Guinea (L. Lartigue, USAID); tea workers in Sri Lanka (Dennis Hurd); logging in Central African Republic (JG Collomb, World Resources Institute); silk workers in China (Andrew Hitchcock).

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Executive Summary

This report presents a methodology for assessing business development impact, and outlines a management framework for gathering, interpreting and reporting information on development performance, and managing associated risks. The methodology has been implemented in the oil and gas sector, but most aspects are relevant for other sectors, and the framework can be adapted for wider application.

Persistent Challenges to Reporting Economic Performance

The study upon which this report is based reviewed a number of initiatives in the area of corporate economic and socio-economic benefits analysis and reporting, including the OECD Multi-National Enterprise and UN Global Compact principles, the Dow Jones Sustainability and FTSE4GOOD rating indices, the GRI 2002 Sustainability Reporting Guidelines, and the IFC method for assessing project economic impact. The study concluded that the discipline of economic impact reporting is not well evolved, and suffers from a number of persistent challenges. These include:

- weak analysis and reporting of the commercial and public policy constraints and incentives that frame business strategy, and thus provide justification, or not, for a company's economic and socio-economic performance;

- a tendency at Group level towards reporting aggregated economic information that rapidly becomes meaningless to country-level stakeholders, and which fails to focus attention on those particular operations material to the earnings of the Group as a whole due to specific short-term political risks or unprotected long-term growth opportunities;

- a bias towards reporting Cash Value Added (CVA) and the breakdown thereof in the form of dividends, taxes, employee wages and benefits, re-invested earnings and charitable giving, and their presentation as indicators of an economic rate of return – a practice that, particularly in low- income and poorly governed countries, fails to account for extreme inequalities in economic benefits distribution;

- a dependency on gathering economic and socio-economic performance data from high-cost, stand-alone studies and surveys;

- a lack of attention to reporting the significance of economic performance in the context of the specific economic and social priorities of the host society, be that

national economic development targets, the economic and social policies of local district authorities, the livelihood aspirations of communities or the economic interests of civil society groups; and

- the potentially adverse commercial consequences for energy businesses arising from continuous performance improvements with respect to some of those indicators chosen as the basis for economic reporting, such as wage levels, rate of local staff succession or use of local suppliers.

A Management Framework for Improved Economic Benefits Reporting

Designed to overcome the above challenges, the building blocks of a more comprehensive management framework for gathering, interpreting and reporting the economic and socio-economic performance of oil and gas business operations are presented in this report (*Section 3*). The design combines a *Scoping Exercise* with a *Reporting Register* of compiled information and an integral *Risk Assessment*. Together these features enable formulation of a new type of narrative on reported business benefits: one more meaningful and credible to a variety of audiences. Applications for such a framework include preparation of country-level environmental and social reports, country-level business updates, group-level annual sustainability reports, group-level financial reports (in particular their interpretation for medium-term earnings security and long-term access to business growth), and online country or project-based reporting.

Box A Categories for Economic and Socio-Economic Reporting

- Products and services
- Monetary flows to the public sector
- Reinvested earnings
- Profits
- Dividends
- Political stability
- Macro economic stability
- Investment climate
- Transactions
- Employee benefits
- Procurement (suppliers and contractors)
- Infrastructure and equipment
- Banking sector
- Ethical and quality standards
- Security
- Charitable giving
- Eco-technology
- Bio-diversity and conservation
- Community investment
- Regional development (region of operations)

Business-to-Host Society Connectivity

As part of the proposed framework, a checklist is used to aid the initial scoping of economic and socio-economic impacts to report. The main category headings in this checklist are presented in *Box A*. A further 80 sub-categories are identified in the report. During site visits undertaken for the study upon which this report is based, the checklist was used to explore in more detail a number of areas of economic and socio-economic connectivity between energy companies and their host society (see *Box B* overleaf).

Box B Economic and Socio-Economic Connectivity between Energy Companies and their Host Society Explored in the Study

Upstream – oil and gas developments

- the contribution of oil or gas field developments to the provision of affordable gas and electricity supplies in-country;
- contributions of the business to macro-economic stability through payments to a state oil fund;
- meeting the local content requirements of production-sharing agreements;
- the potential for a positive effect on local financial institutions from the business passing financial transactions through domestic banks;
- indirect tax payments to government from national and foreign employees working for local contractors and subcontractors;
- the contribution of the business to skills enhancement through engagement with training and education institutions;
- diffusion of ethical and health and safety standards to contractors and suppliers;
- economic and socio-economic impacts of a business's community investment programmes.

Downstream – refining, retail marketing, chemicals and renewables

- contributions to economic development in underdeveloped countries from crude oil sourcing decisions;
- employment opportunities in depressed local markets;
- innovation in service stations, eg convenience stores;
- local employment and the local economic multiplier effect of service stations;
- operator support to develop domestic businesses;
- impact of oil tax collected by service stations on the economy, eg in meeting of pension requirements;
- charitable contributions; and
- energy businesses as leaders in research and development for clean fuel and eco-efficient technology, eg within refinery and retail operations.

Findings

The study concluded that an effective management framework for economic and socio-economic performance reporting needs to (i) be integrated with existing reporting procedures, (ii) be cost-effective, (iii) promote prioritisation in the choice of economic and socio-economic impacts to report, and (iv) guide the systematic gathering of information. Specific conclusions arising from this study are as follows:

- The risks to shareholders associated with the shift in geography of corporate growth centres towards poor and politically unstable countries, combined with a

drift in comprehension of the mutuality of benefits between downstream manufacturing/retail businesses and wider society, suggests a move away from the global corporate reporting of economic performance based on generic, aggregated financial indicators or isolated qualitative 'good news stories.' Needed is a move towards the reporting of highest-priority, location-specific economic and socio-economic connectivity (or potential connectivity) between the energy business and society, reflecting genuine host country stakeholder concerns and goals.

- The checklist of economic and socio-economic performance themes and categories presented in this report offers an opportunity to broaden the range of economic benefits reporting beyond the conventions of charitable giving, community investment and breakdown of Cash Value Added (CVA).

- Countering the persistent challenges to effective economic and socio-economic performance reporting outlined in this report requires the collation of five types of information, and their formulation into a suite of individual *Reporting Registers*: (i) the business context – competitive realities, legal and regulatory requirements, public policy stipulations and incentives that frame business decisions and determine whether a company has overall control or only partial influence over the economic benefits stream generated by its operations; (ii) financial data – indicators that describe financial performance in relation to economic and socio-economic impacts and that can be tracked through the standard accounts (Income Statement, Balance Sheet, Cash Flow); (iii) non-financial management data that is readily accessible and that will enhance the reported narrative; (iv) external stakeholder priorities – benchmarks or targets reflecting external stakeholder concerns and goals that can be referenced to interpret the relevance of the company's performance to the intended audience; and (v) external roles – actions to be taken by entities outside the immediate business to embed, enhance or sustain the socio-economic or economic gains contributed by the company.

- Within each individual *Reporting Register*, all quantitative data should, as far as practicable, be linked directly to the relevant financial and other management system so that the figures can be called up 'on command.' For data-sets that currently require costly freestanding surveys, such as soliciting the geography and/or ownership profile of suppliers, ways need to be found to automate the data-gathering process: for example by inserting new reporting clauses into the contracts of the main engineering, procurement, construction and asset maintenance contractors.

- There is a danger in economic reporting of over-stating the contributions of an individual company by failing to make it clear that it is but one of a number of joint venture partners. This problem is most apparent when the company holds the position of project operator.

- For upstream projects in their development (pre-production) phase, the importance of more accurately reporting 'local content' cannot be overstated. Energy companies need to both (i) better define what is meant by 'local content,' be that the nationality of employees, ownership of supplier firms, sphere of geographic influence of suppliers, country of registration or incorporation etc; and (ii) reduce their dependency on freestanding surveys for gathering local content information, putting in place instead automated procedures.

- In the medium term, reporting the volume of transactions with domestic banks may provide an incentive for an improved range and reach of local financial products targeted at the domestic country's SME sector, including suppliers of the oil and gas business.

- Given the marked change in the type and magnitude of economic benefits experienced during the different exploration, development and production phases of major capital investments, annual reporting of economic and socio-economic performance should consider including forward projections of payments to the public sector, showing how these will vary over time in relation to anticipated expenditure and revenue 'curves.'

Conclusion

For underdeveloped countries where the national economy is often weak and the quality of public financial management poor, the trend for some trans-national corporations to disclose the breakdown of Cash Value Added of operations provides a shallow basis for reporting the economic and socio-economic return on investment. Offering financial numbers as economic surrogates provides audiences with little context for interpreting whether these are either meaningful to the economic priorities of local, regional or national society, or are material to the political risk and business growth concerns of shareholders. Put more candidly, in both developed and developing countries, few are impressed when a big company generates big numbers. What would impress more is a reporting narrative, backed by a rolling register of location-specific credible data, which gives an honest interpretation of the relevance of these numbers to the social, economic and investment priorities of those receiving the information.

1. Introduction

1.1 Purpose

This report presents a methodology for assessing business development impact, and outlines a management framework for gathering, interpreting and reporting information on development performance, and managing associated risks[3]. The methodology has been implemented in the oil and gas sector, but most aspects are relevant for other sectors, and the framework can be adapted for wider application.

The study falls under the programme on Business and Development Performance at the Overseas Development Institute, which focuses on developing the tools, policies and incentive mechanisms needed to improve the development impact of business.[4]

1.2 Objectives

The objectives of the study upon which this report was based were fivefold, exploring ways to:

- facilitate the systematic reporting of the positive economic and socio-economic performance of energy companies at the operational, country and corporate levels;
- strengthen the linkage between the reporting of financial performance and reporting of economic and socio-economic performance;
- provide external stakeholders with a 'lens' through which to interpret performance in the context of the economic and socio-economic priorities of the host society;
- automate data-gathering processes to support low-cost annual (or quarterly) reporting of socio-economic performance; and
- identify and fill existing gaps in reporting by major energy companies in order that future external communications present the 'whole' impact of a business on the host society, enhancing the capacity of observers to make informed opinions about trade-offs and the mutuality of benefits.

[3] This report updates an earlier ODI report 'Bridging the Economic Benefits Gap: A Management Framework for Improved Economic and Socio-Economic Performance Reporting by Energy Companies' ODI, October 2004.
[4] For details of the programme, see www.odi.org.uk/business

1.3 Approach

The study upon which this report is based reviewed a number of initiatives in the area of corporate economic and socio-economic benefits analysis and reporting, including the Global Reporting Initiative, FTSE4GOOD, Dow Jones Sustainability Indices, OECD MNE guidelines, and the International Finance Corporation's Economic Valuation Method and Sustainability Framework. In addition, during the study period a rolling series of discussions took place with a major energy company at corporate level and site visits were undertaken to one upstream operation in a developing country, and one downstream operation in a developed country. These discussions involved access to a wide range of expertise including finance, tax, legal, human resources, procurement, communications and community investment.

2. Context For The Report: The Economic Benefits Gap In The Energy Sector

The need to strengthen the internal capacity within energy companies to report economic and socio-economic performance is underpinned by two principal drivers. The first has to do with a 'shift' in the geography of profits towards developing countries, the second with the 'drift' in comprehension of stakeholders in the developed world about the overall role of the hydro-carbons business within society.

2.1 A 'Shift' in Geography

2.1.1 The Geography of Profits

"We suggest that the greatest challenge of corporate responsibility today lies with company
activities in developing countries, for three reasons: globalisation means that more Western companies have operations or supply chains in developing countries than previously; companies operating in developing countries often face acute problems associated with poverty, disease, corruption, conflict and the abuse of human rights…; governments of developing countries are often unable or unwilling to provide the strong regulatory supervision that guides and constrains company activity in rich countries."

Insight Investment (2003) Defining Global Business Principles, p4

An increasingly sizable portion of the near-term future profits of multi-national integrated[5] oil and gas companies, such as BP, Royal Dutch Shell, ExxonMobile, ChevronTexaco and Total, will come from oil and gas field developments located in low-income or low-middle-income developing countries. For Shell, this includes: China, Nigeria, Philippines, Venezuela, Kazakhstan and Brunei. For BP: Azerbaijan, Indonesia, Angola and Trinidad and Tobago. And for ExxonMobil: Equatorial Guinea, Cameroon, Chad, Nigeria, Angola, Papua New Guinea and Indonesia. Further, over the longer term, in line with the dual trends of economic growth in emerging economies (eg China, India, Malaysia) and economic growth and energy security considerations in developed nations, these companies are likely to diversify into other underdeveloped regions.

[5] ie combining upstream with mid and downstream operations.

Operating in such regions requires consideration of a wide range of societal characteristics not present in, or far less pronounced than in, conventional operating environments. These include, inter alia, unstable political regimes, weak economies, volatile exchange rates, low education levels and skills capacity, underdeveloped supply chains, poor local infrastructure, chronic poverty within the wider population, weak institutions and regulatory enforcement, severe environmental degradation, corruption and, in some cases, violent conflict. These 'alien' business environments are not exactly new to the oil and gas 'supermajors'. What *is* new is the recent emergence of three coincident features of the hydro-carbons sector:

- the high **relative proportion** of corporate profits derived from operations in low and middle-income countries;

- heightened corporate awareness of the **reputational risks** of doing business in underdeveloped regions in relation to two sets of external stakeholders: (a) institutional and commercial investors, with respect both to short-term operational risks and to long-term access to growth opportunities; and (b) special interest groups, in particular with respect to the responsible management of community and human rights issues; and

- the growing **politicisation** of the upstream hydro-carbon industry within the country of operations.

Further analysis of the geographic spread of current, near-term and future profits is clearly warranted but lies outside the scope of this report. More useful at this stage is to offer a summary of some of the reputational and political risks inherent in a business growth strategy targeted at mineral resources located in developing countries, and of the way in which these risks act as an incentive for businesses to enhance the public reporting of their economic and socio-economic performance.

2.1.2 Overview of the Economic Benefits Gap

"The long-term prosperity of companies ultimately rests upon a favourable and stable political, legal and regulatory climate. If broad political opinion turns against them, the very core of their business can be endangered."

Insight Investment (2003) Defining Global Business Principles, p24[6]

[6] See: www.insightinvestment.com/documents/responsibility/GBP_project_report.pdf

There is now evidence of the reality of the 'oil curse'[7] in developing countries, which in turn is creating pressures both in-country and internationally for increased transparency in public sector fiscal management and in the payments by oil companies of resource rents. These political pressures are compounded by the transnational nature of the oil industry, vulnerable as it is to the charge by domestic political forces (be they right or wrong) that foreign-owned companies are exploiting nationally-owned resources. Further, the increased interest in corporate social responsibility issues has focused more on the contribution of the business to local and regional economic and social development. This is in contrast with many western countries, where the emphasis is on environmental protection, labour standards and corporate governance.

Stimulated by the media, the combined effect of these pressures has been to raise expectations, among both the general population and those living in oil and gas-producing regions, of the need for the host nation to be seen as receiving its 'fair share' of the benefits from oil and gas investments. Although equally true across other sectors – water, power, mining, transportation – it is in the high-profile capital-intensive hydro-carbons (and other extractive industries) sector where in-country popular support for foreign direct investment is fast becoming 'business critical.'

It seems no longer sufficient for foreign investors and operators to assume that the general population (or, more specifically, the population living in oil production or transportation regions) will perceive there to be connectivity between investments in upstream oil and gas projects, and public sector efforts to redistribute resource rents through expenditure frameworks (poverty-focused or otherwise). Nor should it be taken as given that company-driven localised community investment programmes will successfully bridge the gap between the expectations of local people for immediate benefits, and the delays in revenue redistribution to the oil-producing region. A study by the World Bank as part of the Extractive Industries Review,[8] found that "*all stakeholder groups recognise that the distribution of benefits and costs is the crucial issue in EI [Extractive Industries],*" and yet the "*…IFC [along with other development banks and many companies] typically has not calculated shares accruing to different levels of government or accruing direct to local communities.*"[9]

There is in short, an economic 'benefits gap'. *Figure 1*, overleaf, shows schematically how this gap emerges. In the context of upstream oil and gas field development, first, the interim local economic benefits of the construction phase are

[7] Auty, R. and Mikesell, R. (2000) Sustainable Development in Mineral Economics. Oxford University Press.
Karl, T. L. (1997) The Paradox of Plenty: Oil Booms and Petro-States, Studies in International Political Economy, No. 26, University of California Press.
Gelb, A. (1998) Oil Windfalls: Blessing or Curse, World Bank Research Publication. Washington DC: World Bank.
[8] OED/OEG (2001) Extractive Industries Review, Internal World Bank Group Assessment, Annex D, IFC Experience, p81
[9] ibid, p82

often limited, owing to the short-term nature of employment opportunities and technical constraints on employment and supply chain access for local people and firms arising from a low level of capacity.

Second, there is the time delay between the end of the period of construction-related opportunities and the advent of improvements in public services arising from the distribution of production revenues, a delay accentuated by the extended capital expenditure cost-recovery period integral to many upstream capital investment projects.

Third, even when revenues have accrued within central government, the correct proportion may not return to the operating provinces: either because the legislation is not in place; for fiscal priorities such as international debt repayments; or as a result of inefficiencies, mis-management or corruption in expenditure management at the national or provincial level.[10]

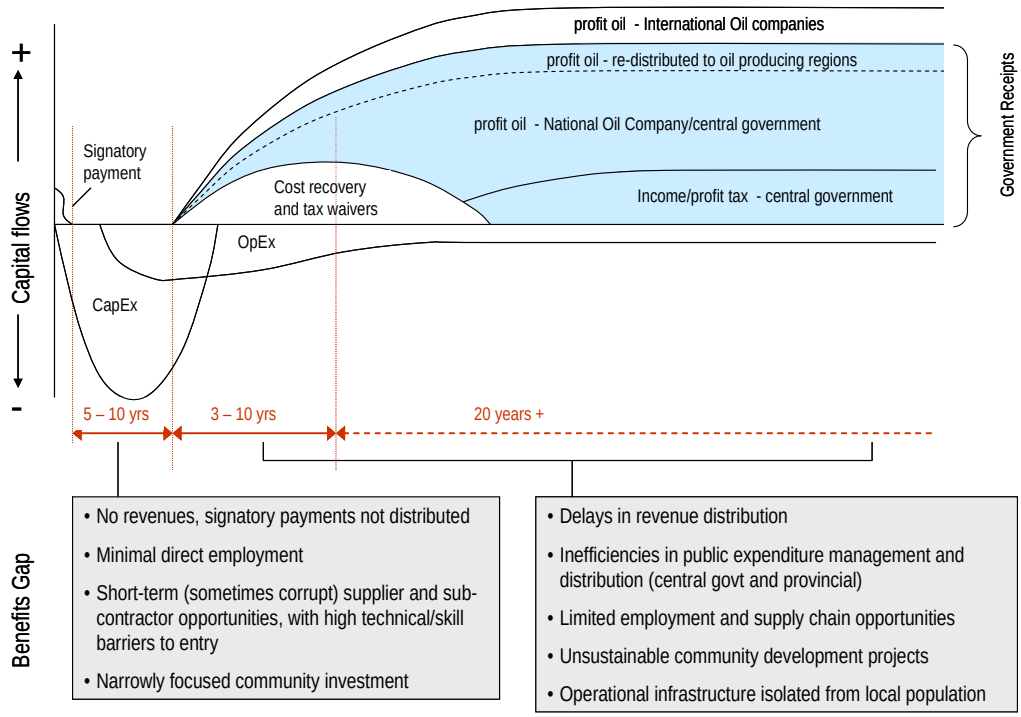
Fourth, where redistribution to the provinces *is* forthcoming, this may simply be used to satisfy existing, recurrent, administrative expenditure, rather than to develop new or enhanced public services.

Fifth, community investment throughout the life of the project tends to be targeted at only a few directly affected people, fuelling inter-community jealousies. And finally, the dominance of central government – partly in an effort to manage the economic volatility of revenues caused by fluctuating commodity prices – means that municipal and provincial governments receive relatively low levels of direct local tax receipts from the investments.

There is evidence that in some countries this economic 'benefits gap' has already been recognised at the public policy level, as demonstrated, for example, by the emergence of attempts to achieve harmonisation of 'local content' requirements across oil-producing African countries[11] and elevated 'local content' clauses in the recent production sharing contracts, as in Trinidad and Tobago (see *Box 1*).

[10] ibid
[11] For example the African Association of Petroleum Producers (APPA) is preparing an initiative to entrench local content provisions in upstream laws enacted across the continent (Upstream newspaper, 14th May 2004).

Figure 1 Schematic Representation of the Economic 'Benefits Gap' in Upstream Oil and Gas Development



Also evident internationally is the plethora of academic papers and roundtable initiatives[12] on the ways in which states can better manage and distribute petroleum revenues to, *inter alia*:

- prevent 'Dutch Disease' (eg through precautionary extra-budgetary oil funds);
- smooth out the inherent price volatility of the oil market (eg through hedging and other futures strategies);
- bring forward the timing of revenue streams into government (eg through elevated signatory and bonus payments and social funds);
- enhance the impact of revenue-sharing with oil-producing regions (eg through the phasing of field development infrastructure with regional infrastructure development plans and industrial zoning).

[12] For example: Daniel, P. (2004) Petroleum Revenue Management: An Overview, World Bank, ESMAP Programme, draft.
Clark, A. and Clark F. (1999) The New Reality of Mineral Development: Social and Cultural Issues in Asia and the Pacific Nations, *Resources Policy*, 25, 3.
Publish What You Pay – www.publishwhatyoupay.org
Extractive Industries Transparency Initiative – www2.dfid.gov.uk/news/files/extractiveindustries.asp

Despite these initiatives though, domestic political pressures are mounting in many countries, and the consequences of oil and gas investments failing to meet national, regional and local economic expectations may be far reaching. Already, investment in the mining and minerals sector in the Philippines – which suffers many of the same criticisms and challenges as does upstream onshore oil and gas development such as a lack of local economic benefit and poor record on sustainability – has all but been halted by the political actions of national NGOs. Currently only two foreign operators are active in the country. Ten other major foreign operations have closed or been suspended since 1997, and the industry's contribution to export earnings has fallen from a high of 25% to less than 2%.[13] With the equity-holding rights of all foreign-owned investments under legal challenge by national NGOs at the highest judicial level, there is a very real risk that the gas sector may be next.[14]

2.1.3 Weaknesses in Current Economic and Socio-Economic Reporting

At the operating level in many low-income countries, a general absence of domestic regulation requiring companies to report on their economic, environmental, and social performance (also know as the triple bottom line) has led many major multinational companies to turn to international ethical standards for guidance. Most commonly used are the United Nations Global Compact principles (human rights, labour, the environment and anti-corruption), the International Labour Organization core conventions (human and labour rights), AA1000 Assurance Standard (sustainability

Box 1 The Importance of Local Content in Securing New Business

In 2003 the Government of Trinidad and Tobago signed a Production Sharing Contract (PSC) with BHP Billiton and its co-venturers, TotalFinaElf, Talisman and British Gas.

"We in Trinidad and Tobago appreciate and welcome the high level of interest shown by the international community in our local energy sector. My challenge to you though, our partner, is to join with us to also invest in and build our local capability. It is critical that we invest in our people, skills and local businesses that support the energy value chain. If our growth scenario is to materialise, it is important for us to invest in local content now.

"Currently, the Ministry is reviewing many of the issues involved in ensuring that guidelines for minimum local content in projects and activities are met and that procedures are developed to ensure compliance. Although there is presently collaboration between the state and some private companies on this matter there is a definite need for more coordination and an aggressive approach by companies. It requires a greater cooperation between government, industry, educational institutions and local businesses."[12]

…one year later…

"Let me firstly congratulate BHP Billiton and their partners in Block 2(C) Total and Talisman for the confidence they are demonstrating in the ability of local contractors and suppliers to meet their fabrication needs. As your development plans have progressed, I am pleased to note that Damus will be the local supplier for this contract, a marvellous opportunity for a local company to build capacity on the fabrication side of the energy industry. It is hoped that other local contractors will benefit from such transfers of technology and knowledge in the long run and I expect that this BHP Billiton initiative will be the first of many more to come. It is the view of the Government of Trinidad and Tobago that such partnerships are critical to its overall goal of sustainable development as the country moves towards realising developed country status by the year 2020.

"Ladies and Gentlemen, one of the key challenges facing the Government of Trinidad and Tobago is the equitable distribution of the country's wealth to the benefit of the widest cross-section of its citizens. …In this context, the Government of Trinidad and Tobago views the creation of local expertise in the energy sector which is transferable to other sectors of the economy, as critical to building local human resource capacity. In addition, the Government will institute measures to ensure that a significant portion of capital expenditure investment in the energy sector is channelled into the local for economy. …the Government of Trinidad and Tobago has identified several strategies as the means of achieving this goal. Amongst these are increasing the productive capacity of local business for both domestic and export markets as well as increasing local enterprises' share in projects with heavy capital inflows from Foreign Direct Investment."[13]

Hon Eric Williams, Minister of Energy and Energy Industries

[13] Hubo, C. (2003) Exploring Alignment between the Social and Environmental Practices of Mining Industry and Public Sector Development Priorities in The Philippines, Working Paper, World Bank, CSR Practices Unit.
[14] In February 2003 the Supreme Court of the Philippines declared illegal the right for foreign companies to hold more than 60% equity in a joint venture. The decision was not limited to the mining and minerals sector but in theory affects all industries. At the time of writing the ruling was being challenged.
www.energy.gov.tt/documentlibrary.incLinks.asp?Linkid=101
www.energy.gov.tt/documentlibrary/incLinks.asp?Linkid=196

performance including social, environmental and economic), and ISO14001 (environmental management). There is also an array of sector or process specific standards that are used by companies to measure their economic, environmental, and social impacts.

Clear and transparent reporting of performance underpins these and other standards, and has become in itself a tool to tell a story about a company's contribution to sustainable growth, poverty reduction and human development issues.[15]

One of the most widely accepted frameworks for reporting sustainability is the Global Reporting Initiative (GRI). The cornerstone of the GRI framework is the Sustainability Reporting Guidelines, the third and most recent version of which – known as the G3 Guidelines – was published in 2006. Other components of the framework include Sector Supplements (unique indicators for industry sectors, developed in 2005-06) and Protocols (detailed reporting guidance, 2006) and National Annexes (unique country-level information, due to be developed in 2008).[16] The GRI G3 economic indicators are listed in *Box 2*.

Box 2 The Global Reporting Initiative (GRI) G3 Economic Indicators

Economic Performance		
Core	**EC1**	Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.
Core	**EC2**	Financial implications and other risks and opportunities for the organization's activities due to climate change.
Core	**EC3**	Coverage of the organization's defined benefit plan obligations.
Core	**EC4**	Significant financial assistance received from government
Market presence		
Additional	**EC5**	Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation.
Core	**EC6**	Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation.
Core	**EC7**	Procedures for local hiring and proportion of senior management hired from the local community at locations of significant operation.
Indirect economic impacts		
Core	**EC8**	Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, inkind, or pro bono engagement.
Additional	**EC9**	Understanding and describing significant indirect economic impacts, including the extent of impacts.

Sustainability reports based on the GRI framework can be used to benchmark organizational performance with respect to laws, norms, codes, performance standards and voluntary initiatives; demonstrate organizational commitment to sustainable development; and compare organizational performance over time. GRI promotes and develops this standardized approach to reporting to stimulate demand for sustainability information – which will benefit reporting organizations and those who use report information alike.

[15] Slater, A (2004) GRI's Economic Performance Indicators: Measuring Impacts One Stakeholder at a Time. Amsterdam: Global Reporting Initiative http://www.globalreporting.org/NR/rdonlyres/E782C8D3-5B6B-435F-8826-F48DAFBD26A0/0/SlaterEconomicPerformanceIndicators.pdf
[16] http://www.globalreporting.org/AboutGRI/WhatWeDo

Over the past five to ten years, these standards have played a part in helping some multi-national energy companies frame their own operational 'safeguard' policies and practices (ie the prevention or mitigation of social and environmental harm and of corporate governance risks) in areas such as labour rights, human rights, environmental management, ethical sourcing, bribery and corruption.

The various existing reporting initiatives are under constant development and refinement. Indeed, there is room for further work to provide a more detailed methodology for assessing some kinds of economic impacts, and incorporate some of the additional analytical dimensions that are discussed in this report, for example in relation to the economic and socio-economic *distribution* of benefits, and the economic multiplier performance of investments.

To date many companies have focused reporting of their development contribution on community investment programmes and measures of Cash Value Added (CVA). This leaves companies exposed for at least two reasons. Firstly, community (or social) investment programmes, although often rationalised as a form of operational risk management, tend to have little to do with core business activities, instead playing a role as a form of global reputational assurance.[17] Reporting financial contributions to community investment programmes may satisfy to some extent institutional ethical investors and international community development NGOs that companies are doing 'something' to build a relationship with society, but it is unlikely to provide sufficient information to persuade the wider domestic political audience that, in the country as a whole, the business is a positive force for social and economic development.

Further, as proportionate expenditure on community investment increases, institutional investors have a new concern – that this expenditure might begin to materially affect overall earnings. As one anonymous ethical investment analyst recently explained, "What is most important is not to prove that community investment programmes realise local benefits, but that this expenditure is 'cost neutral,' ie does not adversely affect the overall financial performance of the business."

Secondly, with respect to the reporting of Cash Value Added (CVA), in economically poor and poorly governed countries such information is limited as a means of providing assurance to investors and 'credible witnesses' (media, NGOs, opinion formers etc) that the investment is generating an adequate rate of economic return.[18]

[17] There are of course exceptions, such as in Nigeria, where there is a strategic attempt to link investment in community development to reductions in crude oil deferment. SPDC (2003) People and the Environment *Annual Report*, Port Harcourt: Shell Petroleum Development Company, Nigeria

[18] It seems likely that accountants were influential in the selection and design of the GRI economic indicators, which might explain the promotion of indicators that present figures taken directly from the financial accounts (principally from the profit and loss account/income statement) as surrogates of economic benefit.

Although in theory the financial value added (the difference between the costs of raw materials and payments to suppliers) is available for distribution to employees, governments, investors and local communities, in the upstream oil and gas business in developing countries obstacles to the equitable distribution of this value are many. For example:

- in many low-income countries, public sector finance suffers from institutional weaknesses, and may be ineffective in managing the volatility of *resource rents* in relation to exchange rate stability, or in allocating revenues to public expenditure priorities, including development or poverty reduction programmes targeted at the region of operations;

- *dividends* tend to return to the equity holders of the joint venture partners, who, other than the ubiquitous national oil company partner, are frequently 'incorporated' outside the host country;

- the economic value added to society from *capital expenditure* during the development phase of upstream investments may be constrained by technical limits that act as barriers to local people realising employment opportunities or to supply chain entry for local firms;

- with regard to *operational expenditure*, once operating the upstream oil and gas business is rarely employment intensive and the same supply chain constraints often apply; and

- the positive economic impact of tax allowances that encourage *re-investment* in new 'expansion' projects, can be undermined if companies intentionally schedule their expansion programmes to minimise tax payments on a rolling basis.

To be meaningful to stakeholders living within the host society, overall figures on contribution need to be given context so that their relevant magnitude and significance can be gauged. What is also needed is to know how overall figures break down at the country level and over time, and the significance of this breakdown to the country or audience in question. For example, is the majority of this expenditure during the development phase of an oil or gas field project, and does it represent 5% or 0.005% of GDP? What proportion of expenditure was made through firms who employ people living within the oil or gas producing region; and within this, what proportion provides direct or indirect (supplier-related) employment benefits to directly affected communities?

Returning to the example of the GRI economic indicators, it is understood that the issue of 'significance' in the reporting of economic impacts did arise during initial discussions to define the GRI 2002 economic indicators.[19] Indeed, progress was made in incorporating supplementary information that would provide some broader economic context to the financial numbers. For example, the 2002 indicator EC2 on revenues (which in the G3 version, is split between EC1 and EC3) suggests companies report not only the financial figure for net sales of products and services but also report market share and sales for countries where national sales represent more than 5% of a country's GDP. One can thus argue that the principle of reporting the economic significance of financial performance does underpin some of the GRI economic indicators. More though, could perhaps be done to extend this idea of reporting the significance of financial figures to take account of the interests of different stakeholder groups and of the distributional effects of economic impacts. 2002 indicator EC13 on indirect economic impacts makes a start in this direction, and further progress has been made in the equivalent EC9 in the G3 version,[20] but it is not considered a 'core' indicator, and is still a narrative and mostly qualitative indicator. The management framework presented in *Section 4* of this report offers some ideas to improve reporting of the significance and distribution of positive economic impacts.

The gaps in identified in the GRI 2002 economic indicators explain in part the new sectoral focus of the GRI in developing the G3 indicators with sector supplements and national annexes. As these discussions move forward, a clear distinction is needed between the use of financial figures as economic surrogates and the interpretation of these numbers in terms of their distribution as benefits across society. But, linking economic benefits reporting to the financial accounts is important, and should be retained, not least because it helps to inform the commercial business case for the company's efforts in this arena. Where more effort is needed is in interpreting the significance of these numbers in terms of their contribution to public policy targets for national or local economic development, and in terms of the way in which economic benefits are distributed to different parties at the local, provincial, national and international levels.

In summary, countries where economic development is poor and the public sector inefficient, disclosure of Cash Value Added provides a shallow basis for reporting the economic and socio-economic rate of investment return. Offering financial numbers as economic surrogates provides audiences little context for interpreting either whether these are meaningful to the priorities of local, regional or national society, or whether they reflect well on the short or long-term status of the business. Put more candidly, few are impressed when a big company generates big numbers.

[19] A. Henriques, pers comm., Sept 2004
[20] Global Reporting Initiative *G3 Indicator changes* http://www.globalreporting.org/NR/rdonlyres/8F4781CA-BB96-4B68-8FBD-A1CC3AA0E353/563/IndicatorChanges_G2DraftG3_FinalG4.xls

What impresses more is an honest interpretation of the relevance of these numbers to the social, economic and investment priorities of those receiving the information. A number of other initiatives point to the need for reporting a deeper analysis of the components of Cash Value Added. These are given in *Box 3.*

2.1.5 Beyond Cash Value Added

The focus on a breakdown of Cash Value Added is further limited by the omission of other ways in which upstream oil and gas development businesses interact with the development priorities of poor countries. Areas of reporting that could benefit from a 'widening' of the current focus of economic reporting on CVA include the performance of the business in contributing to:

- macro-economic stability;
- an improved foreign investment climate;
- a stable and predictable tax base;
- direct product and services utility (mobility, lighting, energy, product R&D eg solar);
- the indirect impact of products and services on public services: health, education etc;
- the transfer of ethical and quality standards to subsidiary company shareholders and suppliers/ contractors;

Box 3 Initiatives That Have Sought to Deepen Economic and Socio-Economic Reporting

- the IFC economic framework for assessing development impact – a valuation model promoted by the International Finance Corporation which uses a stakeholder-orientated approach to measure the economic additionality of private sector investment. The framework measures, for example: the economic benefits of staff training; technology and skills transfer to local supplies and contractors; effects of supplier and distribution networks; local market development; and the multiplier effect on local trade through procurement (IFC (2002) *Results on the Ground* – www2.ifc.org/economics/pubs/results.htm)
- the Sustainability Framework of the International Finance Corporation, which offers a means to rank companies against a suite of environmental, governance and socio-economic performance standards. With regard to socio-economic performance, companies achieve the highest level of ranking only if they have a wide influence in driving best practices in the areas of local economic growth and SME development, and/or enter into public-private policy dialogue relating to revenue management and improvements in the legal framework for revenue-sharing that leads to results in substantive change at the national level (IFC (2003) Measuring Sustainability: a Framework for Private Sector Investments – www2.ifc.org/sustainability/docs/measuring_sustainability.pdf)
- the World Bank CSR-Public Sector Diagnostic Framework, which includes monetary flows to the public sector, employment and human resource development, technology transfer, and procurement and supply-chain management (Corporate Social Responsibility Practice, World Bank – www.worldbank.org/privatesector/csr/prac_work_prog.htm)
- studies on the role of public sector in incentivising foreign direct investment point to the main benefits of FDI, including: improvements in balance of payments, growth in domestic savings and investment, transfer of input technology and skills, job creation, environmental benefits, stability in foreign inflows of funds and higher export growth (for example, Mehta and Dugal (2003) *ABC of FDI*, pub, India: CUTS)
- a framework for 'pro-poor' investment framework developed by Emerging Markets Economics for the UK Department for International Development. This looks at the contribution of business in three ways: (i) conventional economic growth, in the form of 'revenues-less-expenditure' on wages, depreciation, interest, tax and profit; (ii) socio-economic benefits, in the form of business activity that inherently contributes to social inclusion and social development arising from, *inter alia*, the geographic location of business activity, the extent of market penetration, the effect of distribution channels, the types of labour requirements, local business linkages and local multiplier effects, revenues reinvestment in the local area, and the redistribution of taxation; and (iii) socially responsible business practices, such as goods and services designed for low-income consumers, social investment and charitable giving (including partnerships with local communities), efforts to maximise local content through procurement and sub-contracting, and employment policies that favour the disadvantaged (DFID – www.dfid.gov.uk search: 'pro poor investment')

- operational infrastructure that provides a public service (eg certain facilities access roads or port facilities, or PPP arrangements for dual-purpose power generation or water supply); and

- community investment activities that contribute to regional and national level development, such as in the area of economic planning.

Overall, it would seem fair to conclude that international standards for reporting the economic and socio-economic benefits of business in the context of the development priorities of poor countries could be improved.

2.1.6 Trends in Investor Analysis

There is though perhaps a more fundamental change taking place in the field of corporate reporting than working up new economic indicators. Institutional portfolio investors have for some time relied on Socially Responsible Investment (SRI) information for companies reporting their performance against aggregated generic indices, which are applied to all business operations regardless of whether they are operating, sourcing or marketing in developed or developing countries. The way in which the GRI, FTSE4GOOD, and Dow Jones sustainability indices have been applied are cases in point. As companies move into developing countries, and social and economic issues become more important, some SRI fund managers[21] are beginning to find that the benefits of being able to compare companies directly against a common set of indicators are outweighed by the limitations of such 'comparability' as a means of informing investors of their true exposure to reputational and commercial risks.[22]

SRI fund managers and in-house corporate governance analysts have responded to these shortcomings by increasing their direct 'engagement' with companies at the corporate level. These face-to-face visits focus on pre-selected environmental, social and governance topics allowing, in theory, the analyst to gather information on the areas of highest commercial risk or opportunity, and provide a level of confidence that the risks are being properly managed and the opportunities realised.

This is the theory. In practice it seems that at present the emphasis in 'engagement' strategies remains centred on generalised topics rather than specific risk events or opportunities at specific locations and that might have a bearing on a company's revenues, profitability or cash flow or its long-term business growth. Further, engagement strategies tend to be built around the more mainstream environmental and social issues of the day: global warming, human rights (child labour), and

[21] Personal experience of the author.
[22] Beyond the recognised shift in the geography of earnings, another possible cause of this change of heart in the investment community could in part be the introduction of the mandatory 'Live Risk Register' for UK-listed companies, which profiles location-specific commercial and non-commercial risks.

community (social) investment. Direct engagement on a company's performance in contributing to the broad sweep of economic and socio-economic benefits in relation specifically to its developing country operations seems not to have materialised in any depth.

Despite these limitations, the strategy of institutional investors to extend their analysis from simply the comparison of companies against aggregated generic indicators, to direct engagement on particular issues, is of significance. It is arguably symptomatic of a broadening of the basis for fund management decision-making in relation to governance issues from the use of aggregated Group-level information, towards the use of information on operation-specific, short-term operational risks and long-term growth prospects, material to the commercial fortunes of the Group as a whole. There is hope then that before long fund managers with energy companies in their portfolios will begin to assess whether future returns for their clients (such as the large pension funds) might not be tied in part to the domestic political and social acceptability of the upstream hydro-carbons industry in the Group's main growth centres. Where this is thought to be the case, an engagement strategy will be needed that focuses discussion not only on whether, as a whole, the Group has policies and systems in place to assess and mitigate the conventional range of potentially adverse environmental and social impacts of oil and gas operations, but how individual operations are contributing to the distribution of in-country economic and socio-economic benefits.

To be more specific, it is quite likely therefore that in the near future engagement with corporations by investor analysts will require evidence of the ways in which 'high-risk' or 'high opportunity' subsidiaries, joint ventures or country businesses are contributing to regional and national economic and socio-economic development priorities. Those subsidiaries, joint ventures etc that can demonstrate that they are systematically gathering, reporting, and continually enhancing their economic and socio-economic performance in relation to the priorities of the host government and those living in operating regions, are likely to be rewarded by the mainstream investor community.

2.1.7 Conclusions

Within many of the world's multi-national integrated oil and gas companies, the geographic shift of growth centres towards underdeveloped countries and regions in Africa, Asia and Latin America carries new risks for both near-term earnings and long-term access to business opportunities. Expanding the business principally through upstream developments in developing economies demands not only external investor confidence but also broad in-country political support. The greater the reported mutuality between, on the one hand, the internal returns on oil and gas

investments and, on the other, in-country economic and socio-economic development benefits at the local, provincial and national level, the more likely it is that this political support will be maintained and shareholders satisfied.

However, delivering and reporting enhanced economic and socio-economic performance is not easy. Oil and gas production in low-income countries and regions brings about an array of complex commercial, political and governance challenges. These serve as barriers to achieving connectivity between the activities of the business and tangible economic and socio-economic benefits within society. Identifying where exactly this connectivity lies, or might be developed, and finding meaningful and credible ways to report business performance against it, is the focus of subsequent sections of this report.

2.2 A 'Drift' in Comprehension

The discussion thus far has centred on upstream investments in developing countries. In downstream manufacturing industries (chemicals, refining) and retail operations (lubricants, fuel, convenience stores etc) located in more developed countries, the drivers for socio-economic reporting still exist, though they are arguably perhaps less urgent. The drivers fall into two categories:

- the attention of the media to negative 'issues' in the industry; and
- the one-dimensional reporting of financial accounts.

Here the economic 'benefits gap' is more one of perception, with a drift in comprehension in the connectivity between the internal activities of downstream energy companies and their economic impact on wider society.

2.2.1 Dislocation of the Hydro-Carbons Industry from Society

The first driver for change in external reporting is the dislocation in perception between the general public and the industry, brought about in large part by the attention of the media to 'negative issues.' Over the last ten years, four sets of issues have come to and continue to dominate:

- **redundancy** in declining oil-producing regions (eg in Aberdeen, Scotland with respect to the operations in the North Sea), or in regions where oil refinery operations are losing business to new refineries built in developing countries;
- **fuel station prices**, for example 'the pump wars' in the UK in 2000;

- **global warming** and **renewable energy**, as noted in John Browne (CEO of BP plc) in his Stanford 1997 address acknowledging a "*link between the concentration of carbon dioxide and the increase in temperature;*" and

- **tax exemptions** and **avoidance vehicles**, such as foreign sales corporations (FSCs), home country tax credits, tax waivers for mergers and acquisitions etc.

The argument put forward in this report is that the focus by the media on the negative perceptions of the industry has begun to cause a dislocation in the minds of some opinion-formers. The concern is for a drift in comprehension in terms of a linkage between the internal activities of the downstream hydro-carbons business and its external economic impact on wider society. For example, few in the media report on oil and gas companies as 'energy' businesses contributing to mobility, lighting and heating; or on the ways in which these products in turn contribute to improvements in almost every aspect of modern life, from health care to education; or on these companies as innovators in areas such as eco-efficiency technology, lubricants, solar panels and convenience stores.

As with economic and socio-economic reporting at the operational level in developing countries, a dedicated framework for reporting that identifies, prioritises and fuels a narrative on the economic and socio-economic performance of downstream operations is needed to 'reconnect' the business with society.

Currently, there seems to be an absence of a systematised approach to reporting the positive economic impacts of the hydro-carbons industry at a global or country level, or the ways in which positive economic impacts might be assessed in the wider context of the industry's short and long-term adverse environmental, economic and social impacts. It should be noted, however, that the management framework for economic and socio-economic reporting presented in this report makes no attempt to judge the possible trade-offs between the positive economic contributions of the business and its adverse impacts, such as against bio-diversity issues, climate change, health and safety incidents, or localised adverse economic 'boomtown' impacts. Indeed, it is difficult to conceive of a credible methodology that would calculate and report the overall external 'net benefit' of an investment on society. This said, finding a way defensibly and honestly to report the economic and socio-economic benefits of business will go some way to informing discussions with both internal and external stakeholders as to where the trade-offs, particularly the socio-economic trade-offs, might lie.

2.2.2 One-Dimensional Financial Disclosure

As with reporting on business performance for upstream operations in developing countries, disclosure of the company's financial accounts for downstream operations in developed countries remains the principal source of external information reporting on broader economic performance. The problem is that the interpretation is one-dimensional, focusing on what the figures mean only in direct commercial terms. There is very little interpretation of the financial numbers – opex, capex, corporate tax, employee and R&D expenditures etc – in terms of the socio-economic consequences of the business's financial performance.

The same is true for businesses in developing countries, though this may be changing. Some operations in poor countries and regions are beginning publicly to disclose aspects of their socio-economic performance alongside their financial performance. This includes reporting against local content, payments to government, human resource development, and community investment.

Nevertheless, it is clear that more work is needed to address shortcomings in economic and socio-economic reporting for operations in both developed and developing nations. The framework for reporting described in this study may offer a starting point. Other work is also needed to clarify the precise pathways through which core business activities contribute to society, especially with respect to the impact of integrated oil and gas businesses as 'energy' companies.

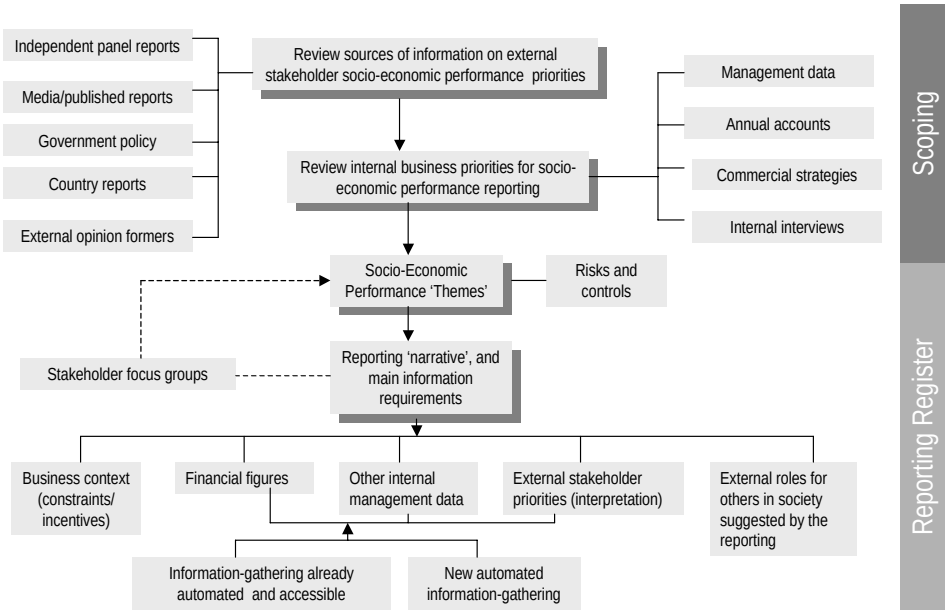
3. Overcoming the Challenges to Reporting Economic and Socio-Economic Performance

3.1 Introduction

As indicated in *Section 2,* there have been various attempts, both external and internal to the major multi-national oil and gas companies, to improve economic and socio-economic corporate reporting. Among the external initiatives are the aforementioned Global Reporting Initiative (GRI), IFC Economic Valuation Model, and the DFID programme on measuring the impact of business on poverty. The internal initiatives undertaken by energy companies are many. These generally include annual corporate sustainability or corporate citizen reports; health, safety, environmental and community reports at the operational level; and disclosed financial information at the operational and corporate level.

Each of these efforts has met with varying levels of success. Described below are ideas learned from these efforts for overcoming the main challenges to reporting economic and socio-economic performance. The ideas form part of a broader management framework for economic benefits reporting described in *Section 4* and summarised below in *Figure 2*.

Figure 2 Building Blocks of a Management Framework for Economic and Socio-Economic Performance Reporting



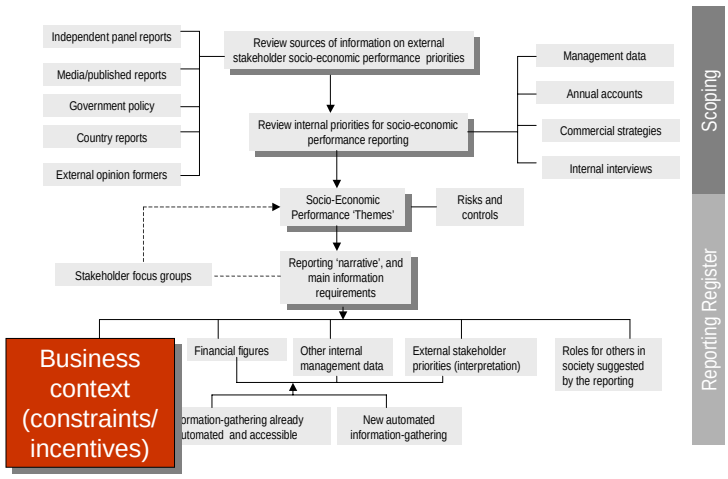
3.2 Reporting the Public Policy Context for Doing Business

In compiling this report, many of the company staff interviewed cited the constraints they were under as an energy business to being able to enhance their economic and socio-economic contributes to wider society. These included the terms of transactions with government and national oil companies, for example in relation with the timing of payments of resource rents; the wider policy context for upstream development, such as the strategy of the government for export-led economic growth; or the reality of competition in a global free market which limits the room for companies to take unilateral actions that might raise costs or reduce returns. The problem with omitting to report these higher-level legal, contractual, policy and business constraints is that much of the economic and socio-economic performance currently reported 'appears' to external stakeholders to reflect internal business decisions and priorities, when in fact these decisions are shaped by forces outside the control of the business.

An example would be Kazakhstan. Here, the government has adopted an oil-based, export-led, economic development strategy, supplying markets in Europe in order to reduce their dependency on Russian supplies. Criticism levelled at oil companies operating in Kazakhstan for not investing in economic value-adding facilities such as refineries, distribution etc, would therefore seem misdirected. Companies *do* make a choice about where they operate, but are rarely involved in the economic growth policies of sovereign governments.

What is needed, therefore, is an approach to economic and socio-economic benefits reporting that provides an upfront explanation of the main regulatory and public sector policy constraints and incentives acting on the business, and the strategies adopted by the business to work within these limits. This aspect of the draft framework is 'located' in *Figure 3a.* For detail refer back to *Figure 2*.

Figure 3a Business Context (constraints/incentives)



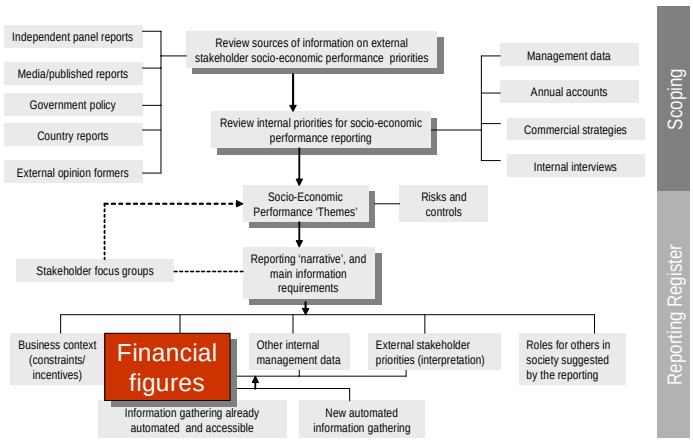
3.3 Tracking Socio-Economic Benefits through the Financial Accounts

More so than the external disclosure of localised community investment programmes, reporting the wider economic and socio-economic contributions of energy companies at the regional and national levels will need to be closely tracked in financial terms by each business. Internal assurances will be needed that the information reported is defensible, and that any targets set for improving performance over time, in particular those which might lead to modifications to core business practices such as sub-contracting or facilities maintenance, reinforce rather than undermine core business objectives (see *Section 3.6* on managing the risks of reporting).

To meet these requirements, the draft framework for socio-economic performance reporting proposed in this report draws on recent thinking in Benefits Realisation.[23] This is the process of tracking the deployment of a company's resources and expenditure to assure compatibility between the outcomes of an activity and the original strategic business objectives that lay behind the deployment decision. In the case of reporting economic and socio-economic benefits, this means, for example, tracking improvements in localising the use of sub-contractors, so that not only socio-economic improvements are recorded (eg increased local employment opportunities and economic multiplier effects) but also the consequent operational expenditure savings in contracting costs to the operating company.

Such 'benefits tracking' will be easier to sustain over time, and more likely to point towards a 'win-win' outcome for the business and wider society (ie delivery of a 'mutuality' of benefit for internal and external stakeholders) if the process of gathering data for reporting is linked to the mainstream financial accounting and management data systems (see *Figure 3b*). This will mean working with specific line items in the existing financial accounts (P&L, Cash Flow or Balance Sheet) and drawing on related data management systems. The approach has the added attraction of ensuring that, as guidance for benefits reporting evolves it will be truly integrated with

Figure 3b Financial Figures



[23] Warner, M. (2003) Putting the Sustainable Development Performance of Companies on the Balance Sheet. London: Overseas Development Institute – www.odi.org.uk/PPPG/activities/country_level/odpci/c3software/BalanceSheet.pdf

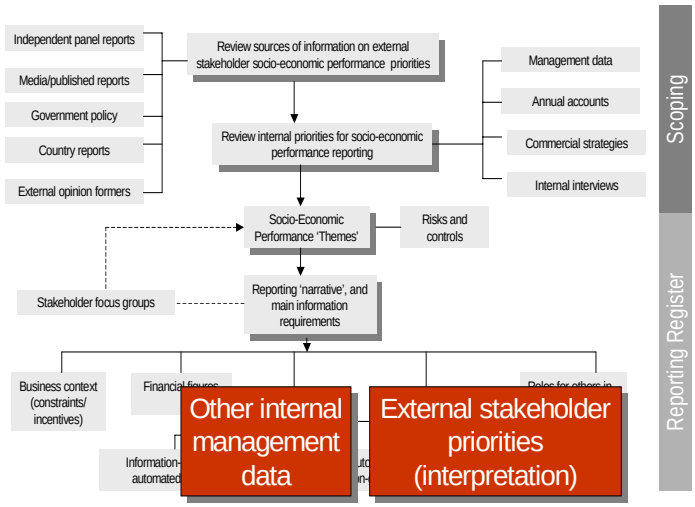
the business, helping to make 'triple bottom line' reporting a reality, and to prevent the principle of 'mutuality' being narrowly interpreted as a bolt-on, unconnected with the reporting of internal financial returns.

3.4 Meaningfulness of the Information Disclosed

As discussed earlier, the indicators adopted under existing initiatives usually offer little context within which to judge whether the value cited is significant in terms of its contribution to some economic or social priority in society. In other words, the 'magnitude' of the variable is reported, but less so its 'significance'.

The draft framework for reporting developed in this study seeks to stimulate the disclosure not only of financial information but also of additional 'interpretive' information (see *Figure 3c*). This interpretive data takes two forms:

Figure 3c Internal Management Data and External Priorities



- internal (non-financial) management information, such as the number of employees, proportion of nationals versus expats, or proportion of employees living locally; and

- external contextual information, such as reporting average skill-based wages as proportion of average national wages, or number of employees living locally as proportion of total number of local unemployed.

In addition, and as noted, Cash Value Added and other conventional economic indicators can be a poor reflection of the economic contribution of business to the development priorities of poor countries or local societies. A broadening and deepening of the choice of themes for economic and socio-economic reporting is needed: one which allows for a closer fit with the activities and impacts of the business in terms of the development agenda of the host country and region. To achieve this, the framework promotes an early 'scoping' exercise to guide the compilation of information for reporting towards those economic and socio-

economic benefits that are a priority (see *Figure 3d*). The proposed scoping exercise is not limited to solicitation of benefit priorities from external stakeholders only.

It also encourages the views of internal staff to be taken into account, inviting comment on the areas in which they believe the business adds or could add value to wider society.

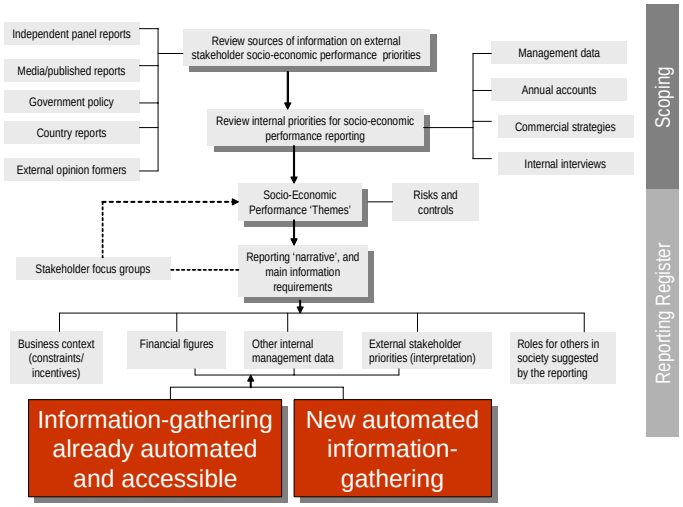
Figure 3d Scoping Exercise

3.5 Prohibitive Costs of Benefits Reporting

Both Shell's experience with country 'location reports,' and the recent surveys undertaken by Emerging Market Economics for the UK Department for International Development (DFID) on economic impact reporting in the context of poverty reduction, show that the costs of economic reporting are not insignificant. Detailed costings were not available for this study, but most likely run into tens of thousands of pounds for consultants' fees plus substantial man hours of internal staff time in finding or compiling the requested information. Because economic benefits reporting is not systematised within companies, much of the information has to be collected through stand-alone surveys or requests for specific information not readily available within existing databases. According to the site visits conducted for this study, informational areas particularly lacking with regard to economic and socio-economic benefits reporting include:

- the impact of procurement strategies and supply chain management on generating economic multiplier effects at the community, municipal and provincial level;
- the effect of capital expenditure on improving local and regional infrastructure;
- the impact of products and services on consumers, eg in terms of utility, mobility etc; and
- the impact of operations on local institutions and the legal framework, such as the effect of stability clauses and international arbitration within production-sharing contracts.

Figure 3e Automated Information-Gathering and Interpretation



For benefits reporting to become a reality, ways are needed to reduce the current dependency on free-standing surveys and to move towards automated data-gathering and interpretation. Integration of benefits reporting with existing financial reporting is one way to achieve this, combined with the use of 'softer' management data to provide interpretation. Further, new quarterly reporting requirements could be introduced into the contracts of the main engineering and procurement contractors, for example requiring information on the registered location of suppliers, nationality of employees, training hours contributed and technologies transferred.

Interpreting these data in the context of public policy incentives and external stakeholder priorities is more challenging. Success will depend to a large degree on the effectiveness of the aforementioned scoping exercise in identifying 'what really matters,' as well as accessing national and international data on macro-economic and human development targets and indicators available from sources such as the Finance Ministry, World Bank,[24] United Nations[25] etc.

It is worth noting that the upfront scoping exercise need only be undertaken every three to five years, or at discrete junctures in the life of an investment. This is because it is unlikely that, within time frames of three to five years, the broad public policy environment, the basic business strategy or the external stakeholder priorities will change significantly.

3.6 Risks to Business of Benefits Reporting

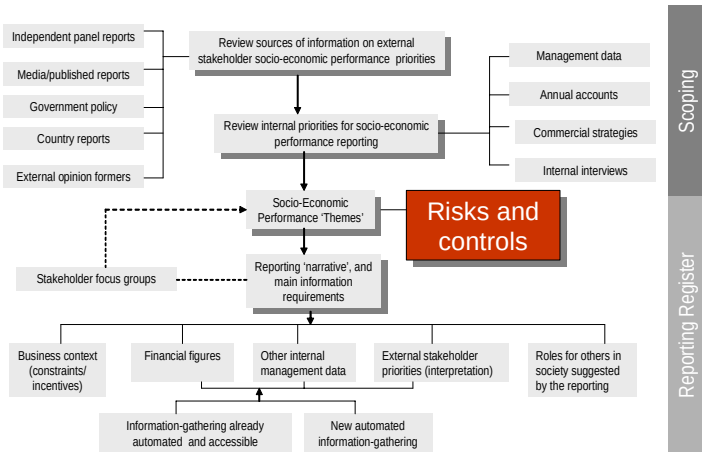
It became clear during the progress of this study that reporting economic and socio-economic benefits carried varying degrees of risk to the company. The basic problem is that many of the economic benefits likely to be reported are implicitly 'directional.' For example, if a company reports the nationality of its employees, it is making the implicit statement that the more nationals employed, the better the economic performance of the company. Depending on the skills levels of the

[24] World Bank Data and Statistics – www.worldbank.org/data
[25] United Nations Human Development Indictors – http://www.undp.org/hdr2003/indicator/index_indicators.html

available labour pool, improving performance in this area may actually carry commercial risks. Likewise, by reporting third-party spend on suppliers contracted from the local region, the company is running the risk that it will, over time, promote procurement of sub-standard materials and unreliable contractors.

One can see that in the future, as a deeper and wider range of economic and socio-economic themes are reported year on year and become a *de facto* performance target, improvements in performance might actually work against the short to medium-term commercial interests of the business (notwithstanding the fact that they might concurrently contribute positively to the company's reputational and compliance interests).

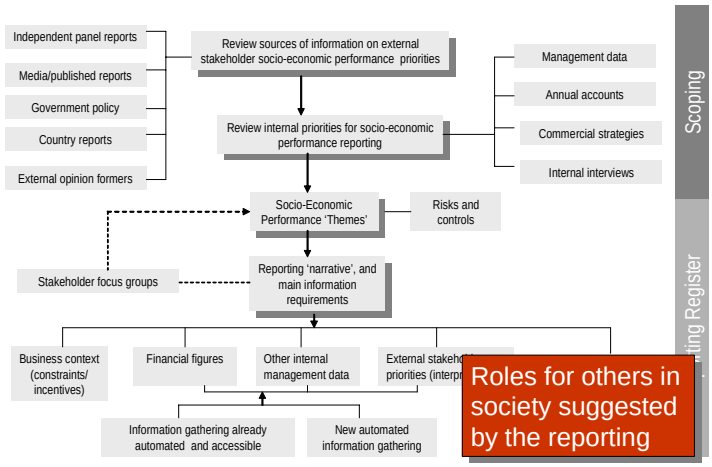
Figure 3f Controlling the 'Risks' of Reporting



The study looked at three ways of controlling these reporting 'risks.' First, the scoping exercise, suggested as a way to focus on benefit themes and indicators 'that matter,' now includes a risk grading column identifying reporting themes and information carrying commercial, compliance or reputational risks. Second, explicit 'control' measures can be identified to reduce risks to acceptable levels. Third, it is recommended that the reporting of economic and socio-economic benefits incorporate an advocacy component, identifying the possible 'role for others' – government agencies, international donors, international NGOs etc – in shaping policy or regulatory standards, or working in partnership to incentivise the company and share the burdens of continued enhancement of socio-economic performance.

With regard to the latter of these roles (partnerships), BP, Shell and the other oil supermajors are actively engaged in developing strategic alliances with civil society and public sector authorities to manage social and environmental issues. Initially aimed at improving the relevance and sustainability of short-term community investment programmes, the approach is now being applied with the aim of reducing the cost burden and sharing the risks of wider economic benefits, such as maximising local content, widening training opportunities, building local, regional and national institutions, and contributing to local and regional infrastructure.

Figure 3g External Roles



Examples from within the BP Group include the Regional Development Planning Forum initiated by BPXC in Casanare, Colombia, and the Diversified Growth Strategy of BP's Tangguh LNG project in the Berau-Bintuni Bay region of West Papua, Indonesia. Both of these are partnership-based initiatives involving a range of civil society and public authority parties, and both seek to scale up and provide long-term sustainability to the economic and socio-economic benefits brought by the company to the region of operations. The former aims to achieve this through more transparent and effective public sector management of oil production revenues; the latter by stimulating economic growth, not immediately adjacent to facilities (which is deemed unsustainable) but in regional towns able to accommodate the anticipated pressures.

4. A Framework for Reporting Economic and Socio-Economic Performance

4.1 Introduction

Designed in part to overcome the persistent challenges to meaningful economic and socio-economic performance reporting, the building blocks of a framework for gathering, interpreting and reporting the economic and socio-economic benefits of energy companies is presented as *Figure 2* (page 19). Its main applications are discussed in this section, along with a description of the ways in which the scoping exercise might be carried out in practice, the importance of compiling different types of information into *Reporting Registers*, and a method for managing the inherent risks.

4.2 Applications

Above all, the framework is intended to broaden external reporting within energy companies in a manner that makes more explicit the positive linkage between core business activities and the economic and socio-economic priorities of the host society.

The framework is intended to be applicable first and foremost at the country operational level, for example to inform quarterly business reports or the preparation of annual country-level social and environmental reports. With regard to corporate reporting, the utility of this will emerge over time. For example, it could be used to generate a generic set of economic and socio-economic indicators that could be aggregated across operations, such as in the areas of payments to government, local content and training.

It could also be applied to generate a global map (accessible online or in hard copy) showing how oil and gas operations around the world contribute to the economic and socio-economic performance of the country in which they operate. As illustrated overleaf in *Figure 4*, 'drop-down' boxes would allow the user to look at the overall scope of economic and socio-economic reporting for a particular country, as well as to access detailed data for each of the prioritised 'benefit' themes.

4.3 Scoping

An evolving checklist of potential positive economic and socio-economic reporting categories and themes for the hydro-carbons industry is presented overleaf in *Table 1*.

A wide range of sources was used to compile the checklist including those detailed after the table, on page 31.

Figure 4 Country Economic and Socio-Economic Contributions of Multi-National Energy Companies: *an application of the framework for online performance reporting*

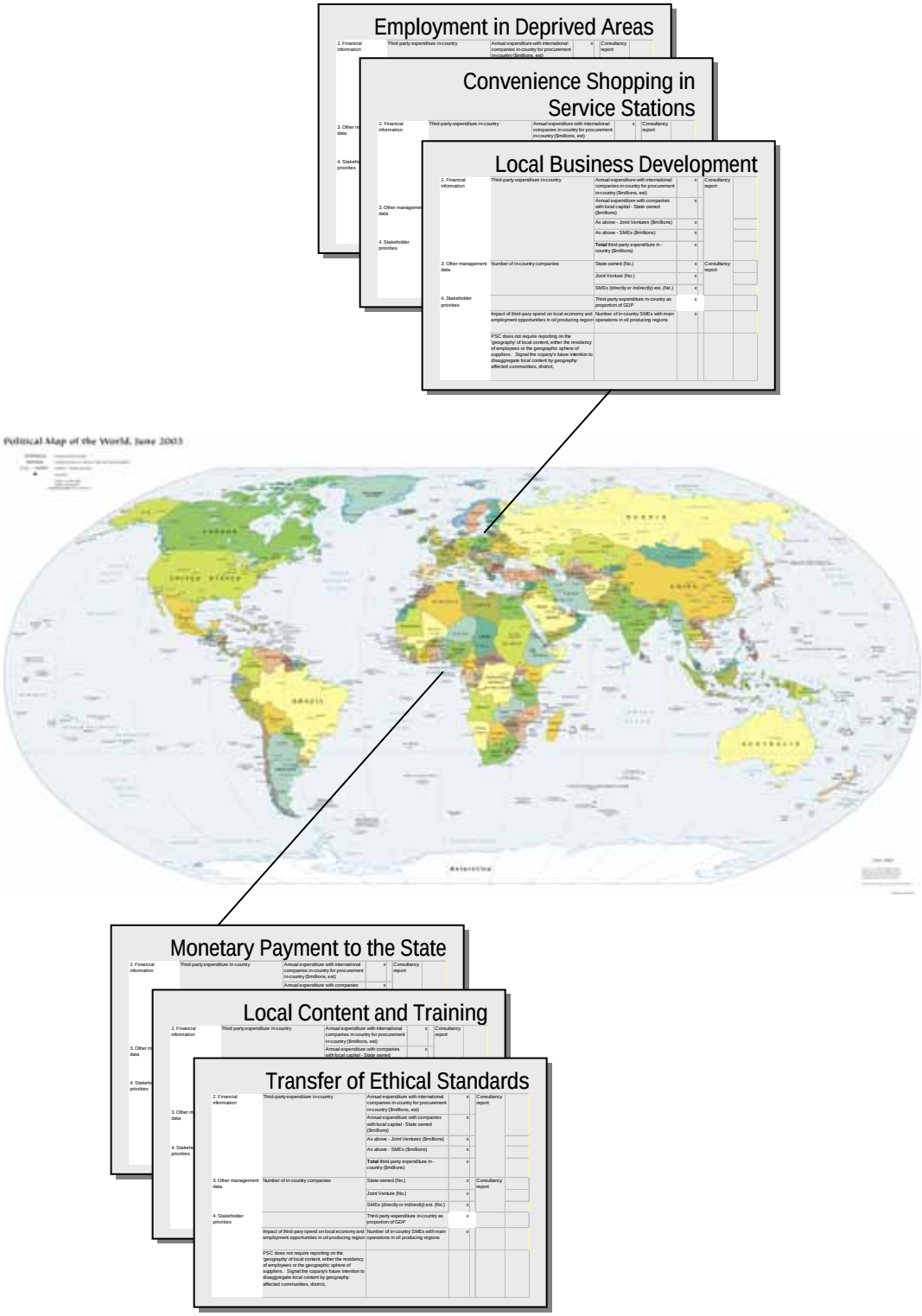


Table 1 Checklist of Economic and Socio-Economic Reporting Categories and Themes for Integrated Oil and Gas Companies (with template for identifying Stakeholder Interests)

Reporting Categories	Reporting Themes	Discrete business or JVs			Stakeholder Groups												
					Internal Stakeholders				External Stakeholders								
					Business investors/financiers	Sponsoring ministry	Employees	Suppliers and contractors	Institutional investors	Customers and end-users	Affected communities	Civil society – in-country	Civil society – international	Public sector – local/regional	Public sector – central government	International development
Products and services	Country/region source of raw materials/supplies															
	End-user utility of products and services – fuel, mobility, lighting, convenience															
	Market penetration and product diffusion															
	Product and service taxes															
	Research and development															
Monetary payments to the public sector	Signatory and bonus payments															
	Social funds															
	Royalty payments															
	Profit oil															
	Cost recovery															
	Profit tax															
	Withholdings from foreign sub-contractors															
	Tax credits															
	Indirect taxes – contactors and sub-contractors (profit tax)															
	Indirect taxes – income tax paid by national employees and foreign employees working for contractors and sub-contractors															
	Indirect tax – social security contributions paid by national employees working for contractors and sub-contractors															
Reinvested earnings	Location of reinvested earnings															
Profits	General division of allocations															
Dividends	Joint ventures/subsidiaries															
	Corporate level															
Political Stability and Governance	Involvement of government institutions in international processes															
	Transparency in revenue flows															
	Development of capacity to manage revenues at national/regional level															
	Development/reform of government institutions															
	Strengthening the 'rule of law', eg hierarchy of legal norms, international arbitration															
	Disclosure of project documents															
Economic growth/stability	Balance of payments/terms of trade															
	Export growth															
Investment climate	Direct effects on regulatory stability– (tax regime, compliance requirements															
	Investment competitiveness – availability of domestic financing															
	International competitiveness – appropriate skills and knowledge															
	International competitiveness – capacity of domestic companies															

Reporting Categories	Reporting Themes	Discrete business or JVs			Stakeholder Groups											
					Internal Stakeholders						External Stakeholders					
					Business investors/financiers	Sponsoring ministry	Employees	Suppliers and contractors	Institutional investors	Customers and end-users	Affected communities	Civil society – in-country	Civil society – international	Public sector – local/regional	Public sector – central government	International development
NOC – IOC transactions	Intangible economic benefits of PSC/concession arrangements, eg local content, training															
	Transaction design effects on regulatory stability (tax, compliance, NOCs 'backing-in' etc)															
	Benefits arising from conditionality of project financing, eg 'Equator Principles', development finance															
Employees	Salaries and wages															
	Training and human resource development															
	Local content and staff succession															
	Other employee benefits															
Suppliers and contractors	Local content															
	Technology transfer															
	Skills transfer															
	Local market/business development															
	Local economic multiplier effect															
Infrastructure and equipment	Operational infrastructure that provides a public service, eg roads, power, health, education, telecommunications, water and sanitation															
	Operational equipment that provides a public service, eg office equipment, vehicles															
Domestic banking sector	Cash deposited in local, region and national banks															
	Debts to local, regional and national banks															
Ethical and quality standards (HSE and social)	Effects on subsidiary company shareholders															
	Effects on suppliers and contractors															
	Effects on regulatory regimes															
Security	Employees															
	Wider society															
Charitable giving	Cash															
	In-kind															
Eco technology	Eco efficiency															
	Renewables															
Bio-diversity	Innovation – bio-diversity/conservation															
Social investment in affected communities	Community content/employment															
	Community business development															
	Community infrastructure															
	Community institutions and human resource development															
Regional development (region of operations)	Regional content/employment															
	Regional business development															
	Regional infrastructure															
	Regional institutions and human resource development															

- discussions at staff level from Shell Int and BP plc;
- lessons learned from field visits undertaken with Shell in London and the Philippines; AMEC in the Philippines; Balfour Beatty in Indonesia; and with two BP country operations;
- various BP and Shell Location Reports;
- the Shell Report (2003) on sustainable development;
- the BP Environmental and Social Review Annual Report (2002) and Sustainability Report (2003);
- BP disclosed financial accounts (country and group levels);
- sample Production Sharing Agreement (AICO 1996, Azerbaijan);[26]
- World Bank Extractive Industries Review;[27]
- International Finance Corporation 'Sustainability Framework;'[28]
- International Finance Corporation 'Economic Valuation Method;'[29]
- CSR standards, principles and indices: GRI, OECD MNE Guidelines, Global Compact, FTSE4GOOD and Dow Jones Sustainability Index;
- other corporate annual sustainability reports (Shell, Unilever, Rio Tinto, Anglo American);
- World Bank CSR-Public Sector Diagnostic and Appraisal Tool;[30]
- Poverty Reduction Strategy Papers (various);
- United Nations Millennium Development Goals;[31]
- various literature on the impact of foreign direct investment.[32]

[26] See – www.caspiandevelopmentandexport.com/Downloads/SHA/Eng/agmt1/SD%20PSA_final.pdf
[27] See – World Bank (2003) Extractive Industries Review: Striking a Better Balance, Final Report. Washington DC: World Bank – www.eireview.org/EIR%20Final%20Report/Volume%20I%20Final/Volume%20I%20Final.pdf
[28] IFC (2003) Measuring Sustainability: a Framework for Private Sector Investments – www2.ifc.org/sustainability/docs/measuring_sustainability.pdf
[29] IFC (2002) Results on the Ground. Washington DC: International Finance Corporation – www2.ifc.org/economics/pubs/results.htm
[30] World Bank (2004) CSR-Public Sector Diagnostic and Appraisal Tool. Washington DC: World Bank, CSR Practices – www.worldbank.org/privatesector/csr/diag_tool.htm
[31] UNDP (2003) Human Development Report 2003 – Millennium Development Goals: A compact among nations to end human poverty. New York: United Nations Development Programme – www.undp.org/hdr2003
[32] including: Te Velde, D. & Morrissey, O. (2001) Foreign Direct Investment and Poverty, Proposal to DFID. London: Overseas Development Institute; UNCTAD (2001a) *World Investment Report 2001 – Promoting Linkages*. Geneva: United Nations Conference on Trade and Development. UNCTAD (2001b) *FDI in Least Developed Countries at a Glance*. Geneva: United Nations Conference on Trade and Development; Rodrik (1999) *Making Openness Work: The New Global Economy and the Developing Countries*. Washington DC: Overseas Development Council; Borensztein, E., De Gregorio, J. & Lee, J-W. (1998) "How Does Foreign Direct Investment Affect Economic Growth?", Journal of International Economics, 45, pp. 115-135; Berman, E. & Machin, S. (2000) *Skilled-Based Technology Transfer: Evidence of Factor-Biased Technological Change in Developing Countries*. Boston: Boston University, Dept. of Economics.

The checklist can be used in a variety of ways: (i) as a guide to review sources of information on external stakeholder socio-economic performance priorities (reports of independent panels, media reports, government policy, country social and environmental reports etc); (ii) as the basis for a discussion with external stakeholders to identify and prioritise the most critical economic and socio-economic contributions of a company; or (iii) as a point of reference for discussions with internal company staff on what they consider to be the priorities for socio-economic and economic reporting. The main categories in the checklist are listed given in *Box 4*.

The checklist also provides an opportunity for the user to indicate which discrete business entity (company or JV) is relevant to which reporting theme, as well as which themes are of interest to which types of stakeholders: be they internal business stakeholders (investors, sponsoring ministry, employees or suppliers); or external stakeholders (institutional investors; customers and end-users; directly affected communities; civil society – in-country; civil society – international; public – local/regional/national; and official development agencies).

Box 4 Categories for Socio-Economic and Economic Reporting

- Products and services
- Monetary flows to the public sector
- Reinvested earnings
- Profits
- Dividends
- Political stability
- Macro-economic stability
- Investment climate
- NOC-IOC transactions
- Employees
- Procurement (suppliers and contractors)
- Infrastructure and equipment
- Banking sector
- Ethical and quality standards (HSE and social)
- Security
- Charitable giving
- Eco-technology
- Bio-diversity
- Community investment
- Regional development (region of operations)

Drawing on the results of discussions with staff from upstream and downstream operations, the narratives on economic performance for which reporting registers have been explored in this study include:

Upstream – oil and gas project developments

- the contribution of oil or gas field developments to the provision of affordable gas and electricity supplies in-country;
- contributions of the business to macro-economic stability through the payments to the state oil fund;
- contributions of the business to export-led economic growth in-country through payments to government and suppliers;

- compliance with the local content requirements of production-sharing agreements/contracts;
- the potential for a positive effect on local financial institutions from the business passing its financial transactions through domestic banks;
- indirect tax payments to government through national and foreign employees working for contractors and subcontractors;
- contribution of the business to skills enhancement through engagement with training and education institutions;
- diffusion of ethical and health and safety standards to contractors and suppliers; and
- economic and socio-economic impacts of the business's community investment programmes.

Downstream – refining, retail marketing, chemicals and renewables

- contributions to economic development in underdeveloped countries from crude oil sourcing decisions;
- employment opportunities in depressed local markets;
- innovation in service stations, eg convenience stores;
- local employment and the local economic multiplier effect of service stations;
- support to develop domestic businesses, eg major and minor suppliers;
- the impact of oil tax colleted by service stations on economy, eg in meeting of pension requirements;
- charitable contributions; and
- the business as a market leader in research and development for clean fuel technology and eco-efficient technology within refinery operations.

4.4 Individual Reporting Registers

A rationale was provided in *Section 3* for the reporting of economic and socio-economic performance to be informed by the compilation of five types of information, as follows:

- the **business context** – competitive realities, legal and regulatory requirements, and public policy stipulations and incentives that frame business decisions and determine whether a company has control or influence over the economic benefits stream generated by its operations;

- **financial numbers** – a financial indicator that will help describe performance with respect to the theme and that is readily tracked through some aspect of the financial accounts (P&L, cash flow or Balance Sheet);
- **non-financial management data** that is readily accessible (now or in the near future), and which will enhance reporting;
- **external stakeholder priorities** – benchmarks or targets reflecting external stakeholder priorities, which can be used to interpret the relevance of the company's performance, eg regulatory compliance requirements; public sector policy targets; national international development targets (such as within PRSPs); policies and targets in regional or provincial economic development plans; etc and
- **external roles** – suggested actions to be taken by non company parties – government service providers and regulatory authorities, trade union movements, NGOs, community groups, international development agencies etc – to embed, enhance or sustain the socio-economic or economic gains contributed by the company.

It is suggested that the five types of information are gathered together into a single *Reporting Register*. Three illustrations of completed registers are given as follows:

- *Figure 6a* – contributions to export-led economic growth through payments to government and third parties;
- *Figure 6b* – contributions of a discrete gas condensate project to the country's energy needs; and
- *Figure 6c* – contributions to the national economy through expenditure with local contractors and suppliers.

In each register, quantitative and qualitative data need to be subdivided. Where a single figure (monetary or otherwise) is used, this is allocated to the relevant year of reporting (2002, 2003 etc) and a direct link made between this and the origins of the figure in the company's financial or management databases. Such figures need to be located in their own dedicated column.

It is this register that then provides the information required by those within the company or at corporate level to prepare 'narratives' on economic and socio-economic performance for public disclosure. As demonstrated in *Figure 4*, the register can also provide a direct source of information for an online 'visualisation' of a company's economic and socio-economic performance around the world.

4.5 Risk Control

During the compilation of individual registers, a common question arising from those interviewed within the company was whether or not the information for disclosure identified by this tool required approval at the corporate level. Also raised was the notion (discussed earlier in *Section 3.6*) of the inherent 'inverse' relationship between reporting progress against certain socio-economic performance themes or indicators (such as local supplier content) and the commercial objectives of the company (such as maintaining local procurement within limits for quality and reliability).

To address these concerns, a risk assessment (*Figure 5*, below) has been added to the Reporting Register (see *Figure 6*). The approach is common to other forms of risk assessment, with a risk severity rating (between 1 and 5) reflecting the consequences of a risk event being realised, and management controls introduced to try to reduce the risk to an acceptable level. The risks of reporting are divided, as is common practice, into 'commercial,' 'compliance' and 'reputation.' Simple colour coding has been introduced to assist those responsible for approving the disclosure of the Reporting Register. Precise criteria for the rating of risk severity remain to be developed, but one idea might be to define the highest severity rating (ie red/dark = 5) to risk events that, if realised, would lead to consequences of significance at the corporate level.

Figure 5 Controlling the Risks of Economic and Socio-Economic Reporting

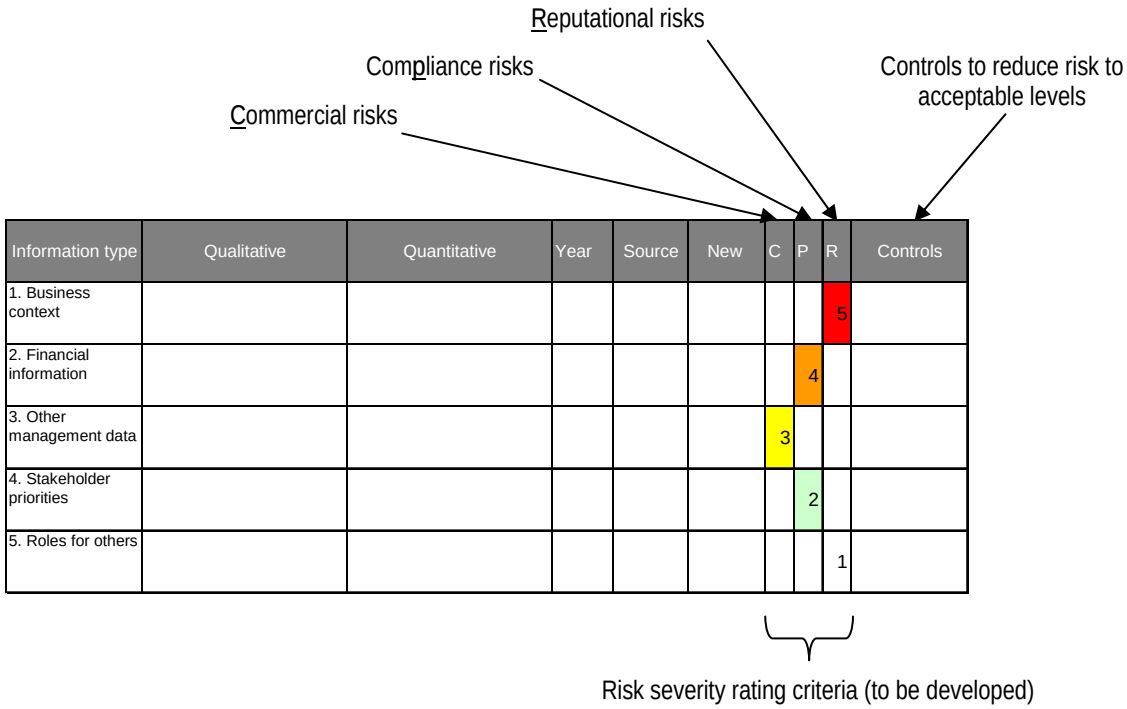


Figure 6a Reporting Register Example 1: *Contributions to Export Led Economic Growth through Payments to Government and Third-Parties*

Reporting Categories	Theme	Discrete operation, businesses or JVs	Socio-Economic Performance 'Narrative'					Information already gathered	New information required	Risks of Reporting: Commercial	Compliance	Reputational	Risk Controls
Macro Economic Stability	Export growth	Country level operation	Information type	Qualitative	Quantitative		2003	Source	New	C	P	R	Controls
			1. Business context	State has adopted an oil-based, export-led, economic development strategy, supplying markets in Europe as part of their wider energy security strategy and oil sourcing diversification. Current GDP ranking of country is xth place.	GDP-PPP ($) per capita (2002)	x		World Bank		1	1	2	Large variability in different GDP estimates. Cross-check with other credible sources and adjust.
					GDP ($million) (est 2002)	x		World Bank		1	1	1	
			2. Financial information	Country business operations contribute significantly to total GDP (though both captial expenditure and payments to government). Projections are for this figure to increase markedly.	Third-party expenditure in-country ($millions)	x		Supply Chain Management	P&Ls of main contractors	2	1	1	Set-up costs for amending or introducing new 'local content' reporting requirements within main EPC and O&M contracts
					Other contributions ($million) = operators' corporate tax + tarrifs + National Oil Company (NOC) profit oil + operators' local employee payroll + operators' tax payments of expatriates)	x		Consultants report	P&L of country operations	2	1	1	Set-up costs for automating total operators' contributions
					Country operations' total contributions as % of total GDP-PPP	x				1	1	3	Of figure not as high as might be expected, report 'projected' contributions
			4. Stakeholder priorities	Local consumers in fear of 'dutch disease' raising local prices, eg retail goods, construction, restaurants.	Inflation rate for consumer prices (2002)	x		Index Mundi		1	1	1	
			5. External Roles	State oil fund management and its relation to public expenditure needs to take account of potential for 'Dutch disease'						1	1	3	Refer to other country examples of effective state oil fund management

Figure 6b Reporting Register Example 2: *Contributions of a Gas Condensate Project to the Country's Energy Needs*

Reporting Categories	Theme	Discrete operation, businesses or JVs	Socio-Economic Performance 'Narrative'					Information already gathered	New information required	Risks of Reporting: Commercial	Risks of Reporting: Compliance	Risks of Reporting: Reputational	Risk Controls
Products and Services	End-user utility of products and services	Gas and condensate development project	Information type	Qualitative	Quantitative	2006		Source		C	P	R	Controls
			1. Business context	Stage 1 projected to deliver first gas to market before winter of 2006. Small proportion of gas market will be internal to country for power generation.		x		JV Business Plan	Ministry of Finance; Ministry of Energy	1	1	1	
			2. Financial information		Projected sales in-country in yr of peak production ($millions)	x		JV Business Plan		1	1	3	Report @ 25% to reflect stake in JV, and prevent double counting with other JV partners
			3. Other management data		Projected gas output of project at peak production, proportionate to projected output to be secured for in-country market in same yr (bbl)	x		JV Business Plan	Ministry of Finance; Ministry of Energy	1	1	3	Report @ 25% to reflect stake in JV, and prevent double counting with other JV partners
			4. Stakeholder priorities	Affordable and reliable source of electricity to residential and commercial properties in rural towns and peri-urban areas of main cities, plus critical electricity supplies for health, transport and education.		x		2002 Company country-level environmental report	Poverty Reduction Strategy Paper	1	1	1	
			5. External Roles	Inward investment stimulation needed to develop downstream gas industry in-country relevant to household and public service power requirements, including removal of electricity transmission bottlenecks.		x			Finance Ministry; Ministry of Energy	1	1	1	

Figure 6c Reporting Register Example 3: *Contributions to the National Economy through Expenditure with Local Contractors and Suppliers*

Reporting Categories	Theme	Discrete businesses or JVs	Socio-Economic Performance 'Narrative'				Information already gathered	New information required	Risks of Reporting			Risk Controls
									Commercial	Compliance	Reputational	
Procurement (suppliers and contractors)	Local content - suppliers and local multiplier effect	Country operations	Information type	Qualitative	Quantitative	2003	Source	New	C	P	R	Controls
			1. Business context	Production Sharing Contract requires preference to local suppliers (equipment, materials, machinery, vehicles etc), defined as firms registered and incorporated in the country, "so long as suppliers are competitive on price, quality and availability".			PSC				2	Check possible anomaly between operaator's definition of 'local' supplier (part equity owned by nationals) and PSC definition (registered and incorporated in the country of operations).
			2. Financial information	Third-party expenditure in-country	Annual expenditure with international companies in-country for procurement in-country ($millions, est)	x	Consultancy report		3	1	1	Current figures depend on consultant-based surveys of main procurement adn construction contractors. This runs risk of having to repeat costly surveys. Control future costs by amending or introducing new 'local content' reporting requirements as condit
					Annual expenditure with companies with local capital - State owned ($millions)	x			3	1	1	
					As above - Joint Ventures ($millions)	x			3	1	1	
					As above - SMEs ($millions)	x			3	1	1	
					Total third-party expenditure in - country ($millions)	x			3	1	1	
			3. Other management data	Number of in-country companies	State-owned (No.)	x	Consultancy report		1	1	1	
					Joint Venture (No.)	x			1	1	1	
					SMEs (directly or indirectly) est. (No.)	x			3	1	1	
			4. Stakeholder priorities		Third-party expenditure in-country as proportion of GDP	x			1	1	1	
				Impact of third-pary spend on local economy and employment opportunities in oil producing region	Number of in-country SMEs with main operations in oil producing regions	x			3	1	1	If reported figure is based on dedicated survey of SMEs, then see above.
				PSC does not require reporting on the 'geography' of local content, either the residency of employees or the geographic sphere of suppliers. Signal the copany's future intention to disaggregate local content by geography: affected communities, district,					1	1	4	This reporting may set a precedent for the corporation as a whole. Seek corporate level approval to move to geographic reporting of local content.
			5. External Roles	Future PSCs need to be more specific about the definition of 'local content', and ensure performance targets are within 'technical' limits so as not to delay project schedules.					1	1	1	

5. Analysis and Conclusions

Analysis of the suggested framework for benefits reporting, and of the experience of compiling *Reporting Registers* for individual economic and socio-economic themes, is provided below along with the main conclusions of the study.

5.1 Designing a Systematic Framework for Reporting Economic and Socio-Economic Performance

The experience of compiling reporting registers suggests the need for a management framework that is integrated with existing reporting procedures, promotes systematic and 'high priority' reporting, and is cost-effective. Suggestions for the building blocks of such a framework are shown in *Figure 2*, *page 19*. The proposed design combines a scoping exercise with a register of compiled information and an integral risk assessment. These then act as inputs into the formulation of a more meaningful and credible 'narrative' for disclosure. Conclusions on the design of the framework are given below.

5.1.1 Scoping

1. The risks to shareholders associated with the shift in geography of corporate growth centres towards poor and unstable countries, combined with the drift in comprehension of the mutuality of benefits between downstream manufacturing/retail businesses and wider society, suggest a move away from the global corporate reporting of economic performance based on generic, aggregated, financial indicators or isolated qualitative 'stories,' towards the reporting of high-priority, location-specific, economic and socio-economic impacts that reflect stakeholder concerns and reveal the genuine connectivity between the energy business and society.

2. To achieve this change in emphasis, a systematic 'scoping' exercise is required at the country and/or project level, with the aim of prioritising the themes for economic and socio-economic performance reporting, such that the choice is credible to both internal (business) and external (wider society) stakeholders.

3. The checklist of economic and socio-economic performance themes and categories presented in this report (*Section 4*) offers a starting point first for broadening, then for narrowing, the range of benefits reporting beyond the

conventions of charitable giving, community investment, and breakdown of Cash Value Added (CVA).

4. Such a scoping exercise need only be undertaken once every three to five years, or at discrete junctures in the life of an investment. Outside of this timeframe, it is unlikely that the public policy environment, the basic business strategy, or the external stakeholder priorities will have changed significantly.

5.1.2 Reporting Register

5. Recent experimentation by a number of UK-listed companies and independent bodies around economic and socio-economic reporting shows that the discipline suffers from a number of persistent challenges. These include: (i) weak reporting of the commercial and public policy constraints and incentives that act on business decisions; (ii) poor tracking of socio-economic benefits over time through the financial accounts; (iii) a tendency towards aggregating economic information across operations that rapidly becomes meaningless to external stakeholders in the context of the priorities of the host society; (iv) a bias towards reporting Cash Value Added (CVA), and the breakdown thereof, as indicators of the rate of economic return – a practice that, particularly in low income and poorly governed countries, fails to take account of the distribution of economic benefits; (v) a dependency on economic and socio-economic performance reporting of high-cost stand-alone surveys; and (vi) the medium-term commercial risks to the business of reporting certain economic benefits if these lead to demands for continuous improvement.

6. To counter these challenges, effective economic and socio-economic performance reporting requires the collation of five types of information. Bringing these together into a single *Reporting Register* would foster the rapid formulation of a benefits 'narrative' more credible and meaningful to its audience. The five types of information are:
   (i) the **business context** – business strategies, legal and regulatory requirements, public policy constraints and incentives etc;
   (ii) **financial** – some financial indicators that describe performance with respect to the socio-economic or economic theme and that can be tracked through the financial accounts (P&L, cash flow or Balance Sheet);
   (iii) **non-financial management data** that is readily accessible (now or in the near future), which will enhance the narrative;
   (iv) **external stakeholder priorities** – benchmarks or targets reflecting external stakeholder priorities that can be used to interpret the relevance of the company's performance, eg regulatory compliance requirements,

public sector policy targets, national international development targets (such as within PRSPs), policies and targets contained within regional or provincial economic development plans, etc; and

(v) **external roles** – actions to be taken by entities outside the immediate business to embed, enhance or sustain the socio-economic or economic gains contributed by the company.

7. Within each individual *Reporting Register*, all quantitative data should, as far as practicable, be linked directly to the relevant financial and other management system, so that the figures can be called up 'on command.' For datasets that currently require costly freestanding surveys (such as soliciting the geography and/or ownership profile of suppliers), ways need to be found of automating the data-gathering process; for example, inserting new reporting clauses into the contracts of the main engineering, procurement, construction and maintenance contractors.

8. The design of a *Reporting Register* that successfully brings the first three types of information together – ie business context, and financial and management data – should draw on recent thinking in 'Benefits Realisation' – ie the process of closely tracking the deployment of a company's resources and expenditure to assure compatibility over time between the outcomes of an activity and the original strategic business objectives that lay behind the deployment decision. This approach will ensure that the narrative reported externally is integrated with core business, guiding managers, and external stakeholders alike towards genuine mutuality ('win-win') benefits for the business and wider society, preventing the principle of mutuality becoming embedded as a 'bolt-on', unconnected with the reporting of commercial returns.

5.1.3 Risk Assessment

9. During this study, concerns raised by operational staff over (a) the release of commercially sensitive information, and (b) the inherent 'inverse relationship' between certain socio-economic performance themes (such as labour wages and local content preferences) and the short-term commercial objectives of the company (such as employee costs and supplier reliability), suggests the addition of a risk assessment to the *Reporting Register*. For this, one can draw on conventional 'project' risk assessment techniques: introducing pre-defined risk severity rating criteria to classify the different commercial, compliance and reputational risks that would be realised were different types of economic and socio-economic information to be reported. As demonstrated in this study,

control measures can then be introduced to try to reduce the risks to acceptable levels.

5.2 Lessons Learned from Compiling 'Reporting Registers'

Some of the lessons learned from compiling reporting registers as part of the study are described below.

10. With regard to contextual information, to some extent companies' country-based websites do contain some reference to the constraints and incentives acting on the business associated with commercial strategies, regulation and public sector policies. However, this information is patchy at best, and rarely aligned either with the financial or management data needed to support reporting on economic and socio-economic impact or performance, nor with benchmarks or targets reflecting external stakeholder priorities.

11. Finding credible benchmarks or targets that reflect external stakeholder priorities, against which business performance can be interpreted, is limited by the quality and accessibility of meaningful public sector survey information. For example, it may not always be possible to access reliable information about medium-term expenditure priorities for the allocation of resources from state oil funds; figures for unemployment rates in the immediate vicinity of refineries may not be readily available. When reporting, such limitations should be openly acknowledged. In addition, every effort should be made to find some alternative, generalised, benchmarks, eg PRSP priorities or regional unemployment figures, respectively. Further, under the heading 'external roles,' identification should be made of what actions need to be taken, and by whom, in order for more meaningful targets to be established that can better help the company measure and report its economic performance. For example, support might be voiced by the company for those engaged in transparency initiatives that encourage not only the notion of 'publish what you pay,' but also publish 'what you received' and 'what you spend.'[33]

12. For countries where macro-economic indicators are weak, and the quality of public financial management poor, the trend in some trans-national corporations of disclosing the breakdown of Cash Value Added provides a shallow basis for reporting the economic and socio-economic rate of investment return. Offering financial numbers as economic surrogates provides audiences with little context for interpreting whether these are either meaningful to the priorities of local,

[33] For example the new direction of the Extractive Industries Transparency Initiative – www2.dfid.gov.uk/news/files/extractiveindustries.asp

regional or national society, or reflect well on the status of the business. Put more candidly, few are impressed when a big company generates big numbers. What impresses more is an honest interpretation of the relevance of these numbers in the context of the social, economic and investment priorities of those receiving the information.

13. With energy companies that are operators of upstream investments, there is a possible danger of overstating the economic contributions of the company by failing to make it clear that they are but 'one' of a number of joint venture partners. The economic themes particularly vulnerable to this misperception are payments of resource rents to the public sector and third-party spend during project development. One way to reduce the likelihood of external criticism in this area is to apply a simple 'divisor,' particularly to any financial figures, such as one proportionate to the equity share of the operator within the joint venture.

14. It seems justified, however, for individual project operators to claim full credit for economic and socio-economic impacts where these are the direct result of management decisions taken as the operator. These might include actions taken, for example, to raise environmental, health and safety standards through the supply chain, or to sustain or broaden the benefits of community investment programmes.

15. For upstream projects in their development (pre-production) phase, the importance of accurately reporting 'local content' – for example, in the form of payments to employees and third parties – cannot be overstated. It is frequently the case that during the construction of field developments or transportation infrastructure, micro and meso economic impacts are at their highest. With the bulk of revenue flows to the state dependent upon the start of production and with cost recovery periods and tax waivers commonplace, unless the opportunities for direct and indirect employment can be fully realised during the construction phase, there is the danger of a perception that little positive economic development or other benefits will be apparent in the operating region for a number of years. This study suggests that energy companies need both to: (a) define better what is meant by 'local content,' be that the nationality of employees, ownership of supplier firms, sphere of geographic influence of suppliers, country of registration or incorporation etc; and (b) reduce their dependency on freestanding surveys for gathering local content information, putting in place instead automated procedures.

16. Given the marked change in the type and magnitude of economic benefits experienced during the exploration, development and production phases of major capital investments, it might be appropriate to include in the annual reporting of economic and socio-economic performance some forward projections of payments to the public sector, showing how these will vary over time in relation to anticipated expenditure and revenue 'curves.'

17. In the medium term, reporting the volume of transactions with domestic banks may provide an incentive for improving the range and reach of financial products available to the domestic SME sector, including suppliers to the operator. Clearly, if volumes are to increase over time, such that this effect is realised, there will be a need for increased security and guarantees. With respect to reporting, this security could be expressed in the narrative as, for example, a role for international development finance institutions.

18. For upstream operations in more politically and economically developed countries, improvements could be made in reporting the 'business context' for economic and socio-economic performance. The commercial and competitive realities of mature markets, the increasingly stringent legal and regulatory requirements imposed on companies, and public policy incentives such as tax concessions for acquisitions and mergers, all play a part in shaping the room available for energy companies to enhance their economic and socio-economic performance. As far as practicable, the most prominent constraints and incentives acting on the business need to be reported.

5.3 Conclusion

For underdeveloped countries where economic performance is generally weak and the quality of public financial management poor, the trend of some trans-national corporations to disclose the breakdown of Cash Value Added of operations provides a shallow basis for reporting the economic and socio-economic rate of investment return. Offering financial numbers as economic surrogates provides audiences with little context for interpreting whether these are either meaningful to the economic priorities of local, regional or national society, or are material to the political risk and business growth concerns of shareholders. Put more candidly, in both developed and developing countries, few are impressed when a big company generates big numbers. What would impress more is a reporting narrative, backed by a rolling register of location-specific credible data, which gives an honest interpretation of the relevance of these numbers to the social, economic and investment priorities of those receiving the information.

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