From CSR to Social risk management –

Impact of strong and weak ties in Armenian mining MNCs

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Abstract

When it comes to social risks multinational companies (MNC) within Mining are one of the most exposed businesses one can imagine. This paper examines how social risk management is practiced through the case of Teghout copper-molybdenum mine in North-Eastern Armenia, supplemented with evidence from other mining MNCs in the country, onsite fieldwork, interviews with key stakeholders, and public available information. This evidence suggest that a standards based social risk management strategy is adopted and that this strategy is based on international Corporate Social Responsibility (CSR) standards and philanthropic activities. However, evidence reveal that local and regional stakeholders, from whom social risk rise, feel disengaged from the process, continue to raise questions about transparency and in some cases actively oppose mining activities and that this is happening despite the use of stakeholder engagement management systems that is promoted through the standard. The implemented social risk management systems are ineffective because they makes the MNC unable to recognise the value of weak ties and fail to build legitimacy and trust with some of the key stakeholders resulting in the creation of more instead of less risk. It is argued that this is caused by MNC's use of CSR systems focuses on building strong ties, rather than on building trust with the stakeholders that actually pose the biggest social risk.

Introduction:

A quick look at multinational companies (MNC) websites shows that they routinely communicate that they aren't just in business to make a profit, but that their goals are equally focused on servicing the communities that they affect, for a broader and bigger social purpose (Vallex, 2014, Rusal, 2014, Geopromining, 2014). At the same time the very same companies are looking for compelling reasons why it make good business sense to engage in strategies looking for the connection between profit and 'doing good' (Schwartz & Carroll, 2003; Visser, 2010). This development has happened under the umbrella term Corporate Social Responsibility (CSR) promoting the idea that the actions of companies effects the societies that they operate in and the voices of these stakeholders should be included in the management decision making process (Carrol,

2004). One of the areas were business have found CSR useful is through the introduction into risk management and the argument that it enables companies to reduce social and environmental risks (Kytle & Ruggie, 2005; Vogel, 2008). An example of the use of CSR as Risk management can be witnessed in how MNCs within mining, that are present in Armenia, use standards to communicate with stakeholder groups. However, with globalisation and by that more easy access to information about company operations, it has become increasingly difficult to manage the number of stakeholders that could influence company operations. Research also supports that the principal reason why mining companies had to stop their operation is because they could not live up to the expectations of their local stakeholders (BSR, 2003). This paper is a continuation of this research investigating how mining MNCs in Armenia use CSR standards in an effort to manage social risk in order to building legitimacy with local stakeholders. The central case company used is the Cyprus based MNC Vallex group who operates the mining company Teghout CJSC supplemented with evidence from other mining MNCs operating in Armenia. Empirical evidence is gathered using public sources and a series of interviews with Armenian government officials, politicians, Non-Governmental Organisations (NGO) and local stakeholders who are directly affected by or is affecting mining operations. Research was conducted April to June 2014 and included a two-week field study to Armenian.

Mining in Armenia

Armenia is a country with a population of about three million and an area of 29,800km^2, located in the southern Caucasus Mountains in between Azerbaijan and Turkey to the east and west, and Georgia and Iran to the north and south (Armenia, 2014). Armenia was one of the most industrialized republics of the former Soviet Union (USSR) including significant industries within metallurgy and mining. The mining sector in Armenia is quite diversified with over 670 mines currently operating of which 30 are metal mines (Mining Journal Armenia, 2011,). The industry is dominated by many smaller companies operates one or two sites. The biggest sites are within Copper, Iron, Gold and Molybdenum as well as some rare metals (Mining, 2011). As a developing country the mining sector plays an important part of the Armenian economy, accounting for a significant proportion of about 14% of the total foreign direct investments to the country (World Bank, 2014). Above 50% of the total exports come from the mining sector making the industry the single most influential driver for economic development (ADA, 2014).

The Concept of Social Risk and MNC

The concept of Social risk is hence understood as corporate behaviour or the actions of others in the operating environment that create vulnerabilities which stakeholders might identify and use to apply pressure on the corporation for behavioural change (risk (Holzman, et al, 2003; BSR, 2003; Brown, 2013). Understanding that the discourse of risk research have been a quest that has focused on expanding the field of ‘existences’ to be measured and improving the quality or measurability of parameters that are believed to be of relevance. It has been hoped that risks can be ‘determined’ in order to satisfy the anxieties of an audience that subjectively perceives the level of risk they are exposed to (Beck, 1992, p.58; Lupton, 1999, p.18). As businesses become increasingly aware that effective risk management is a valuable resource so has the

field expanded in which it has been applied (Power, 1997, p.122; Olsson, 2002; McKellar, 2010). Where the outset was economic risk we now see assessment tools being applied to areas like politics, reputation, and environmental, sustainability and ethics (Morsing & Schultz, 2006; Olsson, 2002; Crouhy et al., 2006; Rotta, 2010; Raufflet et al., 2014). Social risk was a concept that was first proposed by the World Bank as a comprehensive approach drawing attention to the many threats related to poverty (Holzmann et al, 2003). Others have also been interested social risk and how uncertainty and dangers have influenced how organisations and individuals are exposed to risk in an increasingly globalised and institutionalised world (Beck & Beck-Gernsheim, 2002:10f, Arnoldi, 2009:50f). It is within this context MNC maintain their licence to operate keeping on a line between doing business and keeping their social license to operate.

MNCs exploring opportunities in the Caucasus including Armenia there are significant political, environmental, economic and not least social risks (Shaffer, 2009). In the effort to navigate in these conditions, systems for managing Social risks like the one presented by the Word Bank (IFC, 2012), can be quite persuasive in assuring that some of these uncertainties are effectively identified and mitigated.

A concrete example of this development can be witnessed in relation to the Teghout Copper-Molybdenum mine in north-eastern Armenia (Vallex Mining, 2014). It has been known that there were copper in the mountains surrounding the villages of Teghout and Shnogh for many years and a national survey confirmed this as national effort to map all the mineral sites in Armenia, including Teghout, was conducted in order to boost the struggling economy and attract investments (Mining, 2011). The same year a license to operate the mine was granted to the Armenian Copper Program a subsidiary of the Vallex group a MNC based in Lichtenstein at the time. Assessments undertaken have estimated that around 1.6 million tonnes of ore are extractable within the upper part of the reserve and 99,000 tonnes of molybdenum (SEP Vallex, 2012). However, before work could start the long-term environmental impact of the project had to be investigated in an independent Environmental Impact Assessment survey as required by Armenian law (Vallex, 2014). The survey started in 2004 but was not accepted until 2006 and to this date still widely disputed by local and national NGOs mainly on the grounds that the survey was done by a Vallex controlled company (Judgment EKODAR, 2010; Teghout mine case, 2012).

In 2008 Danish FLSmidth supplied $47 million worth of primary comminution and classification equipment (FLSmidth, 2008) in order to start the project and get the site prepared for excavation through a loan from a Russian bank. The land, that the mine was to be situated on, was primarily farmland, summerhouses and forest, which needed to be cleared and the landowners needed to be compensated for their losses. Despite several complaints, court trails and protests by local, national and international NGOs the project went ahead and more or less voluntary compensation agreements was reached with most of the landowners, paving the way for the extraction activities. In cooperation between FLSmidth, EKF and Pension Denmark it was possible to raise 350 million Danish Kronor (approximately 46,6 million €) so that Teghout CJSC (who would take over from the Armenian Copper Program) could buy processing equipment (FLSmidth, 2013). However, it was not possible to attract investments from EKF or Pension Denmark if it had not been for the 2012 CSR program that was put in place which resulted in a series of reports and surveys among those a comprehensive

stakeholder engagement plan in-line with IFC guidelines, including Town hall meetings and other forms of engagement activities (SEP Vallex, 2012; Vallex, 2014). In a joint press release the investors stated, "We're naturally delighted to be able to enter into this agreement, which will increase Danish exports. And, what is more, for a project that is setting new standards for mining in Armenia. We have imposed a number of requirements, which will mean that the mine will be the first in Armenia to satisfy the international standards" (PensionDanmark, 2013). Vallex use of the IFC standard (IFC, 2012) and the subsequent reporting of findings made a compelling argument for investment in the project and assured investors that the risk arising from local stakeholders were identified and handled to the satisfaction of all parties. However, to this date local and regional NGOs continue to make claims against the project that the reporting and apparent transparency are falsified and that the local communities in Teghout and Shnogh have been misled. As the possibilities to address concerns of local stakeholders through the Armenian court system have yielded few results other avenues are being explored. The response has been that local and national NGOs have mobilised in order to confront the institutional investor and EKF in order to make them aware that there are serious flaws in the communication that they and the local community have received from Teghout CJSC and Vallex group with an aim of stopping the project.

At the core of social risk management lays the effort and systems that enables companies to gain legitimacy from local stakeholders. As in the case of Teghout the communication surrounding CSR standards are not only directed at addressing the concerns of the local community but also at investors and government, who have implemented a comprehensive mining code with the help of the World Bank (Mining code, 2011). This has lead to conflict between the company on one hand and the local community supported by NGOs on the other. In between this struggle are the investors who are relying on reports and analysis from the company and expect that the government are enforcing legislation that protects the local community. However, in the case of Teghout, NGOs are claiming that the government have sided with Teghout CJSC and Vallex group and the NGOs have therefor adopted a strategy of pressuring the investor to assert pressure in order for changes to occur that they deem necessary leaving the impression that social risk is not managed efficiently.

Understanding MNC use of CSR as risk management

There is no doubt that mining companies have been confronted with social risk issues and have created different approaches to dealing with these over the years (BSR, 2003). What CSR as risk management propose is the use of structured approaches and normative standards, like the one initiated by the IFC or inclusion of normative philanthropic initiatives, to identify and possible control social. CSR rely to a large degree on self-governance and self-reporting than other traditional risk management systems as they are designed to identify and enable engagement with issues which constantly change e.g. the aspirations and expectations of local communities, local and global NGO, civil society etc. (Bebbington et al., 2008, Barkemeyer, 2009). This means that MNC information needs to have a high degree of validity and be able to withstand scrutiny by outside stakeholders and by having structure to the effort it is possible, or at least appearing to communicating transparency.

The drivers that promotes MNCs to creating CSR risk management systems and normative approaches can be described as threefold. First, it can be a daunting task to navigate between many different and multifaceted business environments that the MNCs operate in (Peng & Lou, 2000; Cavusgil et al. 2002). The number of individual stakeholders can be significant and not all can be expected to have the same influence on the MNC over time. This means that dealing with stakeholders on an ad-hoc basis can create inconsistencies in the way the MNC decision-making is perceived, which in turn create risks to the company reparation. Second, using different standards based on adaption to local social business environment norms can lead to issues with global stakeholders as companies can be accused of subscribing to double standards shopping around for the "easiest" place to operate (Kolstadt & Wiig, 2013). Third, the daily operations of the MNC need to be both efficient and effective putting severe strains on managers and other professionals working on measuring, analysing and assessing different social risk scenarios. This has also encouraged some MNCs, in favour of a more integrated strategy, to adopt international standards in an effort to incorporate national law within one coherent management system (Kemp & Owen, 2013; Raufflet et al., 2014). In summery there seem to be strong driving forces for using CSR systems as a way for organisations to work strategically with reducing their social risk exposure. But as seen in the case of the Teghout mine in Armenia there seem to be some serious gaps between the actions of the company and the expectations of its stakeholders.

The Role of Networks in Social Risk Management

Coming back to the definition of social risk understood as corporate behaviour or the actions of others in the operating environment that create vulnerabilities which stakeholders might identify and use to apply pressure on the corporation for behavioural change. It has been found that CSR activities are not being effective in mitigating the risks constituted by stakeholder efforts in exploiting organisational vulnerabilities. Actually it would seem that stakeholders are using CSR initiatives as a platform for identifying weaknesses in the claims made and a opportunity to confront a company like Vallex from even more issues.

In order to understand how these standards become so widely accepted even though they apparently have significant flaws in their ability to identify and mitigate social risk we need to understand the social structures that influences this process understood as both economic and non-economic entities that through interaction have either a direct or indirect impact on the outcome that the organisations produce (Granovetter, 2005). Social risk management is the incorporation of non-economic factors in order to manage the exposure to the company from salient stakeholders. There is continuous dialogue about the fundamental conceptual understanding on the impact of social structures and networks (Rauch & Casella, 2001). Elaborating even further on the work of Granovetter (1985, 2005) he emphasises that all economic (and non-economic) action is embedded in networks moving organisations away from a traditional understanding of the market as personal exchanges and the transaction cost perspective on among others risk mitigation. His claim is that this simplified view of the market basically subscribes to an idea of organisations as entities that can be decoupled from its context or be interchanged without significantly affecting their surroundings (Granovetter, 1985; Granovetter, 1992, p.61). This 'undersocialised' view of

the firm favours standards based risk management approach as it supports the idea that companies can analyse its social environment and then choose which risks are important and which can be ignored. While this provides a clear and sanitized perspective on organisational performance its rational approach completely ignores that very few organisations get to choose whom, when and what will influence its decision-making process, as it becomes evident in the Armenian mining industry where local stakeholder risks arise despite the implementation of systems for social risk management. Alternatively organisations can by adopting a network approach where the operating environment is understood as made up connections between individuals that can have varying degrees influence or ability to exploit weaknesses. The process can be understood through the concept of strong and weak ties and how stakeholders, groups and organisations can influence each other creating risks and but also opportunities for the MNC (Granovetter, 1973; Swedberg, 1997; Rauch & Casella, 2001; Granovetter, 2005). This view on organisations relationship with their environment is in contrast to the standards perspective and here we find that organisations are always co-constructors of the context in which they are situated and that changings to the system will have an effect on the network as a whole.

A suitable way of describing the two risk perspectives in relation to social risk is to describe them as systems, which subscribe to different levels of organisational embeddeness. And the argument that the behaviour of institutions to be analysed are so constrained by on-going social relations (embedded) that to construe them as independent is a grievous misunderstanding (Granovetter, 1985; Granovetter & Swedberg, 1992:53). Moving from one perspective where we find the direct cause-and-effect system of traditional risk management over to alignment and integration of organisational processes with its operating environment (Taylor-Gooby and Zinn, 2006:202ff, Brammer and Smithson, 2008:250f). Outside influencers or stakeholders can serve as an analytical framework that enables understanding of how different actors, within a given sphere of influence and can contribute with varying degrees of risk. Showing how embeddeness can influence organisations ability to take quality decisions that will have a positive impact on its performance by including more distant stakeholders. Through a networks approach companies can be analysed how patterns of interlocked relationships emerges and the way they influence corporate risk management behaviour.

These networks are made up of nodes that can be analysed through the concept of strong and weak ties, which enables the understanding of how relationships can be influence performance (Granoveter, 1973; Swedberg, 1997). Strong ties or close personal relationships are associated with reassurance and continuity. Strategies based on building these type of ties favours a relative deep understanding of each nodes processes and the challenges faced face. This enables organisations to identify risks that could possible disrupt information flows or hinder the effective execution of organisational processes. However, it also slow down or hinders creativity and introduction of the unknown and thereby new ideas, perspectives and innovation. Relationships based on weak ties can be a source of inspiration and an opportunity to be introduced to organisations who have adopted different approaches to problem solving. These groups become valuable when the organisation need to understand contexts that are radical different from the ones that they are accustomed to.

For the MNC networks also play a central role facilitating knowledge sharing across

industries, subsidiaries and adaption to the local business environment adaption (Dunning, 1998; Dankbaar, 2004; White et al., 2014). In combination with MNC risk management strategies a process based on creating strong ties creates a strong pull towards normative systems, which can facilitate and optimize this process in line with risk management and CSR strategies. Suggesting that organisations create formal structures to cope with or replicate the internal and external environmental pressure (Westney, 1989; Ghishal & Westney, 2005). In the case where subunit or process is incompatible with already existing institutionalized patterns the organisation responds by creating ties across subunits. And as DiMaggio and Powell (1983) have pointed out in instances where uncertainty over the effectiveness of alternative organizational forms is high, organizations are likely to adopt the patterns of other organizations which have the reputation in their immediate environments of being successful effectively creating stronger ties. The argument being that organisations are pulled towards common organisational forms and systems adaption in this case towards adaption of common global standards or towards local adaption, moving away from the need to be efficient in favour of bureaucratic systems. The effect being that the possible valuable insights the MNC would gain from their network would be lost in favour of a systems focus, creating strong ties with salient stakeholders.

Conclusion and Perspectives

When MNCs adopt a CSR standards approach they also commit to engage with the local, national and global stakeholders that have an interest or are affected by the actions and decisions that the company makes. This development has spurred a process of stakeholder engagement where mining MNCs in Armenia have adopted CSR standards and philanthropic initiatives. This isomorphic pull has originated from two directions, the institutional investors and from the Armenian government who have implemented a mining code and thereby the governance systems that the mining companies need to comply with.

While the convergence around systems and standards to manage CSR is positive when it comes to effectiveness and creating clear channels of communication it comes at a price. One of the roles of CSR standards is to identify and help mitigate social risk. However, when there is a horizontal institutional convergence between companies across a few key stakeholders in this case the Armenian government and Institutional investors, the CSR systems in themselves can produce risk as companies start to communicate about their activities. According to a network perspective and an understanding of the organisation as embedded in the social context through weak and strong ties, it is possible to offer an explanation why implementation of CSR systems seem to produce more and not less risk. As the CSR systems are based on the idea that companies should be in dialogue with their stakeholders and through the use of engagement programs, philanthropic initiatives etc. they create organisational strong ties. While these ties are effective when it comes to creating consistency and predictability they hinder creativity and new perspectives from which the company can improve its understanding of the social context in which it is situated. Hence the use of CSR systems especially in the mining industry where there are a significant interest becomes a barrier for alternative perspectives and thereby becomes a vessel for social risk production rather than risk reduction.

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