



STARTING LOCAL:

# Creating value from mining in rural communities

A RESEARCH REPORT



THE UNIVERSITY OF BRITISH COLUMBIA

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## Executive summary

There is growing recognition that successful businesses are those that generate social and environmental value as well as economic gains. Yet measuring social value is difficult, and environmental impacts have sometimes been under-estimated. This has been especially true in the mining sector where proposed land use changes may be significant, where resources may be scarce, or where worldviews may collide. Research has shown that when mining companies purchase locally sourced goods and services it can create lasting value for communities, lower costs for mining companies, and reduce delivery times. Purchasing goods and services locally—or “local procurement”—can also help local businesses to grow and develop and is a way to build mining shared value. Yet in sparsely populated areas with few established businesses, local procurement opportunities can be limited. What strategies could be used to overcome the obstacles to developing local procurement?

In 2020, researchers at the University of British Columbia investigated this question in a project funded through the MITACS Accelerate program. The research was part of an ongoing collaboration with Canada’s Erdene Resource Development Corp. Erdene has discovered a near surface gold deposit in the southwestern Mongolian province of Bayankhongor, an area that nomadic herders have called home for generations. During the study period, Erdene was investigating the feasibility of developing the Bayan Khundii deposit as the first major gold mine in the region.

From February to June, the UBC team examined local data and conducted 24 qualitative interviews. The interviews provided insight to stakeholders’ perspectives on the ways in which the mine and the local population could work together to create sustainable economic value.

Results of the research confirmed there are few current opportunities to purchase goods and services from the region where the proposed mine is located. On a positive note, there is interest on the part of local merchants and officials to explore business opportunities arising from the proposed mine development. In this report, we explore the research findings, offer a guide for the development of local procurement strategies, and share a framework for assessing local procurement opportunities.

## Introduction

Retaining financial capital in the region where it is generated supports a sustainable society (Stubbs & Conklin, 2008). In the mining sector, local procurement – the purchase of goods and services used for mining from suppliers within the region – is one strategy to increase the economic benefits of mining. Research has shown that local purchasing has the potential to lower costs for mining companies, reduce delivery times, and improve overall supply chain efficiency (see Geipel, 2017; Ovadia, 2014; Xing et al, 2017). In addition, purchasing locally sourced goods and services can create lasting value to complement, or even expand, local employment and community development investments from mining. Furthermore, well-designed local procurement strategies can result in local businesses that are able to evolve to meet the needs of other sectors. This resilience reduces the risk of dependency on mining (or any other single industry) and creates options for continued economic activity following mine closure. If managed well, local procurement has a larger potential for positive economic impacts than the contribution from a mining companies' taxes, wages, royalties, and community investment (Geipel, 2017).

However, it can be challenging to develop successful local procurement programs. This is especially true in situations where there is limited past experience with mining, and in sparsely populated areas with few established businesses.

The time and resources to develop suppliers able to meet international standards set by institutional investors and development banks presents a further obstacle. Cost to the company is another consideration, especially for companies working to establish local procurement programs before a mine is built and a source of operating income secured. In addition, the power of non-local companies to secure contracts using lobbying tactics, thus reducing opportunities for local businesses, can be a challenge.

In 2020, a team from the University of British Columbia conducted research to identify strategies that could be used to overcome the obstacles to developing local procurement in regions where existing business and services are limited. The research focussed on Erdene Resource Development Corporation's proposed Bayan Khundii gold mine in southwestern Mongolia.

The objectives of the study were to:

1. Develop an inventory of local businesses able to supply goods and services to the proposed Bayan Khundii mine;
2. Identify barriers to local procurement and business development; and
3. Categorize opportunities for local procurement and business development during mine development and operations.

The outcomes of the research are intended to enhance the project's environmental and social impact management plans and mitigation strategies. The findings may be of use in the implementation and monitoring of the company's Local Cooperation Agreements<sup>1</sup> (LCA).

In addition, the research provides practical actions for working with local communities and herders to create shared value. Creating shared value (CSV) is an economic strategy to improve socio-economic outcomes and related core business performance (Porter & Kramer, 2011).



Figure 1 Project Location. Source: ERD

<sup>1</sup> Mining companies operating in Mongolia have a statutory obligation to establish community agreements, known as Local Cooperation Agreements (LCA). The objective of the LCA is to have minerals projects contribute to the development of the local area and the livelihood of its citizens.

BAYANKHONGER AIMAG/PROVINCE - FAST FACTS	
Population (# people)	~30,000
Provincial economic contribution to national GDP	1.2%
Bayankhongor GDP division by sector	Agriculture (livestock): 44% Services: 30% Industry: 26%
Median annual household income (Mongolian tögrög and Canadian dollar equivalent)	MNT 13,590,000 C\$6,385.00
Education (percent of adult population)	39% population Gr 10-12

Table 1 - Regional data. Source: ESIA Khundii Gold Project (p. 347)

Bayankhongor aimag (province) is in southwestern Mongolia. The provincial capital, Bayankhongor city, has a population of approximately 30,000. The city is 640 km southwest of Ulaanbaatar, Mongolia's capital. The two soums (sub-provinces) closest to the proposed mine site are Shinejinst (population 2450) and Bayan-Undur (population 2670). The town settlements are located about 70 km and 90 km respectively from the proposed mine site. Access from Bayankhongor is via dirt roads. In both soums, most of the population earn their livelihood from nomadic herding of goats, sheep and camels. The principal source of herder income is from the sale of raw cashmere.

Bayankhongor's primary socio-economic objectives are regional economic growth and development, and supporting herder livelihoods by creating markets for livestock products. In Bayankhongor province, there are few local businesses outside of the provincial capital. Soum-level merchants offer bread and pastry, construction services, cafes, household wooden furniture and sewing. There are several small soum centre shops selling food and household consumables. There is also a producer of camel milk, drinks, and yogurt (ESIA, 2020).

## The Mine Developer

Erdene Resource Development Corporation is a Canada-based resource company focused on the acquisition, exploration, and development of precious and base metals projects in Mongolia. The company's shares are listed on the Toronto and Mongolian stock exchanges. Erdene has operated in Mongolia since 2004. As of August 2020, the company had interests in three mining licenses and three exploration licenses in the Khundii Gold District of southwestern Mongolia.

The Bayan Khundii gold project is the company's most advanced asset. Currently at the pre-construction phase, first gold production is targeted in early 2022. In July 2020, Erdene announced a positive bankable feasibility study for the project. The company has also completed an independent environmental and social impact assessment (ESIA).

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### BAYAN KHUNDII GOLD PROJECT - FAST FACTS

Proven and probable reserves	3.4 million mineable tonnes 409,000 oz. grading at 3.73 grams/tonne gold
Initial capital expenditure	US\$59 million
Average annual saleable gold	63,500 oz.
Taxes/royalties over the life of mine	US\$103 million
New direct jobs	400, includes permanent site-based contractor employees personnel

Table 2 – Bayan Khundii Gold Project Fast Facts. Source: Erdene, Press release, July 20, 2020.

## Methods

The study used qualitative methods. To begin, academic and practitioner literature was reviewed. In addition, company-specific materials, including the project ESIA and company management plans, were examined.

Findings from the literature review shaped the development of a semi-structured interview guide.

The guide was used to conduct 24 interviews with local government officials, business owners, and operators located in Bayankhongor and Shinejinst, and with selected service providers and industry experts in Mongolia.

Interviews were analyzed to identify challenges and opportunities for the development of a local procurement plan, and to shape a local procurement framework for Erdene.

In the final stage of the research, the company's construction and operating plans and cost estimates were analyzed to identify areas where there was a match with existing local suppliers<sup>2</sup>. The research also highlighted areas where additional opportunities could be created if the right financial support or capacity building was available.

Field work for this study was interrupted by COVID-19. Like many others dealing with the uncertainty imposed by the global pandemic, the research team had to pivot, replacing proposed field work with virtual research methods. One member of the research team was able to spend a short amount of time in Mongolia as part of this project. Another team member had spent time in Bayankhongor on an earlier research project with the company. It is noted that additional observational data would have enriched the findings.

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<sup>2</sup> A list of existing businesses was supplied by local governments.

## Findings

Interview results revealed different perceptions about the meaning of “local procurement”. About 45% of interviewees defined “local procurement” as the purchase of goods and services from the nearby soums. Another 45% felt the definition of “local” should include the aimag. Ten percent suggested “local” could include suppliers from anywhere in Mongolia.

The findings suggest that companies need to find ways to establish categories representing different levels of local participation and value add. This is important because not all “local” procurement has the same impact. For many mining companies much of the money allocated to local procurement is spent with suppliers who import and resell goods, or in contracts with the branch offices of international firms. This approach may not generate the same level of local economic benefit to businesses operating within the direct vicinity of mining operations.

Nevertheless, in-country procurement does have multiplier effects that can benefit the national economy. For these reasons, a combination of local and in-country procurement can be necessary in areas with a small population, a small number of potential suppliers, and limited infrastructure.

Almost all interviewees commented on the challenges imposed when personnel changes occur within the local and provincial governments. As new officials are elected, there can be a desire to re-negotiate cooperation agreements with mining companies. This can create uncertainty, contribute to low trust levels and erode investor confidence.

Table 3 summarizes the challenges and opportunities for local procurement at the Bayan Khundii project.

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## INTERVIEW QUOTES

*“Mining companies can require local suppliers to employ local workers. When the suppliers also prioritize the local workers, it will be a significant contribution to the livelihood of local citizens in addition to the number of domestic workers that mining companies hire.”*

*“Mining companies can purchase goods from Ulaanbaatar or wherever through local businesses. We still can offer compatible market prices while generating a few jobs.”*

*“If someone comes to our aimag to produce and sell goods, it can be understood as local procurement because they create local jobs and pay taxes in the local area and create more economic opportunities in the aimag despite the ownership.”*

CHALLENGES	OPPORTUNITIES
<p><b>No significant commercial gold mines in the region</b></p> <ul style="list-style-type: none"> <li>Although there has been small scale mining in the region, when Bayan Khundii comes into production it will be the most significant open pit gold mining operation in Bayankhongor. Local merchants and service providers have little, if any, experience with supplying a significant, internationally compliant gold mining operation. As a result, there is limited awareness of the local business opportunities that might be available.</li> <li>The lack of experience working with commercial-scale mining operations may lead some potential suppliers to over-estimate their ability to meet the supply and quality provisions inherent in mining contracts.</li> </ul>	<ul style="list-style-type: none"> <li>Interviewees indicated interest in learning about mine supply opportunities and a willingness to work with Erdene. This creates an opportunity for the current project. It also creates an opportunity for future mining operations in the region.</li> <li>Stakeholder engagement efforts in the region should be complemented with specific outreach activities targeting local businesses. One objective of stakeholder communications should be to increase awareness of the type of goods and services the mine will require, the process for submitting bids, and the bid evaluation criteria.</li> <li>To reach the broadest number of potential suppliers, a range of communications tactics will need to be used. For example, contractor information sessions, web-based communications (such as the company website or Facebook page), printed materials for interested parties to pick up at local company offices and civic offices, public service announcements, and others.</li> </ul>
<b>International standards</b>	
<ul style="list-style-type: none"> <li>Suppliers with experience in mining view tendering standards, contract size, and the use of international standards for quality and quantity as barriers for local businesses.</li> <li>Local stakeholders may interpret these barriers as a lack of genuine interest on the part of mining companies to collaborate with local businesses—as opposed to a way of ensuring quality and safety or an opportunity to improve.</li> </ul>	<ul style="list-style-type: none"> <li>Supplier mentorship programs could involve a local business partnering with a larger established supplier, taking responsibility for fulfilling a small portion of a larger contract to build familiarity with standards. Given the potential competitive tension between suppliers, clear guidance from the company on contractual obligations for mentoring and ongoing monitoring is recommended.</li> <li>The ability to fulfill international standards and to increase compliance with quality and safety requirements is one way to build capacity in the region and create a positive legacy from mining.</li> </ul>

Table 3 - Challenges and opportunities for local procurement at the Bayan Khundii project

CHALLENGES	OPPORTUNITIES
<b>Agricultural rural economy, economic diversification may be challenging</b>	
<ul style="list-style-type: none"> <li>The primary economic activity of the region is herding livestock (camels, goat and sheep).</li> <li>Raw cashmere is the primary good sold.</li> <li>There are limited opportunities for the purchase of goods or services for the mine from the herding community.</li> </ul>	<ul style="list-style-type: none"> <li>Rather than diversification, economic resilience could be considered. A fit-for-purpose herder livelihood support program could improve resilience and create the conditions from which other local business ventures could emerge. Such a program could help herders access best livestock and land management practices. These activities could form part of the mine's monitoring of land use changes and potential impacts.</li> <li>There may also be opportunities to support efforts to bring products, such as raw cashmere, to market at a lower cost to herders. For example, by utilizing the back haul freight capacity from mine site to the provincial centre and Ulaanbaatar.</li> </ul>
<b>Barriers to entry</b>	
<ul style="list-style-type: none"> <li>Due to the remote location of the mine, there is a lack of physical infrastructure.</li> <li>Much of the local workforce is unskilled or low skilled.</li> <li>There is a lack access to markets.</li> </ul>	<ul style="list-style-type: none"> <li>Private public partnerships and/or special purpose companies (SPC) have been used in other jurisdictions to help address local capacity constraints.</li> <li>Some large multi-national or national suppliers may have their own community investment programs that could be leveraged for local benefit.</li> </ul>
<b>Limited local supply</b>	
<ul style="list-style-type: none"> <li>The database of local businesses in the region includes many companies that are registered but do not appear to have active operations.</li> <li>There are a relatively small number of local businesses with established track records and/or success (e.g. number of employees, year-over-year revenues)</li> </ul>	<ul style="list-style-type: none"> <li>In other regions, a community-based economic development tool, known as enterprise facilitation, has been successful in establishing locally owned independent businesses. Funding for enterprise facilitation typically involves the local community, government and a corporate partner. A typical program provides self-identified local entrepreneurs with access to training, mentoring and seed capital.</li> <li>Some development funding agencies offer financial services for local businesses. Although not a company specific activity, the company could facilitate introductions or draw these opportunities to the attention of local stakeholders.</li> </ul>

Table 3 – Local procurement challenges and opportunities continued

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## INTERVIEW QUOTES

*“Local business owners do not understand the obligations to meet the contract requirements. For example, they say I will provide transportation services with this specific vehicle and they signed the contract. However, when the transportation service is needed, they say I’ve become busy, my sibling, or my friend can serve with this vehicle, which does not meet the safety and technical requirements. When the company cancels the contract, they start a negative discussion against the mining company.”*

*“To be honest, we do not know about mining and the opportunities from mining projects. We do not have either negative or positive impacts from a commercial mining project in our soum. We’ve been living in our traditional way.”*

*“Keep providing information on the potential of doing business with us. Keep things transparent. This will change attitudes. Then we can start understanding what mining needs, and what we can do as local suppliers.”*

*“It is unrealistic to ask locals to produce and supply the goods and services that are not already available in the community. It increases the number of fake and non-operational business in the soums and provinces. Instead, mining companies should be looking for the goods and services that are already available and build some capacity based on the existing businesses’ capacity. In that case, it sounds more realistic.”*

## Building a local procurement strategy

The rationale for a local procurement strategy is to:

- Secure cost savings (i.e. reduced labour, transport, or others);
- Improve supply chain resilience, owing to multiple potential suppliers locally and nationally;
- Increase indirect employment opportunities;
- Increase revenue generated in the local economy;
- Raise the local profile and visibility of the project; and
- Strengthen the capacity of existing businesses (standards, volume, variety of products), and create local value.

The proposed objectives of Erdene's local procurement initiative are to:

1. Improve the capacity of local businesses to participate in the project;
2. Encourage local entrepreneurship and investment;
3. Enhance supply chain efficiency;
4. Create residual community value via skills development; and
5. Introduce new standards to help local businesses compete for future contracts and support economic resilience.

A four-step process was used to match existing local suppliers to potential procurement opportunities with the Bayan Khundii project (Figure 2).

Identify	1	Compile a list of existing businesses in Shinejinst and Bayankhongor city with the potential to supply goods and services to the mining project.
Assess	2	Categorize existing businesses based on annual sales/income, number of employees, years in business. Assess potential for residual community value to result from mining contracts.
Sort	3	Review Project procurement plans to sort budget items into critical (time sensitive, high expertise - i.e. building the mine's flotation circuit) and non-critical (lower expertise, limited potential to disrupt the construction or operations schedule yet still urgently needed - i.e. cement manufacture) items.
Match	4	Mapping local suppliers to goods and services identified within Project procurement plans.

Figure 2: The supplier mapping method

The findings of the literature review, qualitative interviews, and the mapping exercise were used to develop a local procurement framework (Table 5). As noted earlier, a key consideration was how local procurement could contribute to a positive economic legacy in the region. One aspect of a positive economic legacy is residual community value. Residual community value is defined as the potential value (in goods, services or expertise) that can be retained within a community after the completion of mining activities.

A series of questions guided the review and shaped the local procurement framework.

### Community readiness

- How ready/able are local businesses to provide the quality of service and quantities of goods that a mine will require?
- If the company (or others) are successful in proving additional mineable reserves, how could the project help prepare local suppliers for the next mine development?
- Are there opportunities to reduce market inefficiencies and improve the quality of goods and services?
- Can the competitiveness of local suppliers be increased?

### Contracting

- What contracts can be sub-divided to create opportunities for micro, small, medium enterprises (MSME) that might lack the qualifications to compete for large contracts?
- Are there contracts within which local purchasing could be mandated?
- Are there contracts where a local supplier would deliver better outcomes in terms of cost, quality, or speed?
- Are there opportunities to strengthen partnerships with local suppliers?

### Residual value

- What local procurement opportunities could create residual value within the region?
- Are there items that can be moved off the project's balance sheet to be owned by a local business or by the local government? For example, could a local company own spares and wares?
- What shared interests between mining and traditional herder livelihoods could help create local value – for example, environmental monitoring, water conservation, animal health improvement?
- Are there opportunities to work with local businesses to train for residual value – for example, train a local company able to do vehicle servicing or rebuild pumps?
- Recognizing that supplier development is a means to increase the sustainability of the supply chain, what sorts of capacity building initiatives could be made available during the project's initial seven-year duration?

Ultimate Impact (5-8 years)	Targeted, deliberate local procurement that strengthens local suppliers and contributes to local economic development, while also creating value for the business.		
Outcome (3-5 years)	<ul style="list-style-type: none"> <li>• Increase the project’s contribution to local economic development by collaborating with local suppliers.</li> <li>• Improve the capacity of local business to respond to demand-supply shifts and new opportunities over time.</li> </ul>		
Output (1-3 years)	Reduced market inefficiencies and improved quality of goods and services.	Increased competitiveness of local suppliers	Strengthened partnerships with local suppliers
Activities	<ul style="list-style-type: none"> <li>• Develop job descriptions for local procurement (LP) team/position</li> <li>• Create cross-functional LP team</li> <li>• Develop LP process and performance indicators</li> <li>• Develop pre-qualification process and business diagnostics</li> <li>• Carry out local business pre-qualification and diagnostic evaluation</li> <li>• Meet with potential partners (business training centers, chamber of commerce, local government, investors, development agencies, etc.)</li> <li>• Identify opportunities for collaboration on supplier development program</li> <li>• Deliver information to interested parties (e.g. workshop on pre-qualification process for local entrepreneurs)</li> <li>• Develop advisory program (outline, curriculum) on target issues: health, safety and environment (HSE), contract compliance, business management, quality assurance, or others</li> <li>• Develop and deliver coaching/mentoring program</li> <li>• Establish targets and monitoring system for local procurement</li> <li>• Carry out regular reviews of tools and materials</li> <li>• Conduct monthly/quarterly reviews of targets against metrics</li> <li>• Facilitate and support local business participation in tender process, including feedback on non-selected bids</li> <li>• Launch public announcements on local contracting opportunities</li> </ul>		

Table 5: Local procurement framework

## Identified Local Procurement Opportunities

The outcome of the mapping exercise identified 43 established companies operating in Bayankhongor or Shinejinst that offer services matching the needs identified with the preliminary purchasing plans for the project.

Business types	Existing local businesses – Bayankhongor & Shinejinst
Construction services	Road construction, concrete slabs and cinder blocks, commercial and residential construction and remodelling
Small Industry	Carpentry, furniture and fixtures, metal crafts (fence etc.), sewing and textiles (uniforms and linen), passenger transportation, bakery, printing and publishing, shoemaking, water and juice factory
Agriculture	Chicken farming, dairy products, vegetables and fruits
Wholesale	Stationary office supplies, cleaning and camp consumables, building material, fixed plant maintenance products
Services	Veterinary, light vehicle maintenance services, garbage disposal, hotel service, hairdresser and barber

Table 6 - Prospective Local Procurement Opportunities

## Herder Livelihood Support

As noted earlier, the principal economic activity in the region is nomadic herding.

Some herders and their family members may be interested in jobs at the mine or supplying the mine with products from their livestock.

Others are likely to wish to continue and improve upon their existing lifestyles.

Opportunities to collaborate with herders on issues of mutual interest, such as environmental protection, water stewardship and market access, have the potential to strengthen relationships, bridging rural-urban worldviews. A herder livelihoods support program could act to complement the local procurement strategy and create additional value for the region and the company.

## Conclusions and recommendations

**Communications** – Local businesses will need information about the potential opportunities, company requirements, and the procurement process. To increase awareness of commercial mining in the region, a public engagement strategy is recommended to enable local business owners and services providers to understand the economic opportunities a mine may generate.

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*The critical first step is stakeholder consultation. The company should meet local business owners, economic development officers, local elected officials and other local stakeholders to talk about their interests and potential opportunities for collaboration. That feedback will help to refine the local procurement strategy.*

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**Establish the procurement process** – Local business owners and service providers understand that local procurement presents challenges. Interviewees acknowledged that there is a lack of capacity within the region but expressed interest in the opportunities that could be generated via local procurement by the mine. One attribute of success will be the creation of a local procurement process that is easy to understand, that clearly outlines opportunities and the criteria for success, and helps unsuccessful applicants to understand why they were not selected. It is noted that products and services that are consistently required by the mine are more likely to support a sustainable market for local suppliers.

**Start small** – It is recommended that the company focus its initial efforts on the provision of small contracts to businesses operating within the soum or aimag. Some capacity building efforts will be required to enable local businesses to compete successfully for contracts and, later, to deliver their obligations. Opportunities for mentorship with larger, established suppliers should be explored, which may enable a gradual increase in the standards and supplier requirements for local suppliers. It is acknowledged that mentorship programs create an initial cost for the mentor, but evidence suggests that this cost can deliver returns over time.

**Build a tiered approach** – To create opportunities for local procurement in an area with few established businesses, a rating system with categories accommodating different levels of local participation and value add will be useful. To begin, the project could focus on working with existing small supply or service companies and, over the life of the mine, seek ways to expand the number of eligible companies for contracting opportunities.

**Brainstorm** – Early dialogue with team members, contractors and local stakeholders is recommended. Many will have had experience on projects in other jurisdictions and exposure to ideas that have worked well elsewhere. Exploring these ideas may identify opportunities for action.

The purchase of goods and services is a major cost over the life of a mine. Purchasing a portion of these goods and services locally is a tangible way to create economic value. In remote regions with few established businesses, challenges to local procurement are evident. Not all contracts will be suitable for local procurement.

However, consultation with key stakeholders and targeted support for local businesses have the potential to identify initial opportunities for local procurement. This approach complements community engagement programs, builds partnership with local business, and, ultimately, creates shared value for all stakeholders.

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## Recommended Readings

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