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ESG and oil and gas

The importance of social value

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ESG and oil and gas: The importance of social value

The momentum behind Environmental, Social and Governance (ESG) is growing. And while there is much focus on the environment, the social aspect in oil and gas is equally important. Many corporates across different sectors now recognise the need to have a net zero strategy baked into their business plans and growth ambitions underpinned by ESG.

As investors, shareholders and broader stakeholders increasingly review the ESG performance of organisations, the oil and gas sector is coming under even closer scrutiny.

Getting the ESG narrative right has broad ramifications: better access to capital, stronger employee engagement, improved corporate reputation and reinforcement of the licence to operate. But instead of simply complying with targets, oil and gas companies must focus on ESG factors as drivers of value creation.

Authors: Drew Stevenson, Ian Milborrow, Gavin Sanderson, Adrian Del Maestro.

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Investors overlooking ‘social’ despite ESG ambitions accelerating

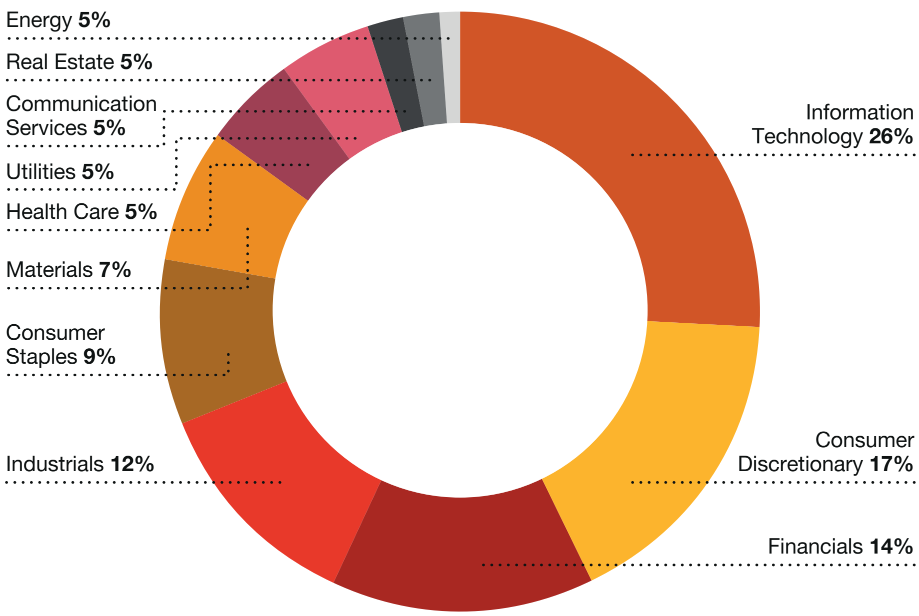
Oil and gas companies take ESG very seriously, with many reducing their emissions footprint. Some are reconfiguring business portfolios by developing ‘transition’ fuels to bridge to a lower carbon future and investing in renewable and alternative energy sources. Others are pursuing, for example, carbon capture technologies and natural carbon sinks.

But while ‘environmental’ remains a critical priority, ‘social’ is sometimes overlooked.

Barron’s, a US publication, ranked a cross-section of American corporates by just ‘social’ weighting. While the geographic focus was narrow, no oil and gas companies made the top 100.

Those players that can articulate and deliver a purpose-driven social narrative will not only contribute to the greater good but will attract ongoing investment and talent, ultimately leading to sustainable operations.

Exhibit 1: The 100 Most Sustainable Companies by Sector, Re-ranked by Social Factors, June 2020



Source: Barron’s

‘Social’ is key to future success

From an ESG perspective, ‘social’ covers communities (human rights, access and affordability, customer safety, fair marketing and advertising) and people (labour practices, diversity and inclusion to employee health, safety and wellbeing). Social has always been front and centre of the oil and gas sector. The industry has a critical role in creating wealth for governments, supporting local content, investing in education and infrastructure and generating tax revenues.

Awareness of this social role was heightened during the pandemic as oil majors provided significant social support to society. For example, Shell offered free food and drink to healthcare workers and truck drivers; bp offered free fuel for NHS vehicles and Total provided fuel vouchers to hospitals. Others provided technology support: Eni used modelling applications to complement infectious diseases research; Repsol used its 3D printing capabilities to produce protective equipment.

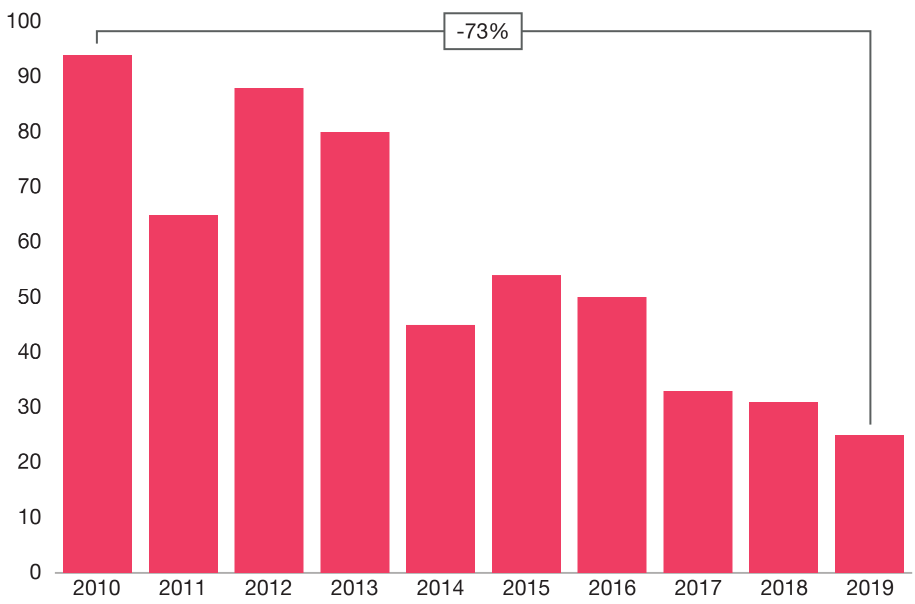
But the broader social role of oil and gas companies remains largely unrecognised. To change those perceptions, they must continue to focus on critical social elements while addressing new ones, particularly if they are to retain their licence to operate. And collectively, the sector must better articulate what it is doing to help address social issues.

> “The oil and gas sector has always had a critical role in creating wealth for governments, supporting local content and generating tax revenues.”

Retain a laser focus on safety

Employee safety and minimising accidents will remain a high priority for the sector, continuing the trend of a more than 70% reduction in the number of fatalities since 2010 (see Exhibit 2).

Exhibit 2: Number of Fatalities in Global Oil and Gas



Source: IOGP Safety performance indicators – 2019 data

Technologies such as artificial intelligence, automation, data analytics, drones and robots will be essential to improving safety standards. While some industry observers suggest the number of accidents will decrease as oil majors transform their operations and pivot to low carbon, they will need to remain vigilant to risks as they run leaner and lower-cost operations, increasingly on a remote basis.

> "Technologies such as artificial intelligence, automation, data analytics, drones and robots will be essential to improving safety standards."

Embrace diversity – the need for new skills

To diversify into new energy technologies and enter value chains that focus on greater electrification and the end-customer, oil majors will need more diverse skills and experience. And the sector is well placed to succeed given its level of innovation and technological sophistication, which is second only to NASA.

Whatever expertise is required – low carbon, climate change, power markets, technology or digital – recruitment alone is not the solution. It's essential to also upskill the existing global workforce. But bridging the digital divide and reskilling for new energy is a complex task that will require business leaders, governments and educators to work together. With its global reach and scale, the oil and gas industry will have a critical role to play.

These new skills will be especially important at board level. If trying to source these capabilities at junior levels is difficult, replicating these skills at a higher level will be a significant challenge. Research from MIT, for example, indicates that among larger companies, only 7% had a top management team where more than half of the members were digitally savvy, but those outperformed the rest on growth and valuation by more than 48%.

Attracting and retaining talent is critical

In some regions, the sector has found it more challenging to recruit new talent. In Europe, where climate change and energy transition are top of mind, oil and gas companies may not be the immediate first choice for the younger generation. A YouGov survey for Barclays in April 2019 showed 62% of 18 to 24-year-olds had a net negative perception of the oil and gas industry.

More broadly, PwC's Upskilling Hopes and Fears survey of over 32,500 workers showed 75% wanted to work for an organisation that made a positive contribution to society. And anecdotal evidence suggests new joiners to the oil and gas industry prefer low carbon operations over hydrocarbons. Clearly oil and gas companies in Europe will need to stress the essential role they are playing to enable the transition and the importance of younger talent.

As for developing countries, the narrative may be different. Talent may actually be more willing to join traditional international and national oil companies, as these roles often provide much needed social mobility.

75%

of workers want to work for an organisation that makes a positive contribution to society

Source: PwC Upskilling Hopes and Fears Survey

Retaining expertise in upstream operations may also be a challenge as businesses transition to low carbon. If a traditional career trajectory no longer exists because a company is transforming, staff may look to competitors, compromising the efficiency of existing oil and gas operations. Where the hydrocarbons business is the cash engine of the group, this may affect the speed of low carbon transformation.

The pace of transformation will increasingly become a critical factor for the retention of leadership teams and talent within oil majors, as well as managing the expectations of external stakeholders. As the low carbon portfolio grows, the hydrocarbon business may become a secondary focus for talent recruitment, which may raise questions around operating models. Companies such as Eni and Repsol have suggested they may carve out their low carbon businesses by way of an IPO to release value, for example. In many ways, the energy transition is manifesting itself in a transition of the workplace.

> "The pace of transformation will increasingly become a critical factor for the retention of leadership teams and talent within oil majors."

A ‘social’ licence to operate will become more important and complex

Licences to operate are, in part, based on a sector’s contribution to the local economy. Operators are required to abide by local requirements, develop the technical expertise of domestic workers and invest in schools, hospitals, infrastructure and technical colleges. Equally as important, they help countries unlock hydrocarbon reserves to advance the national economy and generate revenue for national governments through taxes and royalties on production.

Increasingly, this rationale needs to be viewed through an ESG lens, and the ‘social’ element will be critical. Operators will have to deliver sustainable operations, meaning even if they are helping a country develop indigenous gas reserves, they must do so with the smallest carbon emissions footprint. They will also need to ensure the project supply chain boasts a similar focus on low carbon operations. That might mean electrifying equipment, monitoring emissions leakage and using carbon capture technology, where possible, to create greener supply chains. Moreover, oil and gas companies will need to be wary of different jurisdictions when procuring products and services. Sourcing materials to support their growth ambitions, for example, solar panels for renewable generation capacity, from countries with a poor human rights record will conflict with their governance standards.

The role in helping countries develop cannot be underestimated. According to the International Energy Agency, 750 million people still do not have access to electricity and 2.6 billion people are without access to clean cooking. The oil and gas sector must be part of the solution, providing access to affordable energy, even if the demand for oil and gas may decline significantly as suggested in the IEA’s Net Zero by 2050 road map.

There are many examples of oil and gas companies focusing on social. Cairn Energy, an independent E&P company, for example, implements social investment programmes everywhere it operates. Engineering company Petrofac runs training facilities globally to upskill the workers in the countries it operates in. Saipem, the oil services company, aims to be the driver of local improvements, monitoring its socio-economic impact on areas of operations.

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A ‘social’ role in UK energy transition and job creation

Providing access to energy is not just limited to developing economies. The global scale of the oil and gas sector, its financial firepower, technical and project management expertise will be critical for rebuilding post-COVID-19, as well as enabling the energy transition in developed markets.

Industrial clusters will be a critical focal point for decarbonisation, which the oil and gas sector is well-placed to support. In the UK, Zero Carbon Humber (ZCH) and Net Zero Teesside (NZT) are major projects expecting to generate employment and will require pools of technical expertise to deliver these infrastructure plays. Equinor and bp are members of the consortium in each project. According to a report by Vivid Economics, in the case of ZCH, “as many as 49,700 direct, indirect and induced jobs will be created as a result of deploying CCS (carbon capture and storage) and hydrogen technologies in the Humber region.” NZT could support up to 5,500 jobs during construction. And the challenge of building a supply chain in these technologies cannot be overestimated. In the case of hydrogen (both green and blue), this is a nascent sector, with limited infrastructure in place for storage and distribution, new production technologies being deployed (electrolysers) and many companies evolving their capabilities.

Elsewhere, the UK government is looking to support up to 60,000 jobs in the offshore wind sector, 50,000 jobs in CCUS and up to 8,000 in hydrogen across industrial clusters. The oil and gas sector will be critical to delivering this.

“The global scale of the oil and gas sector, its financial firepower, technical and project management expertise will be critical for rebuilding post-COVID-19.”

Measuring, reporting and articulating performance on social metrics and demonstrating the value generation will be essential in swaying investor views. By the very nature of their existing operations (producing hydrocarbons), oil and gas companies will have a harder time persuading investors about their overall ESG credentials.

Just looking at share price performance, between January 2019 and April 2021, low carbon energy companies saw their share value appreciate by 75% (using Orsted, Enel, SSE and Iberdrola as benchmarks) despite the economic downturn triggered by COVID-19. In contrast, European oil majors (using bp, Shell, Total and Equinor) saw their share value decline by 25%. While there are a multitude of factors influencing share price movement across the majors, including the oil price, there is clearly a difference in the share performance between these two groups. And despite the European oil majors pivoting to low carbon, financial markets remain to be convinced of their ability to execute. If so, oil and gas companies must better articulate their environmental and social dimension and how these create value. And they will need to be patient as the evidence gathers momentum over time.

“Oil and gas companies must better articulate their environmental and social dimension and how these create value.”

So what next?

With the weight of public opinion so focused on environmental factors, the social dimensions of ESG are at risk of being overlooked by investors. To highlight these credentials, oil and gas companies will need to clearly understand the most important social factors: those that align to shareholder value, purpose and societal obligations. They must then determine how to measure, report and evaluate those social goals for the investor community, and articulate a compelling narrative of their social contribution, within the organisation and the marketplace.

Those companies that use the social dimension as a source of value creation will be best placed to thrive in any energy transition.

Who to contact

Rob Turner
Strategy& Partner, Deals
robert.m.turner@pwc.com

Ian Milborrow
PwC Partner, Sustainability and Climate Change
milborrow.p.ian@pwc.com

Adrian Del Maestro
Strategy& Director
adrian.delmaestro@pwc.com

www.strategyand.pwc.com