Can Environmental, Social and Governance be successfully incorporated into reporting standards? Evaluating ESG (Environmental concerns) in the Oil and Gas indus

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Can Environmental, Social and Governance be successfully incorporated into reporting standards? Evaluating ESG (Environmental concerns) in the Oil and Gas industry

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Abstract

This paper examines the current status of Environmental and Social Governance incorporated into company reporting and activity. This investigation first discusses the specific details and components of ESG. It then outlines recent movements towards it, while discussing causes and rationale for companies to consider ESG concerns. Despite Friedman's sentiment that a company must focus on maximizing shareholder earnings, ESG has demonstrated a noticeable rise in implementation, with over $30 trillion in assets under management globally incorporating ESG.

This paper then considers existing ESG frameworks in the Oil and Gas industry, ultimately proposing five criteria to evaluate the ESG consideration/reporting in this industry by different companies. Finally, this paper considers industry leaders from around the world and evaluates their ESG-related activity against the proposed criteria. It concludes that although ESG reporting still lacks common structure and awareness, ESG consideration has become feasible and evident in the Oil and Gas Industry.

Key words

Environmental, Social and Governance, *Financial Reporting*, *Oil and Gas*

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1. Introduction

1.1 What is ESG?

Environmental, Social, and Corporate Governance (ESG) has become a booming standard for financial reporting in the last decade. Since its introduction by the United Nations in 2006[1], ESG has grown to encompass over $30 trillion in assets under management[2]. ESG can be divided into three core components, which address the keystone concerns of an operating business:

1. Environmental Concerns -

   This Environmental component includes environmental, polluting, energy and other activities that a company is involved with. It has expanded to include climate change related activities and carbon emissions.

2. Social Concerns -

   The Social component focuses on relationships with all *stakeholders*, and upholding inclusion, reputation, and appropriate connections with all stakeholders.

3. (Corporate) Governance -

   The Governance component includes internal company practices and rules to fulfill its social responsibility, meet legal requirements, and make decisions.

1.2 Why do some companies implement ESG?

Certain concerns have been raised about the tradeoff between Corporate Social Responsibility (CSR) and shareholder value creation (like Emmanuel Faber and Danone). However, numerous

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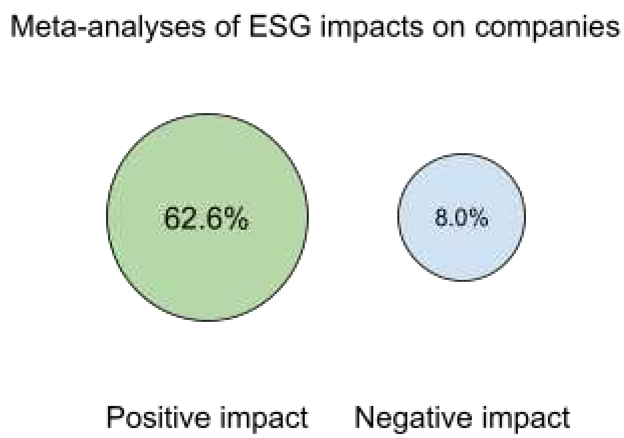
[1] "SECRETARY-GENERAL LAUNCHES 'PRINCIPLES FOR RESPONSIBLE INVESTMENT' BACKED BY WORLD'S LARGEST INVESTORS | Meetings Coverage and Press Releases." *United Nations*, www.un.org/press/en/2006/sg2111.doc.htm. Accessed 15 Sept. 2021.

[2] Holder, Michael. "Global Sustainable Investing Assets Surged to $30 Trillion in 2018 | Greenbiz." *GreenBiz*, 8 Apr. 2018, www.greenbiz.com/article/global-sustainable-investing-assets-surged-30-trillion-2018.

studies and case studies[3] demonstrate that companies need not sacrifice financial performance to pursue ESG. ESG's benefits can be measured from two perspectives: the company, and society. Logically, Corporate Financial Performance (CFP) is a good measure of how addressing ESG concerns can impact a company. Numerous studies (over 2000) have been conducted on the impacts of ESG on equity returns, asset/liability management and other aspects of CFP, and cumulative results have been presented by Gunnar Friede et al[4]. Considering the meta-analyses data (generally accepted as more accurate), nearly 63% of quantitative findings to date reveal a positive impact of ESG consideration on the company CFP.



[5]

These positive results have manifested in different ways, especially depending on the focus on E, S, or G, or a combination of two or three of these aspects.

1. Growth -
   ESG can productively contribute to top-line growth by creating greater customer appeal and improving company image.[6]

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[3] Maddali, Annapurna. "Can Corporations Balance Economic Profit with Corporate Social Responsibility?" *Pioneer Research Journal*, vol. 7, 2020, pp. 42–57, pioneeracademics.com/journals.

[4] Friede, Gunnar, et al. "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies." *Journal of Sustainable Finance & Investment*, vol. 5, no. 4, 2015, pp. 210–33. *Crossref*, doi:10.1080/20430795.2015.1118917.

[5] Ibid.

[6] Henisz, Witold, et al. "Five Ways That ESG Creates Value." *McKinsey & Company*, 23 June 2021, www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value

2. Investment -

ESG considerations have been proven useful in asset management and investment returns, because companies with greater sustainability awareness are capable of focusing on high return strategies. For instance, China's optimistic outlook towards mitigating air pollution is predicted to create $3.2 trillion in investment opportunities by 2030[7]. Shareholders are leaning increasingly towards 'shareholder activism' this decade[8]. A survey of 413 senior investors revealed that 82.1% of investors (US and Europe) consider ESG and ESG ratings pertinent to investment decisions[9]. In continuation, ESG considerations offer investors a 'hidden alpha' factor[10] because of greater transparency and sustainability motives. In particular, ESG 'Tilt' and 'Momentum' strategies (involving ESG ratings affecting stock values) are becoming prominent[11].

3. Costs optimization -

Several companies have combined ESG with Discounted Cash Flow (DCF) accounting to predict the impact of environmental and social investments[12]. For instance, FedEx has converted 20% of its 35,000 vehicle fleet to electric/hybrid engines and saved over 50 million gallons of fuel. Similarly, Walmart predicted that reducing plastic packaging by 5% would reduce costs $11 billion (with $4.3 billion real savings for Walmart).

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[7] 董志成. "Report: Air Pollution Battlefield Brings Investment Opportunities." *Chinadaily.Com.Cn*, 18–04-18, www.chinadaily.com.cn/a/201804/18/WS5ad69dc6a3105cdcf6518f2c.html.

[8] Grewal, Jyothika, et al. "Shareholder Activism on Sustainability Issues." *SSRN Electronic Journal*, 2016. *Crossref*, doi:10.2139/ssrn.2805512.

[9] Amel-Zadeh, Amir, and George Serafeim. "Why and How Investors Use ESG Information: Evidence from a Global Survey." *Financial Analysts Journal*, vol. 74, no. 3, 2018, pp. 87–103. *Crossref*, doi:10.2139/ssrn.2925310.

[10] "GIST | Quantifying Impacts." *GIST*, www.gistimpact.com/quantifying-impacts. Accessed 16 Sept. 2021.

[11] Esg, Remy Briand Head Of. "CAN ESG ADD ALPHA?" *MSCI*, 17 June 2015, www.msci.com/www/blog-posts/can-esg-add-alpha-/0182820893.

[12] ---. "The Costs and Benefits of Calculating the Net Present Value of Corporate Diplomacy." *Journal of Field Actions*, no. 14, 2016. *OpenEditionJournals*, journals.openedition.org/factsreports/4109#ftn2.

Proponents of ESG attribute such predicted successes to greater clarity and transparency, especially from the Environmental perspective. Companies that choose to focus on sustainable practices are likely to benefit from lower pollution/material costs in the future[13]. A study of 180 American companies in 2012 revealed that ‘more-sustainable’ companies would more often place sustainability responsibilities on the board than ‘less-sustainable’ companies[14]. This led to more active movement away from polluting and less sustainable processes.

2. ESG in the Energy Sector

The Environmental component of ESG is clearly pertinent in the Energy sector, with concerns about pollution, environmental damage, etc.

2.1 Case study: Oil and Gas Industry

2.1.1 Methodology

This paper will focus on the environmental concerns that arise from Oil and Gas companies. Using established and proposed frameworks, company actions/data will be evaluated. Data regarding Pollutants, Efficiency, Recyclability and other concerns can be found using 10-K annual reports and annual sustainability reports.

2.1.2 Oil and Gas Industry

Currently, the Oil and Gas Industry is an active center for ESG implementation and reporting. Recent developments have refocused ESG in this area, like the Netherlands government order for oil companies to cut emissions by 45%[15], or Chevron and ExxonMobil experiencing shareholder

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[13] Kotsantonis, Sakis, et al. “ESG Integration in Investment Management: Myths and Realities.” *Journal of Applied Corporate Finance*, vol. 28, no. 2, 2016, pp. 10–16, www.highmeadowsinstitute.org/wp-content/uploads/2019/11/JACF-ESG-Integration-Myths-and-Realities.pdf.

[14] Eccles, Robert, et al. “Is Sustainability Now the Key to Corporate Success?” *The Guardian*, 6 Jan. 2012, www.theguardian.com/sustainable-business/sustainability-key-corporate-success#comments.

[15] BBC News. “Shell: Netherlands Court Orders Oil Giant to Cut Emissions.” *BBC News*, 26 May 2021, www.bbc.com/news/world-europe-57257982.

activism towards addressing climate change[16]. Logically, energy giants across the world are adapting ESG considerations and reporting to boost customer appeal and uphold investor confidence. As an example, Chevron shareholders voted 61% in favor of implementing a carbon-reduction plan, demonstrating how ESG can reassure investors, while a lack of considerations unsettles shareholders.

A key factor in establishing ESG standards in the Oil and Gas industry is Product Impact. The company must consider the Environmental and Social concerns of its product, such as recyclability or availability to underserved markets. To date, an effective impact framework for the Oil and Gas industry has been proposed, considering both *E* and *S* concerns.

The framework relies on Impact-Weighted accounting, proposed by George Serafaim and Katie Trinh[17].

Product Impact Framework Dimensions

Reach		**Dimensions of Customer Usage**			**Env Use**	**End-of-life**
Quantity	Duration	Access	Quality	Optionality	Pollutants & efficiency	Recyclability
The magnitude of individuals reached	Length of time the product can be used, particularly for durables	Accessibility of product through pricing and efforts to provide for the underserved	Quality of product through health, safety, effectiveness, and inherent need or goodness	Ability to choose an alternative product with full information and free will	All pollutants and efficiencies enabled through customer usage	Projected product volume recycled at end of product life

[18]

Inspired by the above framework, this paper proposes certain standards for measuring how actively companies in the Oil and Gas industry follow ESG principles. The standards rely on qualitative criteria, considering various approaches by various companies.

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[16] Ambrose, Jillian. "ExxonMobil and Chevron Suffer Shareholder Rebellions over Climate." *The Guardian*, 25 Aug. 2021, www.theguardian.com/business/2021/may/26/exxonmobil-and-chevron-braced-for-showdown-over-climate.

[17] Serafeim, George, et al. "A Preliminary Framework for Product Impact-Weighted Accounts." *SSRN Electronic Journal*, 2020. *Crossref*, doi:10.2139/ssrn.3532472.

[18] Ibid.

Explaining the Criteria

1. Stakeholder engagement

The debate regarding Corporate Social Responsibility (CSR) originated with Milton Friedman's view that a company exists to maximize *shareholder* earnings. However, CSR has evolved with large companies like Whole Foods actively contributing to society. This sentiment implies the transition from the shareholders to the *stakeholders*[19]. Stakeholders encompass all interacting parties affecting or affected by the company, like suppliers, employees, shareholders and consumers. Mitchell, Agle and Wood's seminal work (1997) defines stakeholders as "any group or individual who can affect or is affected by the achievement of the organization's objective". Therefore, Stakeholder engagement

[19] Mitchell, Ronald K., et al. "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts." *Academy of Management Review*, vol. 22, no. 4, 1997, pp. 853–86. *Crossref*, doi:10.5465/amr.1997.9711022105.

suggests considering the effects of company actions on all stakeholders, whether it be pricing, environmental damage or other actions. Stakeholder engagement relates to the Environmental and Social components of ESG principles.

The Oil and Gas industry holds immense potential for Stakeholder engagement, especially with pricing judgement, environmental impacts on locals, employee health, and more.

2. Identification of material sustainability issues

Material sustainability discusses the areas of contention that are pertinent to a company's sustainability profile. The 'materiality' is a measure of how relevant the matter is to the topic at hand. Therefore, 'material sustainability issues' in the Oil and Gas industry refer to significant environmental/social concerns arising from activities related to these companies. Certain companies may prioritize accident reports, transport costs, or other issues depending on company specifics such as location.

3. Sustainable development activities

These activities include projects and decisions oriented towards greater sustainability processes. In particular, the Oil and Gas Authority of the United Kingdom suggests focus on[20]:

- Health and safety standards
- Gas containment, transport, and other processes (like venting and flaring)
- Air/Water pollution handling
- Waste management and disposal

[20] "'Defining the "E" of ESG' Reporting." *Oil & Gas Authority*, 2021, www.ogauthority.co.uk/media/7145/oga-esg-taskforce-report.pdf.

Such development activities may also engage with improving conditions for stakeholders (like employees) and contribute to social causes rather than the company itself.

4. Reporting Standards and guidance

To date, several financial reporting standards and frameworks are becoming popular from an ESG perspective. The most pertinent are:

- Global Reporting Index (GRI)
- Sustainability Accounting Standards Board (SASB)
- Task Force for Climate-Related Financial Disclosure (TCFD)
- Carbon Disclosure Project (CDP)
- International Integrated Reporting Council (IIRC)

The GRI, SASB and TCFD are most commonly used for guidance in annual sustainability reports, and hold certain keystone metrics/qualitative factors in common.

Environmental Factors	Progress towards Sustainability	Action towards sustainability

The UK Oil and Gas Authority (OGA) plans to impose mandatory reporting requirements by 2025, composing of:

- Mandatory climate-related data in financial reports and websites
- Increased transparency and greater consideration of investor expectations
- Increased qualitative considerations
- Demonstrable improvement over time

Similarly, the American SEC is also considering making financial disclosure on ESG concerns requisite[21]. It is intended to allow fairer comparison by investors, and establish a transparent framework towards sustainability.

This paper will rely on a combination of the aforementioned indices and standards while evaluating company action so far.

5. Communication

Companies may choose to communicate their ESG status and action in order to gain customer/investor confidence and/or improve image. For instance, Burberry (Australian fashion company) places its sustainability pledge prominently at the top of their website[22]. Communication may also be combined with reporting (as communication between the company and governmental institutions/shareholders).

2.2 Comparing Companies in the Oil and Gas Industry

In order to evaluate whether ESG can successfully be incorporated into reporting and company proceedings for this industry, it is useful to analyze what companies have done. This analysis will be done with reference to the criteria developed previously. The companies under study are:

- Chevron Corporation (USA)
- Exxon Mobil Corporation (USA)
- Santos Ltd. (AU)
- British Petroleum (BP) PLC (UK)
- TotalEnergies SE (FR)
- Royal Dutch Shell PLC (NL)

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[21] Kiernan, Paul. "SEC Weighs Making Companies Liable for Climate Disclosures." *WSJ*, 28 July 2021, www.wsj.com/articles/sec-weighs-making-companies-liable-for-climate-disclosures-11627495862.

[22] Burberry. "Beyond." *Burberry*, au.burberry.com/burberry-beyond. Accessed 18 Sept. 2021.

These companies are respective leaders in their domestic markets, as mentioned above. Sustainability reports and ESG reports were considered for all companies under study. Financial statements (10-K and 10-Q) were also considered for Chevron and ExxonMobil, with the 20-F also considered for BP and TotalEnergies. Only certain reports were utilized in Table 1 below.

Table 1 below outlines with detail various activities by the companies under study, with focus on the five criteria proposed.

Key

Evaluated panel

Table 1

	Santos	**BP**	**TotalEnergies**
Stakeholder engagement	Santos identifies 12 key stakeholders and for each stakeholder group rates the importance of each sustainability aspect based on factors such as the perceived impact on the group, and how they are affected by Santos activities.[23]	BP discloses a snapshot of feedback from stakeholders on areas where reporting could be improved.	Total communicates specific commitments for each stakeholder group. They identify the value created for key stakeholders (employees, shareholders, suppliers, local and national government and communities) in ***dollar value***.[24]
	Shell	**BP**	**ExxonMobil**
Identification of material sustainability issues	Shell's five step content selection process used to identify key material issues: i. Stakeholder engagement to identify significant topics ii. Identify topics of significance to business strategy iii. Results are combined in a matrix and each item assessed in terms of impact. A weighting is assigned based on its	BP's materiality assessment process begins with assessing the issues raised by stakeholders, stemming from a recognition that external stakeholder groups have varied priorities for BP. For example, in 2015, common issues raised by stakeholder groups included a focus on how BP were responding to the climate challenge as well as a strong interest in understanding how BP create value in the communities	Exxon follows a three step process to identify the most material issues, which are then used to shape the content of their Corporate Citizenship Report[28]. This process involves: i. Issues identification ii. Issue prioritisation iii. Material issues selected.

[23] Santos. "2021 Sustainability Report." *Www.Santos.Com*, 2021, www.santos.com/wp-content/uploads/2021/04/2021-Sustainability-Report.pdf.

[24] TotalEnergies. "Getting to Net Zero." *TotalEnergies*, Sept. 2020, totalenergies.com/sites/g/files/nytnzq121/files/documents/2020-10/total-climate-report-2020.pdf.

[28] ExxonMobil. "ExxonMobil Sustainability Report 2019." *Corporate.Exxonmobil.Com*, 2020, corporate.exxonmobil.com/-/media/Global/Files/sustainability-report/publication/Sustainability-Report.pdf.

	significance to stakeholders, Shell strategy and sustainability context. All high priority topics are included in the Sustainability Report. iv. Low priority topics are included on the corporate website rather than in the report v. External Review Committee reviews content to ensure its coverage is complete, relevant and balanced. vi. Shell's Executive Committee to be informed of the key topics[25]	where they operate[26] BP reports on 7 key issues including accidents and oil spills, climate change, managing risks, business ethics, human rights, value to society and local environmental impacts BP reports on their approach to managing human rights issues across their supply chains, which includes most of BP's standard model contracts now include human rights clauses that require suppliers to respect internationally recognised human rights in their work for BP[27]	Exxon have an External Citizenship Advisory Panel comprising of experts in social and environmental topics who provide an annual independent review of the company's corporate citizenship activities, including the Corporate Citizenship Report itself
	BP	**Chevron**	**TotalEnergies**
Sustainable development activities	Positive investments in communities focus on three themes: *working with communities*, *supporting development in "societies where we work"*, and *human rights*	Provides six impact stories focused on support and empowerment. For example, a collaborative approach between Born Free Africa, Global Fund and Chevron was	Total's understanding of the importance of climate in driving development saw focus being directed to developing renewable energies, improving energy efficiency and improving the carbon

[25] Shell. "Shell Annual Report 2019." *Shell*, 2019, reports.shell.com/annual-report/2019/servicepages/disclaimer.php?tabc=1e3.

[26] BP. "BP Annual Report." *BP*, 2019, www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/sustainability/group-reports/bp-sustainability-report-2019.pdf.

[27] BP. "BP Annual Report and Form 20-F." *BP*, 2019, www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/investors/bp-annual-report-and-form-20f-2019.pdf.

	In 2015, key concerns and requests raised by communities living near our major operating sites included noise, odour, dust, job opportunities for local residents, community investment programmes, flaring and access to roads. BP's response was to work with the **International Petroleum Industry Environmental Conservation Association** (IPIECA) to develop and promote guidance that integrates human rights into community grievance management.	implemented in working towards the initiative of a HIV/AIDs Free Generation	intensity of its production mix Total's reporting process is centred around key challenges and a set of specific indicators[29]
	Santos	**Chevron**	**TotalEnergies**
Reporting Standards and guidance	Santos' sustainability scorecard is the principal tool used to measure the company's sustainability performance, with a company-wide assessment undertaken on an annual basis based on a self-assessed 10- point rating system Indicators in the 2015 Sustainability Report are based on the Global Reporting Index (GRI) G4 Guidelines and have been tailored to address material sustainability issues	Chevron's 2015 reporting was informed by reporting frameworks and guidelines including the IPIECA industry guidance on voluntary sustainability reporting (2015) Chevron obtains third party assurance over its sustainability reporting on an annual basis	Reporting against GRI G4 guidelines, IPIECA, API and OGP (Oil and Gas Industry standards) guidance indicators Participant in United Nations' Global Compact and signatory to Extractive Industries Transparency Initiative since 2002 Participate in the following: Carbon Disclosure Project (CDP); Dow Jones Sustainability Indices (DJSI) since 2004; FTSE4Good Index since 2001

[29] TotalEnergies. "Getting to Net Zero." *TotalEnergies*, Sept. 2020, totalenergies.com/sites/g/files/nytnzq121/files/documents/2020-10/total-climate-report-2020.pdf.

	Chevron	ExxonMobil	TotalEnergies
Communication	Chevron historically produced annual comprehensive Corporate Responsibility reports, in both printed and online formats. Since 2013, Chevron have shifted to a shorter printed version for the report, and an expanded, more frequently updated content on the website	Produce annual Corporate Citizenship Report Communicate safety and environmental performance to investors at AGMs Corporate blog and twitter feeds	Have a dedicated website section for Sustainable Performance to provide a one-stop shop for information on Total's CSR process and quantitative data on performance against key indicators

2.3 Conclusion and Evaluation

Considering the detailed analysis of company activity, it can be derived that the Oil and Gas industry has implemented ESG considerations in different manners. In particular, French company TotalEnergies demonstrates activity in all five proposed criteria. Based on the evidence that Oil and Gas companies are able to *provide adequate information* and *take action on ESG concerns*, it can be deduced that *ESG can be incorporated into reporting and company activity*. This industry is infamous for its environmental concerns and possible social harm, which is a keystone argument for increasing ESG awareness amongst investors and companies alike.

On the other hand, certain measures by different companies may be more or less effective. The panels marked in the above table

1. TotalEnergies and Stakeholder engagement -

   Total follows the SASB mode of disclosure by assigning *monetary impact valuation* on stakeholders. This suggests that impacts revealed to shareholders, customers, and organizations may be overvalued (or less likely, undervalued).

2. Identification of material sustainability issues -

   All three companies under study in this criteria (Shell, BP, ExxonMobil) followed similar, detailed approaches to identifying sustainability issues. For instance, Shell involves stakeholders to identify topics of contention, while BP requests stakeholders to raise pertinent issues. However, the lack of variety in process for identification is susceptible to missing out on certain criteria. Deloitte, McKinsey and other consultancy firms are entering this space by offering detailed, personalized plans towards sustainability.

3. Communication -

   Communication combined with reporting can be effective forms of outreach for companies towards customers. However, customers rarely visit Oil and Gas industry websites - limiting the effectiveness of this communication. Instead, increased advertising at gas stations/pumps may be more effective.

Despite these limitations, the oil and gas industry has definitely moved towards the inclusion of ESG. To address the raised concerns, relying on a third-party institution for true impact valuation (integrated valuation) can reduce overvalued impact. This also addresses the possible incomplete identification of sustainability issues. Regarding communication as a criteria, this industry would benefit greatly by increasing communication with investors rather than consumers. With rising shareholder activism[30], investors would enforce greater amounts of upward pressuring towards sustainable production.

[30] Armour, John, and Brian Cheffins. "The Rise and Fall (?) Of Shareholder Activism ByHedge Funds." *The Journal of Alternative Investments*, vol. 14, no. 3, 2011, pp. 17–27. *Crossref*, doi:10.3905/jai.2012.14.3.017.

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