BP calls into question existing ESG research and shows the need for third-party information

The oil major was a high risk, reputation concern before the Gulf of Mexico spill.

by Karen Reiner | September 8th, 2010

The recent oil spill in the Gulf of Mexico and the resulting financial implications for both BP and its investors have shown that environmental, social and corporate governance (ESG) risks are too important to be ignored in investment decisions. The significant loss of BP’s market capitalization and its dividend cut following the oil spill testify to the fact that the financial performance of even the most liquid companies can be seriously affected by its ESG performance and the corresponding violations of international ESG standards. The oil spill has also called into question some methods used in identifying and assessing ESG risks. In recent years, BP widely enjoyed the reputation of a “best in class” company with impressive sustainability policies in place that enabled it to attract cash from both ethical (i.e. norms-based) and mainstream investors. However, with hindsight most people agree that for investment decision-making purposes investment managers cannot only rely on the information provided by the company itself, but rather should primarily use independent assessments of the company’s associated ESG risks. It is interesting to note that many norms-based investors were misled because, despite positive ESG ratings, BP was not compliant with expected internal and international standards. A feasible ESG risk screening procedure should be in place in every investment or financing decision-making process, irrespective of whether an investor pursues norms-based investments or is simply interested in the strong financial performance of a company.

At RepRisk we believe that an essential part of ESG risk analysis is screening third-party sources such as print media, NGO websites, newsletters, news sites, governmental agencies, etc. to assess the environmental and social performance of a company based on its activities in the field. The tool that RepRisk uses for assessment of a company’s or a project’s ESG risk, captures relevant criticism from third-party sources on a daily basis and translates the company’s or a project’s risk exposure into a Reputational Risk Index. According to the index, between May 2008 and April 2010 BP consistently ranked among the most environmentally and socially controversial firms, suggesting that its true risk exposure was always high, a fact that was not often taken into account by other types of analysis. This warning sign offered an indication of its serious risk exposure in terms of environmental and social concerns, particularly with respect to health and safety issues in the US, even prior to the Deepwater Horizon oil-rig explosion. The company had come under fire for numerous issues, including its receipt of a record fine for safety violations after the 2005 refinery explosion in Texas, which killed 15 workers and injured 170 more. It had also been implicated in human rights abuses in Colombia where indigenous communities claimed they were illegally forced off their land and accused the company of complicity in 9000 murders. Other controversies included its failure to adequately monitor and maintain its pipelines, which led to major leaks such as that at Prudhoe Bay, Alaska in 2006 when 200,000 gallons of oil seeped into the tundra. The question to ask is why it took a disaster on the scale of the Gulf of Mexico spill in a developed country to alert companies, investors and governments to the importance of addressing social, environmental and related reputational risks and to ensure against financial losses, when there was advance evidence available that such an event could occur?

Karen Reiner is a senior analyst at RepRisk.
Philipp Aeby CEO at RepRisk will speak at the CFA Society, UK, on September 13, on the topic: "Can you afford to ignore environmental and social risks?"

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