

Ethics in the oil and gas industry



INTRODUCTION

This report looks at the importance of ethics in the oil and gas business and its potential impact on business risk and company share value.

Ethics refers to the concept of what is right and wrong, and ethical behavior is generally considered behavior that is proper.

Business ethics is a form of applied ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and organisations. They are the moral values that guide the way corporations or other businesses make decisions.

ETHICS AND BUSINESS RISK

There are many instances throughout corporate history of how companies have disregarded ethics or morals in the quest for wealth. This can increase business risk due to breaking the law, damaging their image and the effects of lawsuits and damages.

Breaking the Law

Bribery and corruption are widespread in the developing nations. Companies say that the only way to get things done is to pay the bribes. Although few companies publicly defend bribing officials in third world countries, many privately condone bribery on several grounds. First, there are strictly financial considerations. Bribes can prevent delays that might otherwise have serious financial implications. In a capitalistic environment, we need an even playing field, and if other businesses engage in bribery, then either we

do or face being at a competitive disadvantage. Second, there are practical considerations owing to what appears to be the universal nature of bribery in third world countries. Often foreign government officials are so corrupt that it is virtually impossible to do business without playing by the unspoken rules. Thus, there's nothing morally wrong with participating in bribery.

On November 4, 2010 the United States Department of Justice announced a series of settlements whereby seven firms were to pay criminal fines and civil disgorgement penalties amounting to a total of \$236.5m, in a settlement in relation to the Foreign Corrupt Practices Act. Five of the firms were Royal Dutch Shell, Transocean Inc, Global SantaFe Corp, Pride International and Noble corporation (Thomson Reuters, 2010).

This type of transgression if repeated has the potential to place the companies involved at serious risk.

It is this acceptance of 'that's the way the system works' that perpetuates and fuels the bribery culture. If all companies adopted a strong ethical position and refused to pay the bribes the corrupt system would fail.

Some companies have taken steps to distance themselves from corruption. BP was the first oil company to support the "Publish what you pay campaign", a campaign for greater transparency in oil companies' dealings with foreign governments.

StatoilHydro was the first major oil company to start disclosing ALL revenues and payments in the countries in which it operates. It has set out a clearly

defined ethics code of conduct and is promoting this in the different countries it operates in (Statoil, 2008).

Damage to Company Image

In the 1990s Shell was involved in a highly damaging controversy in Nigeria. The Ogoni people of the Niger delta, a minority tribe, had seen their land decimated by years of drilling. Ken Saro-Wiwa helped form the Movement for the Survival of the Ogoni People, and began protesting. The army ordered a brutal crackdown and series of killings, beatings, and arrests took place. Saro-Wiwa was eventually framed for murder and executed. This event was met with widespread condemnation and the bad publicity surrounding it was extremely difficult for Shell. It is difficult to say if Shell were complicit in these events but they certainly could and should have stopped it or at the very least spoken out against it. Shell eventually distanced themselves from Nigeria in an attempt to regain credibility.

Total has been in Burma since 1992 and is a supporter of the military regime. The country has an appalling human rights record.

Aung San Suu Kyi, Burma's pro-democracy leader, has said that " Total has become the main supporter of the Burmese military regime." She told the French weekly *Le Nouvel Observateur* that " TOTAL knew what it was doing when it invested massively in Burma while others withdrew from the market for ethical reasons". She added, " the company must accept the consequences. The country will not always be governed by dictators."

(Burma Campaign UK , 2007)

However unlike Shell this does not worry nor deter Total “ Unfortunately, the world’s oil and gas reserves are not necessarily located in democracies” says Total’s website.

Lawsuits and Damages

On April 20th 2010 the BP operated Macondo well blew out. The Transocean owned Deepwater Horizon drilling rig was destroyed with the loss of 11 lives. The well continued to leak oil into the Gulf of Mexico until it was finally killed on the 17th September 2010.

Initial reports show that cost cutting, poor decision making and lack of honesty were important factors in the disaster.

Both companies have suffered damage to their company image, reputation and financial well being. BP initially faced all the blame as this was politically convenient to the point that it suddenly became British Petroleum again after a gap of 20 years which clearly showed that the Obama administration was about as ethically sound as either Transocean or BP.

BP safety record in the US is poor but much of this is down to the poor condition of assets it inherited during its mergers with Amoco and Arco. Due to its failure to live up to its ethical promises BP is viewed with mistrust bordering on outright hatred in the US whilst elsewhere ethical investors are shying away from it.

Tony Hayward, the former group chief executive of BP, stated: “ Our reputation, and therefore our future as a business, depends on each of us, everywhere, every day, taking personal responsibility for the conduct of BP’s

business". Sadly even the chief executive failed to live up to his own statement.

ETHICS AND SHARE VALUE

The effects of this disaster on BP have been significant with BP as a corporate entity particular at risk. The effect of the Macondo disaster on BPs share price was initially catastrophic.

As can be seen in Figure 1, the share price collapsed from 650p/share to 300p/share in a little over 2 months.

Figure . BP Share Price April 2010 - Feb 2011

chart_builder

(Livecharts, 2011)

BP has had to pay out an initial £20 billion in clean-up costs and with civil lawsuits pending, the final pay-out is expected to severely impact on the strength of its business.

After announcing that it had successfully capped the Macondo well however BP shares rose 8% (Gray, 2010). This proves that investors with equally as little regard to ethics are buying in at the bottom of the market in the hope of making a profit.

There have been other cases where poor ethical behaviour has led to significant declines in share price.

In January 2004 Royal Dutch Shell announced that it was downgrading nearly 4 billion barrels of 'proven' reserves to the 'probable' category. As a result Shells share price fell by 7%. An internal report by US law firm Davis, Polk and Wardwell, (Moore, 2004) detailed a damaging series of e-mails showing that top managers at the company had known about the inflated reserves for years and had been arguing about whether and how to lie to investors.

Conclusion

Which means of ethical behaviour a company adopts has been open to much debate. There are some business leaders who think as Milton Friedman did that their duty is, "to make as much money as possible while conforming to the basic rules of the society". Others such as Statoil wish to conduct their business to the highest ethical standards possible.

Companies have set up Corporate Social Responsibility policies. These policies clearly state the companies ethical and social stand point. The main problem with this is when individuals fail to live up to the statements

Unethical business practices will continue to be seen in the oil and gas sector as some companies continue to think that the lack of ethics will have no impact. In many ways they are correct. Shell and Total do not seem to be struggling despite poor ethical records. From a sales point of view ethics, or the lack of them, have little impact. Due to the very nature of the product the ethical stance of the end user will be weaker. When we buy petrol we don't know where it came from or who suffered as a consequence and so companies are protected. The world is reliant on oil and will therefore look the other way as long as it keeps flowing.

If these practices continue it may lead to government intervention and regulations that are more financially costly for companies to adhere to. Even more important than governmental intervention, is trust. Companies lacking trust by employees, business partners, and customers will suffer financially in the long-term. Trust, based on ethical reputations, may become even more important in the future (Richardson, 2002/2003).

We live in an age where the general public are more attuned to, and aware of, ethical concerns and will base their investment strategies on these principles. In the computer age information is more easily accessed and campaigns against companies can be organised worldwide in days. Companies basing their corporate strategies on strong ethical principles may not show so much short term gain however their long term security will be assured.