Are the major oil and gas companies really prepared for a low-carbon energy system? We’re developing a new approach to help investors find out

How should investors establish if oil and gas equities are fairly priced with respect to climate risks?

Currently available approaches focus on commodity price risk for the sector at large, with various tools claiming to allow rankings, allocations or weightings within the sector (such as low-carbon and green financial indices). Unfortunately, these indices present investors with a binary choice on whether individual equities are investible or not.

Existing approaches are largely based on carbon footprinting each company's assets and operations: their CO2 emissions are used as a proxy for climate transition risk. There’s no consideration given to governance, strategic planning or risk management.

A lot of data, but not much insight

The Task Force on Climate-Related Financial Disclosures (TCFD) aims to increase disclosure to help investors better understand which companies are most at risk from climate change. In theory, if investors know which firms are best prepared and which are taking action, they can more efficiently allocate capital and help smooth the transition to a low-carbon economy.

We reach a different conclusion to many of the rule-based indices

Adoption of the TCFD recommendations should result in significantly more qualitative information being made available on governance, strategy and risk management, in addition to quantitative data on metrics and targets. But it’s far from clear how investors should utilise such qualitative information to make relative comparisons and to inform their investment decisions.

Our research is developing a new approach to understanding the degree of engagement with the energy transition by the oil and gas majors. By assessing the mix of new low-carbon assets in their portfolios, recent moves into such low-carbon activities, and their stated strategic intentions, we reach a different conclusion to many of the rule-based indices.

Our assessment combines qualitative information from annual reports, strategy updates, investor updates, press releases and speeches by senior leaders, with quantitative data on recent capital allocation into low-carbon ventures. Relevant capabilities are mapped against the critical gaps in innovation and deployment identified by the International Energy Agency as critical to delivering the outcomes of its Sustainable Development Scenario. The published data on strategic response options were supplemented with selected interviews and the entire data set analysed thematically to identify relevant patterns.

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The resultant findings generate insights into the oil and gas majors’ new low-carbon portfolios, in both qualitative and quantitative dimensions.

What actions are the oil and gas majors taking?

It should come as no surprise that the European-based oil and gas majors are more engaged with the transition than their North American counterparts; this is demonstrated by the extent of low-carbon portfolio diversification activities, as well as explicit future low-carbon response intentions.

But even within Europe, actual capital expenditures towards low-carbon vary widely. Total has been the most aggressive, having invested more than $7.5 billion in low-carbon over recent years.

Aside from renewables, there are a number of strategic actions being taken, to varying degrees, by these companies:

- portfolio adjustments towards natural gas as a lower-carbon fuel
- carbon capture and storage research, development and further commercialisation
Can the oil and gas majors transition to zero carbon?
Francis Shaw, Dr Charles Donovan
02 November 2018

- diversification into alternative low-carbon transport fuels

Most are also pursuing operational excellence in their existing legacy businesses in order to reduce costs and greenhouse gas emissions, as well as increasing transparency and disclosure on emissions reductions as part of their brand and reputation management.

The more actively engaged companies are also stepping out of higher-carbon assets (such as oil sands), diversifying into renewable power generation, and expanding along the power value chain. They recognise many opportunities to deploy their capabilities in response to the transition, reacting to threats to existing business models, and seeking to identify and grasp new opportunities that arise; considerable emphasis is placed on the development of new commercial models and leveraging synergies with legacy oil and gas businesses.

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The most engaged and prepared companies are setting up partnerships with and investing in innovative low-carbon startups. These allow the majors to deploy their non-technology capabilities to help with scale-up and commercialisation. Effectively, they can place bets on a wide range of new low-carbon technologies at relatively low risk, while positioning themselves to take advantage of those that break through to become new large-scale components of the evolving energy system.

The key question is which (combination) of these actions acts best in the interests of shareholders in surviving and thriving in the energy market of the future?

Actions speak louder than words

Our research is seeking to simplify the complexity of potential strategic responses by listed supermajors. The goal is to create a bespoke index that allows investors to more reliably track not just where these companies are today, but where they are headed in the future.

In the recent words of BP: “Our commitment to helping drive the energy transition is embedded in the core of our business strategy”. Investors want to know if that is true. This research, due to deliver its initial report in December 2018, will help them to decide.

We hope the framework we are developing will shed an important light on the pace of change in the oil and gas industry, and other industries as well. With TCFD looming, it’s high time for more reliable evidence-based rankings that support investment decisions in the light of climate risks and opportunities.