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Corporate Social Responsibility in the Energy Industry:

Challenges and Opportunities

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Since retiring from Shell in 2010, Dr. Radhakrishnan has been teaching Undergraduate, MBA and Executive MBA courses at the Bauer College of Business. He has taught courses in Supply Chain Management, Project Management, Innovation Management and Statistics. At UH Energy, he has been involved in the development of UH Energy's strategy working closely with the Energy Advisory Board. He coordinates the day to day working of UH Energy. Dr. Radhakrishnan holds a bachelor's degree in Mechanical Engineering; a master's degree in Industrial Engineering and a doctoral degree in Business Administration.

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EXECUTIVE SUMMARY

In June 2018, UH Energy hosted a group of corporate social responsibility (CSR) practicing professionals across the upstream, midstream and downstream segments of the energy industry to discuss current gaps, challenges and opportunities in the management of CSR. The breakout group discussions were focused on: impact of climate change, community/NGO opposition and expectations, cumulative social impacts and CSR governance. In the open session discussion that followed, several overarching issues critical to the effective implementation of CSR and its subsequent Environment, Sustainability and Governance (ESG) were identified. Five topics were identified as offering the biggest potential for advancing the practice of CSR in the energy industry:

- a. The business case for how CSR can improve the bottom line
- b. Establishing processes and rubrics for implementing CSR
- c. Developing performance metrics for internal measurements and external reporting
- d. Training for entry level, mid-career and executives and establishing career paths for CSR professionals
- e. Establishing a community of energy industry-focused CSR professionals.

This objective of this white paper is to provide more details on the above five topics and a way forward to make progress in the advancement of CSR implementation in the energy industry. The paper is particularly relevant to and aimed at the management and decision makers in the energy industry.



INTRODUCTION

The fossil fuel industry, consisting of extraction, transport and conversion of hydrocarbons, is dealing with a complex and unprecedented brew of social, environmental, market and technological trends and challenges. The emergence of renewable energy, an inherently distributed production technology and associated enablers such as energy storage, with technologies that are evolving, is creating additional challenges for the industry. Concern for the climate and the ways in which hydrocarbons contribute to the changing climate is challenging the future of the industry. Similarly, single-use plastics and the environmental concerns associated with their end-of-life disposal are being addressed by a series of local governmental regulations with limited input from the industry. In an environment shaped by these issues, the nature of the risks that the fossil-based energy industry has to address are also changing.

Unlike traditional forms of business risk, social and environmental risks manifest over a longer time period than the typical business cycle, may affect the business in multiple areas, and are often outside the direct influence of the firm. Managing social and environmental risks therefore requires connecting the implementation of CSR to the business model and developing adaptive strategies to mitigate business risk.

It is important for the industry to engage in a systematic and preferably quantitative analysis of these social and environmental challenges and opportunities. There is also a need for standardized measurements and reporting of corporate social responsibility (CSR) performance.

A COMMON UNDERSTANDING OF CSR FOR THE ENERGY INDUSTRY?

The relevant dimensions of CSR vary from

industry to industry and between different segments of the same industry. However, the CSR challenges of the upstream, midstream and downstream segments of the energy industry have several common aspects. Emissions, environmental spills, water use, climate change, human rights and community relations are issues that are addressed across the industry. At the same time, the details of what is monitored and measured in the three segments of the energy industry can differ. For example, while upstream and midstream segments are concerned about methane emissions, downstream is concerned about varying emissions from refinery and chemical plant operations, including end-of-life issues of products such as single use plastics.

“CSR is a concept with many definitions and practices. The way it is understood and implemented differs greatly for each company and country. Moreover, CSR is a very broad concept that addresses many and various topics such as human rights, corporate governance, health and safety, environmental effects, working conditions and contribution to economic development. Whatever the definition is, the purpose of CSR is to drive change towards sustainability.” Corporate Social Responsibility (CSR) may be defined as “a business approach that contributes to sustainable development by delivering economic, social and environmental benefits for all stakeholders.” (Financial Times Lexicon.)

Similarly, the needs of the community in which the business operate, generally differ between upstream and downstream operations, as does the way those needs are addressed. As an example, attention to community relations in upstream operations is at a higher intensity during exploration and drilling, whereas attention to community relations continues throughout the lifetime of a refinery or chemical plant.

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BUSINESS CASE FOR PRACTICE OF CSR

The energy industry lacks widely used standard methodologies or metrics to measure the benefits of CSR. Currently evaluating the benefits of CSR is mostly subjective and varies from company to company and even within different divisions of the same company. If CSR management is established as part of project management planning, the risk register will identify lack of proper CSR management as one of the risks. Its impact and likelihood will be calculated and proper action to manage/mitigate the risk will be developed. The impact of the delay can be calculated using the same methodology used for other risks that cause a delay. However, this requires that CSR be fully integrated into processes of project management and that companies establish methodologies to calculate the cost of delays (consistent across the company).

The benefits of CSR manifest over a longer time frame, so evaluating short-term benefits poses challenges and uncertainties. Pressure from shareholders to deliver short-term financial results makes it harder for the management of energy companies to focus on the longer term (and as yet sometimes fuzzy) benefits of CSR activities. The management focus on short-term results influences how CSR is perceived by business units within the organization. Some see it as a form of philanthropy, others, a way to meet regulatory requirements. And some consider it part of maintaining good relationships with the communities in which they work. All of these are certainly part of CSR, but they do not completely define the scope of CSR. However, taking the above narrower views tends to make companies look at CSR as a cost item. As a result, companies are challenged to find value in the practice of CSR.

In fact, managing CSR is critical to the success of most energy industry projects. Most

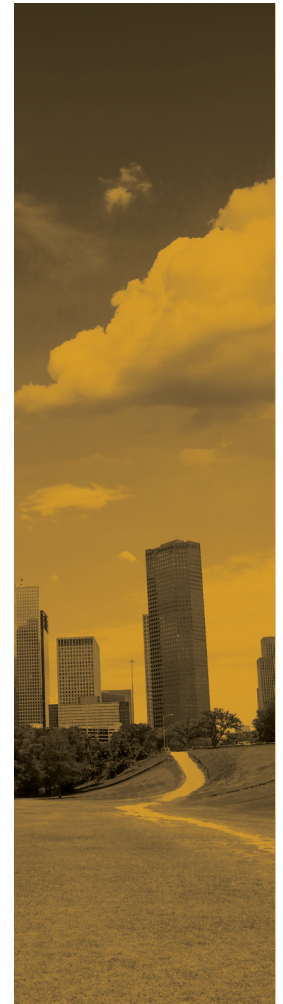
practitioners, as part of calculating project economics, include CSR activities in the construction phase and tend to not include the CSR aspects during the operational phase. This creates higher risks in the operational phase, impacting the overall performance of the project.

Traditionally companies have focused on the benefits to the company and not to other stakeholders. Whelan and Fink provide several concrete examples of companies that have adopted CSR as core to their business strategy and have been successful in creating shared value – to their shareholders and to their stakeholders. They identified benefits including driving competitive advantage through stakeholder engagement and brand differentiation, improving risk management and financial performance, fostering innovation and enhancing investor confidence.¹ Companies that proactively make CSR core to their business strategy will drive innovation and engender enthusiasm and loyalty from employees, customers, suppliers, communities and investors.

Porter and Kramer pioneered the idea of “creating shared value,” arguing that businesses can generate economic value by identifying and addressing social problems that intersect with their business. Companies that embrace this philosophy tend to place CSR core to their business strategy.²

Evaluating the benefits of CSR is still subjective in many cases. Sharing of estimated benefits can sometimes raise questions from stakeholders while at the same time raising expectations about their share of the benefits. Successful management of CSR requires designing models that create value for all stakeholders, including employees, shareholders, supply chain entities, society and the planet.

The management of many energy companies have yet to see the value created by CSR



and continue to view and manage it as a cost item. To change this and create widespread adoption, implementation, and standardization of CSR, a standard methodology should be developed. It must have clear examples to help companies identify appropriate business models that create value for all stakeholders and where the estimation of benefits is consistent across company operations and across the industry.

ESTABLISHING PROCESSES & RUBRICS FOR CSR IMPLEMENTATION

Implementing CSR across a company or an industry requires clear processes for executing the various activities. Moreover, developing and implementing appropriate metrics to measure performance and progress made is crucial.

The implementation of CSR across the energy industry is mixed due to variations in size of the businesses and also in the nature of the businesses. Large multinational corporations have been practicing CSR in several parts of their upstream businesses, in many cases driven by the nature of the agreements with the resource holder. These are not necessarily adequately translated to others parts of their company's operation such as downstream chemicals or refinery operations. Even in the upstream part of the industry, medium sized and smaller companies have not adapted and implemented CSR as their larger competitors have.

CSR covers several areas such as stakeholder engagement, community participation, assessing social impact, developing local talent, hiring a mix of local people, communicating progress to mention a few. These areas differ when it comes to management of CSR in the different business segments (upstream, downstream and midstream) and in sub-segments. Moreover, the nature of business operations (supply chain, project work, legal, community

relations, etc.) also vary in the different business segments. Opportunities to learn from best practices in some companies has not been fully leveraged. Additionally, in many energy companies CSR resources fall below critical mass and are scattered throughout the company, with no central focal point.

Organizations such as BSR (Business Sustainable Reporting) have taken a lead in developing processes and metrics in use and implementation case studies and making them available to interested parties. While these efforts are certainly a move in the right direction, there is a still wide gap in the ready availability of applicable "best practices" – standardized processes and uniform quantitative metrics to measure performance. Expanding collection and sharing of industry best practices will help. What is missing for most businesses is the ability to translate these to the situation on hand. Developing guidelines on how we translate available examples to what is appropriate for the size and nature of the business one is managing would help the industry leapfrog in its CSR implementation journey.

Taken together, these challenges make it difficult for companies to make significant progress in the management of CSR. This highlights the need for the development and sharing of standardized processes, quantitative performance metrics and "best practices" and guidelines to translate these to fit the size and nature of the business being considered.

DEVELOPMENT OF STANDARDS FOR CSR PERFORMANCE METRICS

*"What gets measured gets managed."
"Whatever the measurement system, it needs to be consistent, repeatable and as unbiased as possible".³*

– Pearl Zhu

Another significant challenge for the implementation of CSR is developing



quantitative measures and reporting on performance that is consistent and meaningful. There are several measurement guidelines offered by different industry groups such as IPIECA, (a global oil and gas industry association for environmental and social issues); IFC (International Finance Corporation) Environmental and Social Performance Standard, the Sustainability Accounting Standards Board (SASB); the Global Reporting Initiative; and the S&P Global framework for assessing environmental, social and governance risks, to name a few. These are meant to provide guidelines at the industry level on monitoring areas relevant to CSR and to assess improvements. Each industry or business entity has to translate these to boundaries and units most meaningful to their operations. As demonstrated from the experience of the automobile and healthcare industries, experiential knowledge and sharing of best practices would lead to a common set of measures that are proven to be meaningful for the specific industry are likely to emerge and will be accepted and embraced by that industry as the standard.

“Measurement is the first step that leads to control and eventually improvement.”

– James Harrington

At a company level, a common performance measurement system offers the opportunity to compare different operations in the same company and learn from the better performing areas. It would allow the opportunity to compare performance across companies and learn from best practices.

As in the case for the development of standardized processes, there is need for the development and sharing of common quantitative performance metrics, “best practices” and guidelines to translate these best practices to fit the size and nature of the business being considered.

TRAINING ENERGY CSR PROFESSIONALS AT THE ENTRY, MID-CAREER AND EXECUTIVE LEVELS

CSR practice is perhaps one of the few unique activities that literally touches most functional departments in the company - Supply Chain, HSE, Communications, Operations, Legal, Security, Human Resources, etc. As such CSR is not just the responsibility of a few CSR experts. It must be an integral part of business management systems, processes and tools.

Most energy companies do not have established career paths for CSR professionals. There are few formal internal or external educational programs focused on applying CSR in the energy industry that can teach the needed skills. Most training occurs on the job. Much of the knowledge about the practice of CSR lies with the practitioners. Development of formal CSR training material for the different levels (entry, mid-career and executives) would facilitate the adoption and implementation of CSR in the energy industry.

With more companies looking to implement CSR practices, the lack of talented CSR professionals is becoming a challenge. This will hinder the pace of progress of CSR. Currently there are very few formal educational programs in CSR offered by universities or other academic institutions. Bringing industry knowledge, currently held by individual CSR practitioners, into formal courses offers a significant opportunity to advance CSR.

Developing the educational materials will involve overcoming several challenges. Broadly, these include identifying common themes, measurement metrics and best-in-class examples that cut across the different segments of the energy industry. Additionally, we must identify the unique issues associated with each segment of the industry and the appropriate metrics to measure performance

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and governance for these, the processes to follow for effective implementation and how to develop the business case for CSR. Creating training and educational materials is best accomplished by practitioners coming together, pooling their experiences and learning and translating that into processes that can be implemented.

INTEGRATING CSR INTO THE ENERGY BUSINESS

Despite the challenges, there is growing evidence that CSR is going mainstream and becoming part of board room governance and investor relations discussions in the energy industry. Businesses can no longer afford to approach social and environmental policies as a “nice to have” or employ their CSR group as a unit separated from the “real” business.

In addressing the challenges of integrating CSR into energy industry business operations, one can learn from how the industry created and integrated a safety culture. There are a number of similarities between integrating a safety culture and a CSR culture into an organization.

Some of the key areas industry must develop to grow a broader CSR culture are: (are these ideas derived from comparing to how safety culture was integrated?) if so need to make clear the link to above paragraph somehow.

- A common understanding of what is included in CSR that is relevant to the different parts of the energy industry – upstream, midstream and downstream
- A methodology with clear examples to help companies identify appropriate business models that create value for all stakeholders and where estimation of benefits is consistent across company operations and across industry
- Standard processes and rubrics for CSR implementation that are embedded in basic businesses processes
- Standardized CSR performance metrics

appropriate and specific for the different segments of the energy industry to help build trust with stakeholders

- Incorporate CSR management as part of the company’s management systems, processes and tools.
- Training and educational materials, best accomplished by practitioners working together to agree upon best practices and translate into processes.

Currently, CSR efforts within the energy industry are under-resourced and over-utilized. Coming together as an industry allows practitioners to share practices, develop common approaches to industry issues and speak with one voice. An industry organization dedicated to advancing the practice of CSR in the energy industry will accelerate the process.

Those companies that proactively make corporate social responsibility core to their business strategies will drive innovation and engender enthusiasm and loyalty from employees, customers, suppliers, communities and investors. Most importantly, they will ensure the sustainability of the business.



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FOOTNOTES

1 – Tensie Whelan and Carly Fink, Sustainability: The Comprehensive Business Case for Sustainability, HBR, October 21, 2016.

2 – Michael E. Porter and Mark R. Kramer, 2. Strategy and Society: The Link between Competitive Advantage and Corporate Social Responsibility, HBR, December 2006.

3 – Pearl Zhu, *Digital Maturity: Take a Journey of a Thousand Miles from Functioning to Delight* (2018). <http://www.lulu.com/shop/pearl-zhu/digital-maturity-take-a-journey-of-a-thousand-miles-from-functioning-to-delight/ebook/product-23563765.html>.

4 – SASB Standards, <https://www.sasb.org/standards-overview/download-current-standards/>.

5 – Global Reporting Initiative Standards, <https://www.globalreporting.org/standards/>.

6 – IFC Performance Standards on Environmental and Social Sustainability; January 1, 2012, International Finance Corporation, World Bank Group.



About UH Energy + CECSR

UH ENERGY

UH Energy is an umbrella for efforts across the University of Houston to position the university as a strategic partner to the energy industry by producing trained workforce, strategic and technical leadership, research and development for needed innovations and new technologies.

That's why UH is THE Energy University.

CECSR

The purpose of the CECSR organization is to enable a common platform for industry and academic subject matter experts to enable sharing of practices, development of common approaches, address many of the critical commercial and pedagogical issues as well as critical research and deployment challenges that advance CSR knowledge and its translation to the energy business, all with the intent to advance the practice of CSR in the energy industry.

