

Hot Topics in Corporate Responsibility

Enough responsibility to go around: Lessons in Corporate Responsibilities from corporate crises

By David Grayson and Abiola Barnor

There's enough responsibility to go around, and all parties should be willing to accept it. That includes, by the way, the federal government. President Obama Criticizes 'Spectacle' of Blame at Oil Spill Hearings (May 15 2010 – Businessweek)

"I don't sit around just talking to experts because this is a college seminar; we talk to these folks because they potentially have the best answers, so I know whose ass to kick." President Obama speaking on NBC News "Today" (June 7th 2010)

Introduction

Corporate crises are not new. What is relatively new is the increased public awareness and interest in such crises as a result of globalisation, the availability of 24-hour news and the use of the internet and social media to disseminate news. This means that reactions to and scrutiny of events, such as the 2010 global financial crisis or Toyota's car safety crisis, differs very much from the public reaction to crises in the eighties, such as the Tylenol crisis that befell Johnson & Johnson or the Exxon Valdez disaster, when world reaction was less obvious.

The recent BP Deepwater Horizon Oil Spill in the Gulf of Mexico has indeed borne the brunt of this increased level of scrutiny – but its far reaching consequences provide a good case-in-point to discuss how corporate crises can be prevented and if not, how their impacts might be reduced and their outcomes better managed in the future.

As time passes, a more balanced analysis of such a crisis becomes possible. Whilst definitive judgements about how much responsibility different players should bear has to wait for technical experts and the courts, the list of those who may have to share responsibility – directly or indirectly – becomes clearer. This paper is based on an on-going project amongst a cross-disciplinary group of faculty at Cranfield School of Management to draw out lessons and ideas from the Deepwater Horizon disaster, for leadership, strategy, organisational change, institutional learning, finance, mergers & acquisitions, and corporate governance and responsibility. This includes the development of a multi-part business school teaching case.

The Hot Topic paper is written in collaboration with PA Consulting Group; a leading management and IT consulting and technology firm who are working with organisations around the world to drive sustainability through innovation, regulatory compliance and the measurement and mitigation of the impact of climate change.

This paper has not been written by lawyers or technical experts in deepwater drilling, and was written with no access to confidential information. The intention is neither to pillory nor to exonerate. We use the case with the purpose of exploring some of the issues raised for Corporate Responsibility; and to provoke further debate about the complexities and challenges of doing business in today's connected, global society.

The Authors:

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Welcome to the second in our series of Hot Topics in Corporate Responsibility, a series designed to provide you with quick insight into topical issues followed by a debate to encourage further thinking on important issues. We thank our writing partner, Abiola from PA Consulting.

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The Doughty Centre is a research centre within Cranfield School of Management, with a vision of putting sustainability and responsible at the heart of successful business.
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Case Study: Deepwater Horizon

On April 20th 2010 an explosion on an oil rig operated on behalf of BP, in the Gulf of Mexico, 40 miles from the coastline of the American state of Louisiana, killed 11 workers and oil subsequently started pouring from the well-head, 5,000 feet beneath the surface of the sea. It was to become the worst oil spill in US history and according to Bob Dudley, the new BP CEO, it brought the company “to the brink of extinction”. In the weeks after April 20th President Obama wanted to know “whose ass to kick” but during this time, it was BP’s “corporate asses” that were being kicked – particularly by the US media and politicians. BP’s then CEO, Tony Hayward, was routinely described as the most hated man in America and BP’s share price was almost halved. But what actually happened?

The well is leased to BP, the federally licensed ‘Responsible Owner’ (BP is the largest oil and gas producer in the US section of the Gulf) with a 65% stake in the well. The rig was owned and operated by Transocean (the world’s largest off-shore oil driller). Halliburton was a subcontractor (the world’s second largest oilfield services company) and had cemented the well on the day of the explosion. Another company, Cameron, manufactured the crucial blow-out preventer (BOP).

The rig was drilling an exploratory well, which is typically a high risk economic proposition as many explorations result in little or no oil. In March 2010 it was reported that BP was aware that a large reserve of oil had been observed, which was marked as reserves for future use. However, despite this good news, the rig was costing BP up to \$1 million a day to operate, and was 43 days behind schedule.

BP’s investigation, the Bly report, states that the investigation team did not identify any single action or inaction as cause of the accident; rather it involved decisions made by “multiple companies and work teams”. The Bly report put much of the blame on Transocean and Halliburton. It concluded that the main failures were a combination of engineering design (including weaknesses in the well and cement design and failure of the BOP) and human judgement (by Transocean rig crew and BP well site leaders).

At the time of writing, both subcontractors have dismissed BP’s report as self-serving with “substantial omissions and inaccuracies” and see it as an attempt to divert attention away from BP’s alleged flawed well design. Transocean and Halliburton are yet to publish their own reports.

However, according to a report by the US National Commission investigating the Macondo spill, Halliburton and BP had data weeks ahead of the Gulf of Mexico oil spill that showed the cement mixture the companies used to seal the well was unstable. They did not act on the information.

Other external experts point to a number of separate actions and incidences that could each have caused the explosion, but jointly almost guaranteed it. One such expert is Professor R Bea of University of California, Berkeley (Center for Catastrophic Risk Management), who is leading an independent investigation into the catastrophe and highlights:

- BP chose a cheaper well design with fewer barriers between reservoir and rig
- BP disregarded the advice from Halliburton to have 21 centralisers to keep the well pipe held in place when cementing, so that it would be less likely for cracks in the cement to appear where gas could leak through. BP opted for 6 centralisers.

Indeed, BP does not have a good safety record in the US: repeated regulatory violations and previous spills and fires on the Deepwater Horizon rig, near misses on its Thunder Horse rig in 2005 and actual disasters with the Texas City oil disaster in 2005, and Prudhoe Bay, Alaska in 2006. On his appointment as chief executive in 2007, Tony Hayward promised to focus “like a laser” on safety but as recently as May 2010, up to 62 safety violations were found at BP’s Ohio refinery.

According to the *Sunday Times*, an internal BP review in 2009 suggested the rig had “severe shortcomings and a lengthy maintenance backlog”. The BOP (which failed to operate, thus allowing the gas to rise up to the rig) was found to have not been fully inspected since 2000 and had many components in poor condition, a dead battery, leaking hydraulic fuel, and an inoperative control pod. Evidence is now emerging in testimonials that suggest that several of the rig’s computers were continuously faulty and the vessels alarm system was permanently set to bypass – several workers apparently reported safety issues to Transocean on numerous occasions.

This current set of evidence shows a lack of clear ownership by any of the organisations involved in the accident for ensuring safety standards were upheld. It also shows an inability by the organisations to agree on the direct causes of the accident. This equates to safety failings on the part of BP as the “responsible operator” under US federal law, as well as failings within its relationships with its sub-contractors and suppliers. It also highlights the much broader issues facing organisations nowadays of how values and ethics are shared within corporate contractual arrangements, joint ventures, strategic alliances and extended global supply chains.

Slicing up the rest of the responsibility pie

Deep-water drilling is inherently risky because the well and well-heads are located so far underwater it is extremely difficult to implement any ‘fixes’. But land-based oil exploration in the US has been prohibited on environmental grounds, and so oil companies have resorted to deep sea drilling in their quest for more oil. Deep sea drilling (depths greater than a thousand feet) and ultra-deep water drilling (depths of five thousand feet or more) have only become economically profitable and technically feasible on a large scale in the last decade – in part driven by significantly higher oil prices – as seen by the rising number of rigs in the Gulf, 3 deep-water rigs in 1992 vs. 36 in 2008. About 70% of the world’s oil discoveries in the past two years have been offshore.

Given this level of known risk, congressional hearings in June 2010 showed that other oil companies’ plans for responding to oil spills in the Gulf were similar to BP’s disaster management plans, which failed to prepare adequately for this event. The oil industry as a whole has been moving en masse towards higher risk drilling in the quest to find oil – often engaging in operations with unproven technologies, insufficient data and inadequate disaster-management plans. It is clear that the baseline of acceptable risk in the industry has increased, and the new industry risk norm means much higher devastation if a disaster occurs. By allowing higher risk to become the norm, does the oil industry as a whole bear some responsibility for the consequences of this increased baseline?

In commenting on US congressional hearings about the disaster, President Obama talked about there being enough responsibility to go around, with an emphasis on the US federal government receiving a slice of the responsibility pie. The low liability limit of just \$75 million for clean-ups of oil spills set by US law makers are seen by many as indicating strong support by the US for deepwater oil exploration to enhance economic activity and energy security. In addition, the general relaxation of oil industry regulation by the former Bush administration might well have contributed to the “culture of ethical failure” that has been cited in regulatory inspection reports. Is the US government too closely linked to the oil industry and as such gives them too free a rein on operations?

The Minerals Management Service (MMS), the then US oil and gas industry regulators, have come under fire for their failures and conflict of interests – they both regulate and also sold leases to drill. The relationship between MMS and oil company executives has been reported to be too close and in some cases the MMS have been said to be “in bed with the oil industry”. The replacement of the head of MMS in June 2010 and the plans to replace the agency with two separate entities (one for regulation and one for generating revenues from selling leases) might be interpreted as implicit criticism of their indirect contribution to the disaster. Indeed, one MMS supervisor explained that the MMS employees were behaving as if they were “part of the oil industry” and not regulators of it.

Finally, where do consumers fit into this picture? Given the high volume of oil spills that happen each year, a legitimate question to ask is: is it possible that the continuous demand for ‘cheap’ oil and energy security is forcing the oil industry to drill in environmentally sensitive and hard to access areas, where technologies are as yet unproven and inadequate? Cost is still a main consideration for the majority of consumers and the fact is that lower oil prices are always welcome.

Mark Coeckelbergh of *The Guardian* writes about the importance of not only considering responsibility for oil production but for oil consumption as well. He states that:

“Business and finance are not isolated from our own choices. Companies such as BP can only do what they do because we want what they sell. As consumers, we continue to depend on oil in various ways and therefore maintain the oil-hungry system that makes oil companies drill in deep water and undertake other risky activities”.



What should happen now?

It is clear that while there were direct contributory factors that caused the Deepwater Horizon catastrophe, the indirect actions of a number of stakeholders also had a part to play. A mixture of poor regulation, bad industry practices, and unsustainable demand from consumers resulted in a lot of people 'looking the other way' before this and other crises such as the global financial crisis. There is perhaps also a dangerous and erroneous assumption that someone somewhere in the wider system is evaluating risks and deeming them acceptable.

All too often we are dealing with the aftermaths of crises, but their increasingly devastating impacts and sheer complexity mean a mixture of responses is required. In this case the underlying issue can perhaps be summarised as an imbalance between supply and demand - the challenges of resource depletion and increasing demand forcing companies to employ ever more frontier technologies and approaches (often unproven) to production and operation. When things do go wrong though, the speed and scale of environmental, social and economic impacts are substantial.

In addition, the discipline of CR challenges the classic Milton Friedman view of business by promoting the idea that a responsible business should be committed to delivering sustainable value to society at large as well as to shareholders. This view has been reflected in rising societal expectations of business behaviour, as reported in the GlobeScan survey of international public opinion. The results of the survey showed, since the millennium, a growing performance gap between expectations versus perceptions of businesses behaviour resulting in implications for organisation's licence to operate. At the same time, businesses are faced with continued pressure to survive in today's increasingly challenging economic times by delivering profit and maximising return on investments in the short term. The likelihood of corporate crises happening can perhaps be seen to increase as a result of these sometimes contradicting objectives.

Are there potential crises currently in the making for other issues – and what will their effect be on companies and industries, e.g. product safety for food, drugs and car manufacturers, consumer debts for retail banks and waste management for consumer goods manufacturers?

So, what CR lessons can be learnt? The following are suggested as lessons to be learnt and changes that need to be considered by corporations and wider society to prevent and/or minimise the impact of future crises:

- Higher and more extensive operating standards above what the law requires (e.g. higher environmental and social standards) are now becoming a reality for most corporations and they need to respond by doing more than just pay lip service to their CR commitments, with their actions better matching their words and their investment in sustainability being really integrated within all business critical activities.
- There needs to be a shift in thinking on profit generation from short-term profit maximisation to sustained profit optimisation, where taking a longer term view of investments and stock market value, will allow the inclusion of the true costs of externalities such as the environment and social impacts.
- A new approach to risk strategy and management must be considered to deal with emerging risks with different characteristics (origin, scale, likelihood and impact) that are now a real threat as a result of bigger organisations, changing consumer expectations and an increasing link between the environment and business.
- Corporate expansions through mergers and acquisitions, corporate partnerships and alliances need to prioritise cultural cohesion and the transfer of standards, values and ethics alongside structural change, rationalisation and cost efficiency strategies.
- Governments need to prove their commitment to moving to a more sustainable world by updating policies not to just include the potential negative impact of businesses on the environment and on societies in which they operate but to also make them more accountable for their actions by levelling the playing field and ensuring organisations bear the true costs of externalities.
- A different relationship is needed between government and the business world to prevent the ease with which the line between regulatory bodies and organisations is too easily blurred.
- Consumers need to increasingly consider the role they play in the demand side of all production as well as the influence they have on governments and organisations through the choices they make in their everyday lives in changing the status quo.

The reality is that while organisations may have plenty to do internally in the area of delivering sustainable value to society at large as well as to shareholders, they alone cannot bear full responsibility for preventing future corporate crises. Wider system stakeholders have a part to play as well.