Oil and gas corporates risk future value destruction by rewarding executives for chasing growth

Report to fuel investor campaigns for policies that prioritise returns

LONDON/NEW YORK, February 14 – Most oil and gas companies are jeopardising shareholder returns by rewarding bosses for endlessly chasing growth in a world where investor pressure to conform to climate targets and sharp falls in renewables costs are set to eat into future demand, finds a report from Carbon Tracker published today.

Previous research by the financial think tank has found that rapid growth of clean technologies coupled with tightening climate policies would see global demand growth for oil weaken through the 2020s before eventually declining, with growth in demand for gas curtailed. The new report warns that companies that try to maximise production risk overinvesting and wasting money on projects that deliver poor returns and destroy value.

Paying with fire: How oil and gas executives are rewarded for chasing growth and why shareholders could get burned analyses remuneration schemes at 40 of the largest listed oil and gas companies in North America, Europe and Australia, and will fuel investor campaigns for policies that deliver better value.

Released ahead of these companies’ AGMs, it demonstrates that policies which incentivise production growth and reserves can deliver less value to investors than schemes which reward top executives for delivering financial returns.

Andrew Grant, Senior Analyst at Carbon Tracker and author of the report, said: “The vast majority of oil and gas companies incentivise their executives to chase growth -- behaviour that risks destroying value given uncertainty over future demand. This report provides shareholders with the ammunition they need to challenge this approach and press for remuneration policies which reward executives for delivering solid financial returns.”

Carbon Tracker’s analysis of remuneration schemes found that:

- 92% of 2017 incentive schemes rewarded executives for either increasing production, growing reserves/resources volumes, or both, although companies are increasingly moving away from this model;
- Only one company, US-based Diamondback Energy, does not reward growth, incentivising executives purely on controlling costs and improving financial returns;
- Four companies have no direct incentives for growth, but include other measures which indirectly reward growth: Equinor (although only in a minor element), BP, Galp Energia and Origin Energy;
- The companies that disclose the greatest focus on rewarding volume growth are Anadarko, Cabot Oil & Gas, CNRL and Oil Search; at the other end of the scale production and/or reserves metrics determine just 8% of annual bonuses at Total and 10% at Repsol;

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1 Carbon Tracker and the Grantham Institute: Expect the Unexpected, February 2017.
2 Based on company annual reports, proxy statements and other public documents. Companies chosen are from regions with greater transparency and represent 70% of the S&P Global Oil Index by market capitalisation. (p14)
3 CNRL has 33% of its LTIP relating to reserves replacement (as well as also including production in its bonus). Anadarko, Cabot and Oil Search have at least 40% of their bonuses relating to production and reserves/resources.
Nine companies include metrics related to mitigating climate change -- Shell, Equinor, Repsol, Eni, CNRL, ExxonMobil, Suncor, Total and BP -- but this affects only a small proportion of remuneration, and most still simultaneously reward fossil fuel growth.

Carbon Tracker warns that demand for oil and gas is likely to slow and then decline as a result of action to meet the Paris climate targets and the rapid growth of renewables and electric vehicles. No more than a third of proven reserves of fossil fuels can be burned if the world is to stay below 2°C of warming, and considerably less under the Paris Agreement commitment to stay as close as possible to 1.5°C above pre-industrial levels.

Even a slowdown in the rate of growth can have a major impact. The oil price crash of 2014-16 was caused by a 2% excess of supply over demand. The value of the biggest oil and gas companies (measured by the S&P Global Oil Index) fell by 51% from June 2014 to Jan 2016 even though crude oil demand grew by 3% over the same period.

**Andrew Grant** said: "We believe that oil and gas companies should focus on extracting maximum value whether demand is growing or not -- but particularly so in a low-carbon transition.

"Focusing on generating the highest returns may mean getting smaller in terms of absolute production, as capital is returned to shareholders or redeployed in other sectors where sufficiently low cost oil and gas project options aren't available. Executives should not have pay packets that reward them for chasing ever greater volumes of reserves and output."

Carbon Tracker analysed the link between remuneration policies and total shareholder return in the aftermath of the 2014 crash and found companies that rewarded growth were outperformed by those that rewarded financial returns. From a basket of 18 US exploration and production companies, in the two years from mid-2014 total shareholder return at the three companies with the lowest incentives for growth (determining 0%-20% of annual bonus) was 7% p.a. higher than at the six companies with strongest incentives for growth (determining 50%-100% of annual bonus).

The report identifies different categories of metrics in remuneration policies:

- **Direct incentives for growth** – encouraging executives to develop and produce as much oil and gas as possible, typically relating to production levels, reserves replacement or revenues;
- **Indirect incentives for growth** – for example, a focus on earnings and cash flow may encourage acquisitions that will not necessarily increase value; share options penalise executives for returning cash to shareholders through dividends because this lowers the share price;
- **Growth neutral incentives** – which reward a focus on returns or value with metrics such as return on capital employed, production costs or total shareholder return (which includes cumulative dividends).

The report notes that, in contrast to the previous era of high investment and declining returns, since the 2014 crash there has been pressure from investors to prioritise returns over volume growth, or “manage for margin”.

For example, in 2015 BP accepted a shareholder resolution which has led to a rebalancing of incentives away from growth measures towards more returns-focused metrics. BP is one of ten companies which introduced or increased incentives for executives to deliver financial returns in 2018.

**Once embargo lifts the report can be downloaded here:** [https://www.carbontracker.org/reports/paying-with-fire/](https://www.carbontracker.org/reports/paying-with-fire/)

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4 IEA: [World Energy Outlook, 2012](https://www.iea.org), p3
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About Carbon Tracker
The Carbon Tracker Initiative is a not-for-profit financial think tank that seeks to promote a climate-secure global energy market by aligning capital markets with climate reality. Our research to date on the carbon bubble unburnable carbon and stranded assets has begun a new debate on how to align the financial system with the energy transition to a low carbon future. www.carbontracker.org