SIAPARTNERS

ESG: When Your Core Business is Carbon, How do you Succeed?

June 2023

Summary

The Oil and Gas industry faces mounting global pressure to implement robust environmental, social, and governance (ESG) programs across their operations. Sia Partners conducted a benchmarking exercise involving a sample of large and medium-sized organizations operating across the energy industry value chain in North America to assess the status and evolution of their public ESG reporting metrics. In addition, interviews were conducted with sustainability leaders from a subset of the benchmarking study group to gain insights into organizational priorities and activities.

Findings indicate that 69% of the benchmarking study group currently operate at an ESG Reporting Maturity Level of "Phase 1 – Emergent" or "Phase 2 – Developing". While progress is underway, it is evident that many organizations would greatly benefit from further integration of Environmental Social Governance into their strategic and annual planning processes, as well as their operating models.

Looking beyond North America, we recognize the global nature of the industry's challenges and the increasing importance of ESG considerations across international markets. This study aims to provide insights applicable to all industry participants, shedding light on the need for effective ESG practices within the global Oil and Gas industry.

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The Dynamics of ESG in an **Evolving Oil and Gas Industry**

The Oil & Gas industry is challenged to define and implement effective ESG programs in their operations. Some of the key challenges to be addressed include:

- ***Evolving ESG Standards:*** *Several standards and frameworks are available, and though there is work in progress to consolidate these, adding to the uncertainty is the current lack of a global baseline of sustainability disclosure standards.*

- ***Expanding Regulatory Requirements and Access to Capital:*** *In many jurisdictions ESG regulations are applied (or proposed to be applied) to the financial industry to bring attention to the comparative impacts of investment opportunities. A company's continued access to public and/or private capital to fund growth and ongoing operations requires alignment with these financial and market expectations.*

- ***Increased Public Scrutiny and "Greenwashing":*** *ESG reporting aims to provide greater transparency and third-party access to information. If ESG objectives are not clear, or if progress towards those objectives is not properly substantiated, organizations run the risk of being accused of "Greenwashing": Creating ESG reports or other public communications that focus more on marketing themselves as environmentally friendly rather than factually demonstrating how they are minimizing environmental impacts.*

- ***Ad-hoc ESG Processes and Lack of Integration:*** *Though many Oil & Gas companies have responded to market pressures and have started ESG reporting, they have not fully developed and integrated the policies, systems, and operational processes to embed ESG data collection and reporting into their operational models and day to day activities. Without this integration into the operating model, an examination of year over year reporting can leave the impression of inconsistency and reactionary policy or standards implementation and result in sub-optimal progression towards the organization's stated ESG targets.*

ESG – The Drive to Sustainability

Within the context of the global drive to net-zero and sustainability, addressing ESG issues is a complex challenge in the Oil and Gas industry. Petroleum explorers, producers, shippers, refiners, marketers and retailers along with the service companies that support them across the energy industry value chain each face the significant task of evolving their business model to support this global imperative. Yet while energy transition progresses, the world continues to require access to secure, reliable and affordable traditional energy products to continue to:

- *Spur economic growth*
- *Fund social services*
- *Retain population mobility*
- *Heat and cool our homes*
- *Maintain manufacturing of the myriad of products for which petroleum inputs are utilized*

As the step-change intensifies, investor patterns will continue to shift, and the industry will continue to restructure. There will be winners and losers. Traditional tactics supporting short-term gain may result in longer-term operational and/or financial pain for organizations slow to develop risk-informed strategies and integrate ESG into their operating model to lead them through the paradigm shift. All the while, the socially responsible energy producer cannot afford to be side-tracked by ESG compliance exercises designed only to satisfy the rankings and ratings agencies request, as in some instances this could be to the detriment of business value creation through the allocation of corporate resources to non-value generating activities.

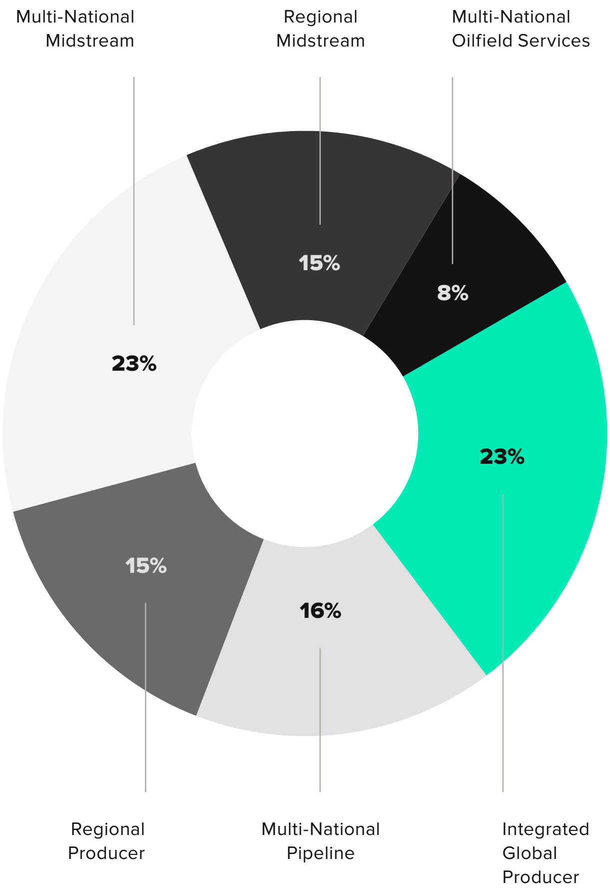
Comparison to Health & Safety

ESG reporting is in its relative infancy. To draw an analogy to Health and Safety (H&S) programs (now generally regarded as a sub-set of ESG in many organizations), large industrials began developing and integrating H&S programs into the corporate operating model over 50 years ago, and H&S continues to be a key strategy element and focus for continuous year-over-year improvement. Organizations will go through a comparable journey for ESG but will need to accelerate their ESG approaches by leveraging digitization and a host of other enablers available to companies today.

2023 Benchmarking Study

In Q1, 2023, Sia Partners conducted a benchmarking study of 13 North American headquartered Oil and Gas organizations' approaches to ESG. The study included an analysis of publicly available ESG and Climate reporting information (quantitative indicators), and qualitative interviews with a subset of sustainability leaders from within the study group.

KEY ATTRIBUTES OF THE STUDY GROUP INCLUDE:



Our high-level analysis of the study group suggests:

1. **ESG strategies are in place:** For most organizations, initial ESG strategies are defined, and organizations are now refining their strategies to better suit their market(s), investor expectations, and sustainability objectives.
2. **Wide interpretation of ESG requirements:** The absence of comparable standards and a solid regulatory framework coupled with investor and rating agency reporting pressures has driven a wide interpretation of ESG reporting requirements, approaches and results.
3. **Value of efforts unclear:** The corporate value of sustainability efforts is still emerging for many organizations, and still largely undefined. ESG efforts are not consistently seen as contributions to business strategy, long-term planning, and value creation - it is more often primarily considered a risk management activity.
4. **Low integration into operating model:** Integration of ESG into the corporate operating model is low, with few exceptions. ESG governance and executive/board awareness is high but translating sustainability aspirations into relatable day-to-day objectives, including incorporating ESG impact as a key consideration in decision-making, remains a challenge for many organizations.
5. **Legacy technical challenges:** Legacy processes, systems, and data accessibility challenges are significant barriers to increasing reporting capacity and ensuring reliable reporting context, data accuracy, and assurance.

Detailed Study Findings

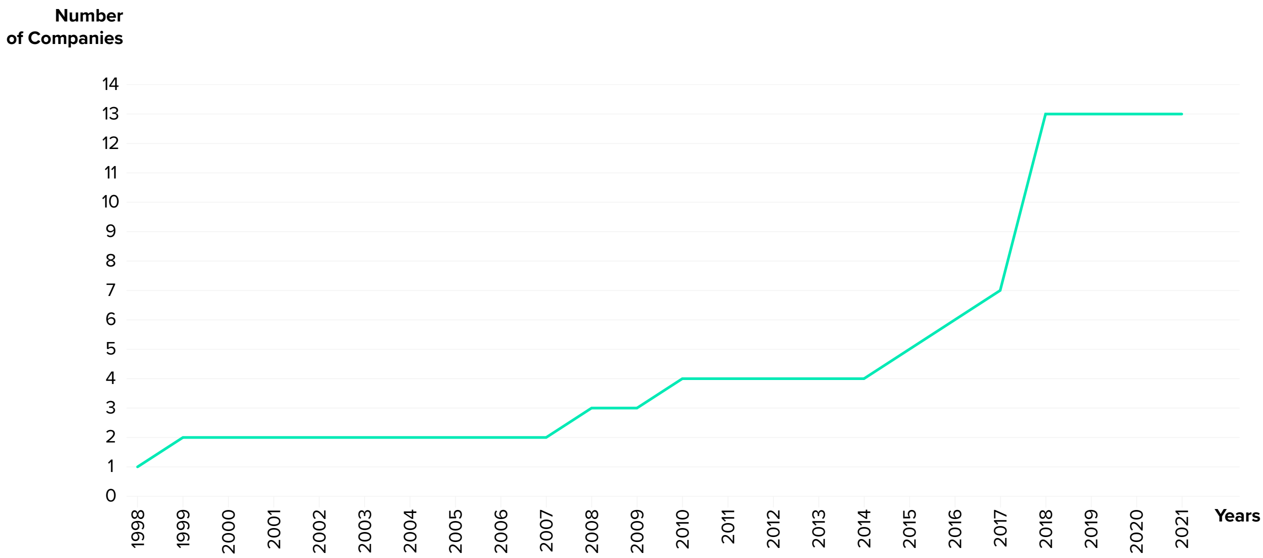
Sia Partners utilized our four-phase ESG Maturity Framework to help categorize the results of the Benchmarking Study and identify industry trends. Using the model, levels of ESG maturity can be categorized as 1. Emergent, 2. Developing, 3. Advanced, and 4. Leading, across 10 organizational dimensions or "ESG Key Themes" based on demonstrated organizational reporting and/or exhibited behaviours. We will share more details about the ESG Maturity Framework later in this study.

Using the ESG Maturity framework as our guide, **our quantitative and qualitative analysis indicates that 69% of the Benchmarking Study group are currently operating at the Phase 1 – Emergent and Phase 2 – Developing levels of maturity**. This is not to suggest individual organizations within the study group uniformly fit into a specific maturity level across all ESG themes, but that their average maturity level across all themes would place them there. Other findings include:

Annual ESG reporting has become the standard

Figure 1 shows that the number of companies adopting ESG reporting has been increasing steadily over time, with a significant increase between 2018 and 2019. The trend suggests that companies are recognizing the importance of ESG reporting and are taking steps to implement it. Undoubtedly, this is driven by several factors, such as regulatory pressures, investor demands for more transparency and accountability, and a growing understanding of the benefits of ESG reporting in improving long-term corporate sustainability and resilience.

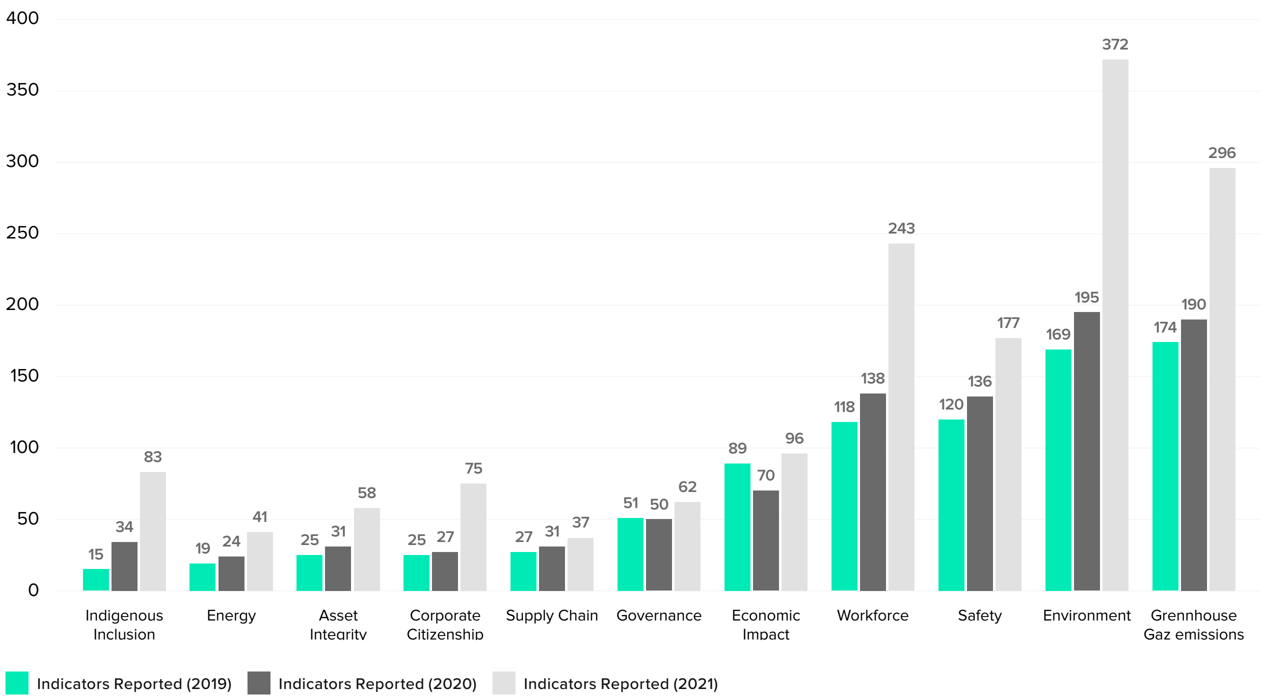
FIGURE 1: ADOPTION RATES FOR ESG REPORTING



Number of metrics reported on has significantly increased

Figure 2 shows the number of indicators reported per category per year over three years. By comparing the three bars, we can see how the total number of metrics reported on have increased year over year, with substantial increases in each category in 2021.

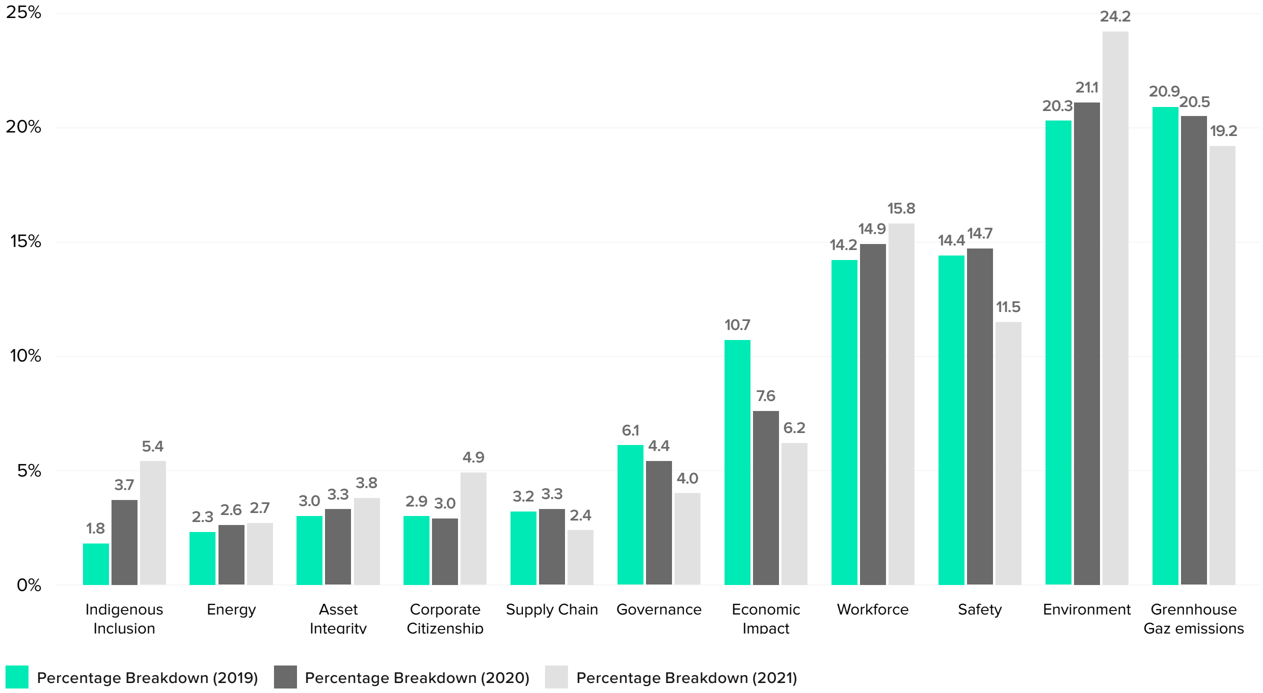
FIGURE 2: NUMBER OF INDICATORS REPORTED PER CATEGORY



The distribution of metrics reported (between categories) continues to shift and evolve

Figure 3 illustrates the ratio of indicators reported per category to the total indicators reported for that year. Although the graph shows downward trends for some categories, this is only as a percentage of the total metrics reported, as we established in *Figure 2*, the overall number of indicators has grown significantly. Our analysis shows companies are not reducing their reporting efforts in some areas, but rather, they are introducing new metrics into what could have been previously under-reported areas.

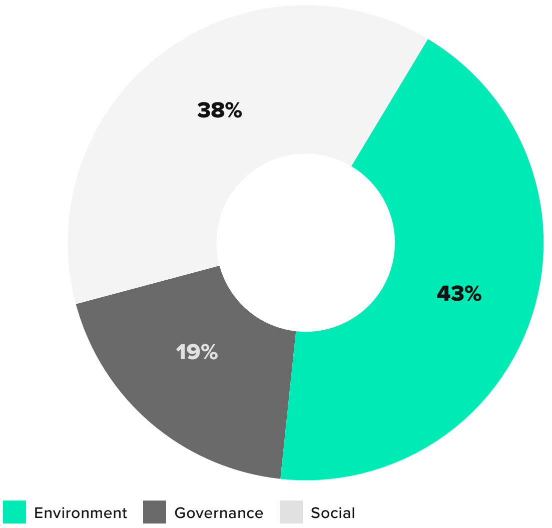
FIGURE 3: RATIOS PER CATEGORY (%)



Environmental metrics dominate historical ESG reporting

Figure 4 outlines that of the approximately 1,600 indicators analyzed in 2021, Environment accounted for 43% of them, with Social and Governance accounting for 19% and 38%, respectively.

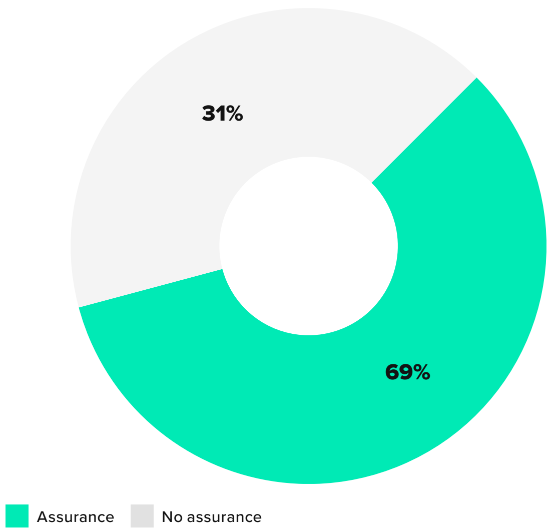
FIGURE 4: CATEGORIZATIONS FOR KEY INDICATORS IN ESG (FOR 2021)



Companies are still working towards Third-Party Assurance Readiness

Figure 5 shows that 69% of the study group engaged third-party assurance to validate at least one or more of their reported metrics. This suggests most organizations in the study group understand the importance and impact third-party assurance has on market credibility. What is not depicted in the chart below is that there is a remarkably high degree of variability both within and between study participants, and between reporting categories with respect to what metrics organizations are choosing to have assured. Factors creating the variability include a) Evolving global reporting standards, frameworks and regulations; b) The lack of robust internal ESG reporting processes, systems and integration, c) Constrained organizational capacity, and d) Poor/unverifiable data. As an organization's ESG capabilities mature, there is a direct correlation to increased third-party assurance activities that increase market confidence in corporate actions and results.

FIGURE 5:
PERCENTAGE OF OIL AND GAS COMPANIES SAMPLED WHO ENGAGED THIRD-PARTY ASSURANCE TO VERIFY ONE OR MORE OF THE METRICS REPORTED ON.



Additional observations from our analysis:

1. Majority of companies that obtained third-party assurance limited their emissions review to Scope 1 and 2. Twenty-one percent of the study participants conducted partial reviews of Scope 3 emissions.

2. Opportunity identification and pursuit is significantly increasing as organizations formulate and refine ESG strategies and share their approaches with the market. A few examples include:

   - *Carbon Capture, Utilization, and Storage (CCUS) to advance decarbonization efforts in the oil and gas (and other heavy industry) sectors is progressing as government incentives, technological advancements, and the implementation of carbon taxes in high income countries encourage action.*
   - *Alternatives to freshwater usage such as Solvent Enhanced Oil Recovery are being investigated as a strategy to reduce freshwater usage and lower Green House Gas (GHG) emissions.*
   - *Alternative reclamation approaches to the traditional excavation models are being considered to enhance sustainability, reduce costs, and improve the quality of reclamation activities.*
   - *Opportunities to electrify operating facilities to reduce the emissions generated at these sites, and obtaining power from renewable sources, will help to further reduce the net emissions generated by each company.*

3. Indigenous engagement and reconciliation are critical and valuable components of many organizations' social policy and approach and typically include some or all of the following actions:

   - *Indigenous awareness training for all employees and consultants to reduce biases and improve the cultural and historic understanding of Indigenous people and their tribes.*
   - *Increased hiring and recruitment of Indigenous people through job fairs and training programs to allow Indigenous people to find meaningful work within the Oil and Gas industry.*
   - *Greater involvement with Indigenous-owned businesses and economic partnerships.*
   - *Enhanced community involvement and support for social programs in Indigenous communities in need.*

4. Reporting on social metrics has been accelerating over the past 3 years due to a heightened focus on diversity, inclusion, and equality. We expect social indicators will continue to expand within ESG and Sustainability reports in the coming years.

Sia Partners ESG **Maturity Framework**

As ESG advances in the Oil and Gas industry, it requires better integration into strategic and annual planning processes and operating models. Regardless of the sustainability strategy (from emissions reduction to carbon offsets, electrification to alternative fuels, biofuels and renewables, or various combinations thereof), defining how the organization intends to succeed alongside measurable performance objectives to help monitor results and inform course corrections, is a critical step to envisioning a sustainable corporate future. **Leading through complexity often requires the ability to simplify, focus, execute and adapt. Sia Partners ESG Maturity Framework can help organizations assess the multiple dimensions that interact to form a comprehensive approach.**

	Phase of maturity			
ESG Key Themes	**Phase 1 - Emergent**	**Phase 2 - Developing**	**Phase 3 -Advanced**	**Phase 4 - Leading**
Leadership, Strategy, & Governance	Define ESG Strategy, Vision & Mission and Governance Structure	Align ESG with Business Strategy and Define Policies	Integrate ESG into Strategic Planning and Refine Policies	Embed ESG across the Business into Strategy & Decision-making
Standards, Frameworks & Best Practices	Identify & Select Relevant Standards, Frameworks and Best Practices	Increase Corp. Awareness of Adopted Frameworks and Guidelines	Refine Framework and Broaden Participation in Industry Collaboration	Benchmark ESG Performance & Innovate to Drive New Opportunities
Materiality & Risk Assessment	Identify Risks and Material ESG Issues and Prioritize	Quantify material ESG Impact & Integrate Risk Management Practices	Integrate ESG and Risk Management into Operational Decision-making	Proactively Manage Material Risks Across the entire Value Chain
Stakeholder Engagement	Identify Stakeholder Expectations (Market Needs)	Develop Engagement Strategy (Market and Business)	Collaborate with ESG Stakeholders to Address Issues & Track feedback	Innovate & Quickly Adapt ESG Engagement Strategies & Practices
Culture & People	Build Leadership Awareness	Increase Employee Awareness & Expectations through formal Training	Foster a Culture of ESG Responsibility & Accountability	Recognize & Reward ESG Performance
Monitoring & Management	Establish ESG reporting structure and identify KPI's	Align KPI Reporting, Structure and Enabling Business Processes	Increase Monitored Objectives as Organizational Capacity Expands	Advanced Analytics and Automation to Enable Monitoring & Control
Commitments & Disclosures	Limited Sustainability Commitments and Disclosures	General Commitments and Disclosures	Specified Commitments and Disclosures with Comprehensive Reporting	Comprehensive Commitments, Disclosures. and Reporting Commentary
Process, Systems & Data	Leverage Existing Systems and Manual Processes for Data Collection	Partial Systems and Process Integration with some Automation	Extensive Enterprise Systems and Process Integration and Automation	ESG data available in Real-time, or Next-to-Real Time across the Enterprise
Assurances & Verification	Informal Internal Verification. No 3rd Party Assurance	Formalized Verification (General). Limited 3rd Party Assurance	Formalized Verification (Specific), Increased 3rd Party Assurance	Regular and Formalized Verification. Broad 3rd Party Assurance
Funding & Opportunity Identification	Limited formal ESG/ Sustainability Budget and opportunity idenification	Established formal budgeting, Variable Tax Credit and Opportunity Assessments	Systematic Tax Credit and Opportunity Assessment Approach	Integrated Tax Credit end Opportunity Assessment Across the Enterprise

The ESG Maturity Framework offers a means to identify, prioritize, and articulate areas of corporate focus and provide the input for a roadmap and tactical action plan to increase corporate ESG capabilities and drive continuous improvements.

The dimensions, or key ESG themes, examined include Leadership, Strategy & Governance, Standards, Frameworks & Best Practices, Materiality & Risk Assessment, Stakeholder Engagement, Culture & People, Monitoring & Management, Commitments & Disclosures, Processes, Systems & Data, Assurances & Verification, and Funding & Opportunity Identification.

In any organization, these dimensions do not mature in a linear path, nor do they need to. Existing operational structures, processes, and systems create several leverage points for enablement. What is of critical importance is that the organization understands its intrinsic capabilities and can be proactive and intentional with its path to improvement for each dimension, and for the system as a whole. This systematic approach to maturing ESG capabilities positions the organization not only to identify opportunities and address challenges more quickly, but to execute ESG strategy in a more cost and resource efficient way that leads to improved verifiable reporting, and the ability to readily adapt as the industry, reporting standards, and regulatory frameworks evolve.

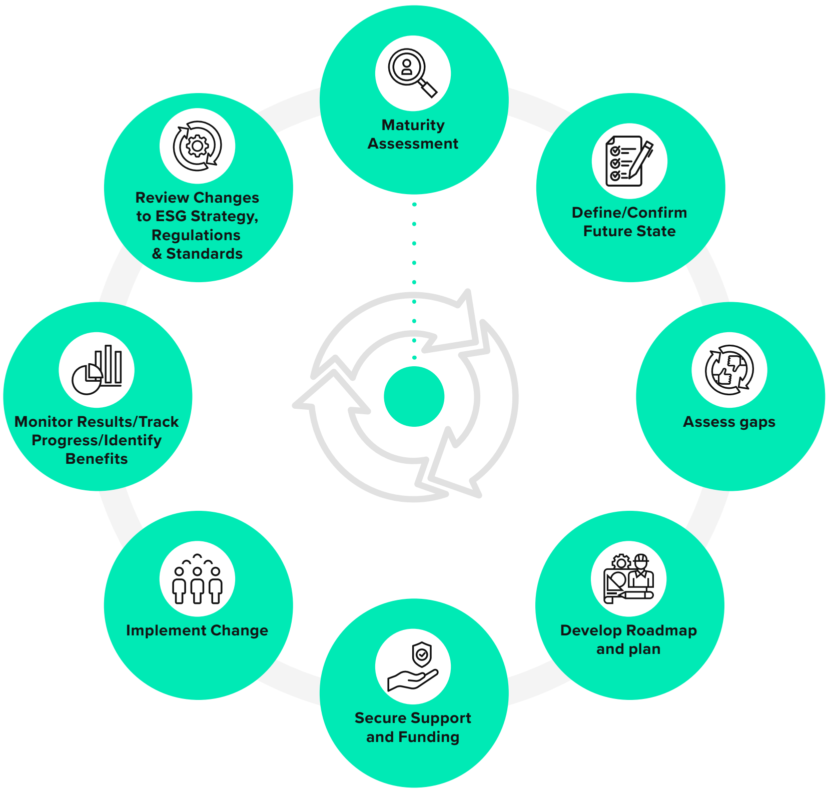
Using the ESG Maturity Framework

Much like the H&S journey, achieving ESG targets will require changes to a number of dimensions (the ESG key themes) to move the organization forward to meet its ESG goals.

The maturity assessment can be utilized in any phase of an organization's ESG journey to provide a current state snapshot that helps create the organizational dialogue necessary to facilitate opportunity identification and improvement. *Figure 6* on the right is the typical approach:

- *Maturity Assessment – Conduct a detailed analysis of each ESG key theme to assess the current state of the organization.*
- *Define/Confirm Future State – For each ESG key theme, identify what level of maturity the organization wishes to aim for, in the short, medium, and long-term.*
- *Assess Gaps – For each ESG key theme, identify the gaps between the current state and the next short-term maturity target, and the work required to achieve that target and close the gap. Consider effort versus benefits as gaps are assessed and identify priority activities.*
- *Develop Roadmap and Plan – Collate the work required to fill all the gaps and develop a roadmap and plan for the organization to define the next set of targets/gaps to be filled as well as the medium, and long-term targets.*
- *Secure Support and Funding – Using the roadmap and plan, secure the funding and internal stakeholder support to move the organization towards filling the prioritized gaps.*
- *Implement Change – Utilizing a program or project management approach supported by Organizational Change Management, execute the plan to fill the prioritized gaps. This should include activities to support each of the ESG key themes.*
- *Monitor Results/Track Progress/Identify Benefits – During and after execution of the plan, monitor the results to confirm the changes have been successfully integrated into the operating model, the ESG data collection processes are delivering consistent and accurate results, and the expected benefits (where possible in the given timing) are being delivered.*
- *Review Changes to ESG Strategy, Regulations & Standards – As organizations mature, they will refine their ESG strategies and there will be changes to external ESG reporting requirements. Organizations need to capture these changes on a regular basis and apply these in the cycle of continuous improvement.*
- *Repeat - Revisit the Maturity Assessment (holistic, or selected priority themes) at pre-defined intervals to monitor systematic progress and update objectives.*

FIGURE 6: TYPICAL APPROACH



Recommendations

Sia Partners is committed to supporting the global Oil and Gas industry in its transition to net-zero and achieving ESG objectives. Based on our benchmarking study and extensive industry experience, we offer the following recommendations for organizations worldwide:

A. Establish a Corporate Sustainability function capable of adapting quickly to evolving ESG standards:

- Sustainability should be recognized as a dedicated function within the organization, with clear executive roles and responsibilities.
- Allocate the necessary capacity and budget to design, raise awareness, and integrate ESG into the corporate operating model.
- Corporate Sustainability goals must receive full executive support to ensure success.
- Develop the ability to adapt quickly to changes in regulations and market expectations.

B. Foster a continuous improvement mindset for the ESG journey:

- Similar to H&S, embrace a cultural and behavioural shift that integrates sustainability into day-to-day business operations.
- Draw on past learnings, experiences, and analogies to share the organization's ESG story and set appropriate expectations internally and externally.

C. Understand the needs of all stakeholders, not just investors:

- Recognize that access to public and private capital hinges on ESG reporting to justify investments.
- Communicate with investors and other stakeholders to understand their specific criteria for measuring organizations and industries, and the implications those requirements have on the organization's ability to comply.
- Acknowledge the broader impact of ESG reporting on reputation, social license to operate, talent attraction and retention, and the industry's ability to participate and compete in developing sustainable, low carbon alternatives to support global net-zero aspirations.

D. Focus on producing «defendable» ESG reports:

- As the industry faces increased scrutiny on the path to net-zero, ESG reports must be driven by consistent operational data supported by robust policies, systems, and processes.
- Reports should be fully «defendable» and capable of withstanding external audits if required.

E. Integrate ESG processes into the operational model:

- Leverage and adapt the existing operating model and management system to support systematic changes aligning with ESG targets.
- Translate ESG targets into changes to standard operating procedures, ensuring alignment between corporate goals and field operations.

F. Rely on ESG data to track progress towards targets:

- Break down aspirational ESG targets into annual corporate and functional targets, identifying activities that support their achievement.
- Integrate ESG targets into the Operations Management System's annual planning processes and quarterly progress tracking.
- Leverage technology and data analytics to enhance data collection and monitoring solutions.

By following these recommendations, organizations in the global Oil and Gas industry can navigate the evolving ESG landscape, meet net-zero aspirations, and contribute to a sustainable future.

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