

CEO Perspectives: Gas Industry Shifts post COVID and the sharp rise of ESG

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Executive Summary

This research project was an investigation into the observations and perspectives of Australian gas industry leaders into the impact of COVID-19 and key industry shifts and trends. It is based on a survey conducted with 25 gas CEOs and senior executives from across the supply chain. Their experiences over the past year and how their priorities and practices are changing as we go forward were also discussed.

The survey investigated several key issues including the impact of COVID-19, issues currently being faced and shifts impacting the industry.

The study findings suggest that, overall, the negative impacts of COVID were short-lived and minimal across the gas industry. Many organisations however, used the time to pivot - changing up their organisational structure, bringing on new products to meet customer demands and fast-tracking technological advancements.

Key concerns currently being faced by leaders include government intervention, the growing green movement, and the increased difficulty in recruiting and retaining quality candidates.

The one industry shift which grew louder over the course of this research was ESG. When I started this research mid 2020 a couple of people mentioned it vaguely in conversation, a year later everyone wanted to speak about ESG at length.

Setting the scene

The past 18 months has been full of challenges and change like we have never experienced before. When I asked gas industry leaders assess the events across since the beginning of 2020, they identified 3 key industry trends. Firstly, while COVID-19 has changed the way we work, live and play now and into the future - it's more than that. Businesses pivoted and not just in terms of working from home. Societal priorities and expectations changed, particularly in terms of climate change, and this has put the gas industry under the spotlight more than ever to decarbonise.

Secondly, the pace of change accelerated significantly. COVID brought forward the innovations and technologies that were sitting in the pipeline. It brought forward government investment, organisational restructures and mergers, and it boosted climate change priorities. While the industry has committed to net zero by 2050 there's a lot of pressure to deliver in the next 10 years not 30.

And finally, the pressure on the industry to be better intensified. These pressures are complex, immense and coming from all angles; they include climate change, diversity, transparency,

technological advancements, market demands, government and community expectations. There has been increased dynamism in the renewables space. Our customers are demanding greener energy options and the industry is stepping up.

One leader referred to the current landscape as a perfect storm where governments and society globally are demanding emissions reductions, resulting in industry divestment and a shift to prioritise renewables over gas; all while gas continues to be an affordable reliable energy option, and demand continues to grow.

This study

This study was based on a survey conducted with 25 gas industry CEOs and senior executives across a 12-month period. It looked at how the industry has evolved and where it is headed.

I spoke to leaders about their experiences over the past year and how their priorities and practices are changing as we go forward. The survey asked questions about:

- The changes they observed
- Issues that keep them up at night
- Industry shifts leading into the future.

The primary industry shift identified was ESG, hence this study also delves into its potential impact on the industry and the pipeliners in particular.

Survey results

General findings

There were two key 'big picture' findings which were identified consistently across the surveys. The first was the positive industry sentiment now and into the future, and the second was how quickly the nature of the industry was changing.

The current sentiment amongst those surveyed was very positive – on the whole. While those surveyed understood very clearly that the world is changing and that gas is crucial to the energy mix now and as energy transitions to a low-no carbon future, there was some concern that the industry was not acting fast enough.

“Gas can carry the energy transition on its shoulders... we just have to be flexible”

“Key constraints such as infrastructure and cost are holding us back... but we’ll get there”

These concerns were primarily regarding the industry demonstrating its commitment towards net zero, particularly measuring emissions or bringing on net zero gas products. On the other hand, some said we were travelling well on the path to net zero.

“The landscape is changing, and the industry is diversifying as we shift towards a low carbon future... and we are being driven by investors to move faster on this”

This disparity between survey respondents is typical of the environmental complexities in which we currently find ourselves.

The other key general finding to emerge was the notion that - the future of gas industry is strong but changing very quickly. Just about everyone saw gas playing a key role in the energy mix over the next 30 to 50 years but, the world of energy is shifting, and the industry is transforming to meet new demands. Most predicted a strengthening role for gas as a bridging fuel as we move away from coal and towards renewables, and many saw renewables as an opportunity for the diversification of the gas industry, with gas-renewables projects already working hand in hand.

The impact of COVID-19

There were mixed results found to asking leaders about the industry changes observed due to COVID. Some reported positive effects to their business, others said it had been a challenge. One thing that was for certain was however was that; it was a shock to the system! Significant effort and expense were put in to keep business continuity; new ways of doing things emerged out of necessity.

One of these was the move to work from home. While it was challenging at first, some thought it worked well and viewed it as a positive shift for productivity and families and would be keeping it as an option in some parts of the business. Others had productivity concerns and preferred to have their workers in the office.

Several organizations used this time to pivot that is, restructuring their business, or merging with another; others brought forward innovations and technologies they had in the pipeline to improve their business; while some of the smaller organisations who were already operating flexibly and were already heavily focused on innovation said it was BAU for them.

The other key shift I heard was that COVID changed the world that we operate in, and the gas industry has been pushed to transform quickly in accord with the emerging green agenda which took a real foothold during this time. This resulted in customers' demands changing and new priorities being set for the industry.

Some leaders spoke about the increased power of the community and how it is driving our customers and investors to go green and now. These drivers saw some businesses add new product lines or alter existing ones in response to demand; others changed their name to better reflect the new direction of their business.

Issues keeping our leaders up at night

Besides the usual longstanding hot topics - Gas markets and Gas prices, there were varied answers to this question; everything from 'Where will I get my next project from?' to 'Will there be a gas industry in 15 – 20 years?' to 'Working with the different state regulations is an absolute nightmare'.

But the one thing they all have in common is they are caused by uncertainty. Our current world and the environment we operate in is extremely uncertain at the moment.

The other issues keeping our leaders up at night are:

Government market intervention especially to get lower gas prices – which those surveyed agree - is killing investment!

The growing green movement is building up negative sentiment and impacting on business and investment. Several leaders said it felt like the gas industry has a target on its back. Others spoke about the shift in local and state governments to phase out gas without proper scientific and/or economic evidence of this decision

Numerous people spoke about the increased difficulties in getting money ...investors shifting to green energy solutions and investment houses moving away from the fossil fuels and banks change their policies on financing fossil fuel projects. Some even spoke of concerns around gaining adequate directors' insurance in the future.

Finally, many leaders spoke about the negative gas sentiment making it difficult to recruit quality candidates – they spoke about the gas industry not being 'sexy' compared to some others – they spoke about good staff jumping to other industries such as waste and distribution. Interestingly, one person said they flipped this challenge into an opportunity when recruiting – that is, when recruiting for an environmental engineer recently they marketed the position as an opportunity to make a real difference.

Industry shifts leading to a new normal: ESG pressures to transform

In terms of industry shifts today with the biggest impact there was one clear standout topic that everyone was talking about, and that's the pressure to transform in response to the rise of ESG. The global push to reduce environmental and social harm and have the governance in place to be accountable and transparent has become a priority across the industry.

"There will be a time when accountabilities and transparencies will force us to be adapt... this in turn will make us a better and leaner industry."

"These are difficult times for the industry but if we can remain nimble and remain ahead of the discourse, we can weather this"

The issue right now is that ESG is a challenge for most! The energy landscape is uncertain for many and ESG is still quite ill defined, its principles and requirements need clarity.

Leaders agreed that ESG is difficult and industry transformation is a rocky road but, that these shifts also represented an opportunity for the industry to improve.

I heard that getting the balance of implementing Environment, Social and Governance (or ESG) goals and remaining profitable was difficult, but I also heard about businesses revisiting their value propositions and adapting in response to ESG and how the industry will be better for it.

"The growing impact of ESG is new and complex to many... but we have everything we need. We can be part of the solution – we have the technology, project management, engineering and finance capability to be part of the solution"

Many leaders commented that there was no leadership in terms of a path forward. That ESG was not too long ago a 'nice to have' but now it is a 'must have' and there needs to be some direction on what's expected.

Finally, there was some concern that whatever we do as an industry will not be good enough! Already, technological advancements in hydrogen, carbon capture and storage are being fast tracked

and investment in the gas sector has increased greatly as the gas sector works to cater to the significant emerging demand for low-no carbon gas, and yet the industry continues to experience a growing backlash.

That said, every leader I spoke to acknowledged and understood that the energy landscape is changing: customer demands are changing, investors are questioning their investments, money is getting harder to get BUT the industry is innovating and responding quickly as it heads into this future normal.

What is ESG and what can we expect?

Looking back at comments about ESG being ill-defined and unclear, I thought I would investigate what it is and what the industry can expect going forward. Figure 1. Below outlines the key components of each ESG category.

ESG started out as a way to measure the environmental, social, and governance performance of a company for the purposes of gauging risk but is now a major force driving business strategy and sustainability.

Figure 1. Key components of ESG



Investors and consumers are increasingly demanding companies incorporate ESG practices into their culture and operations. In the past ESG had been a box-ticking exercise for many industries because it didn't really have any practical implications for society or investment, however things have changed - investment houses now have dedicated impact investment asset managers to review what companies are doing in terms of ESG and whether they are worth investing in.

Research has emerged that has found companies with ESG plans outperform those who do not. Companies who implemented ESG practices reported better operational performance; stock price performance was positively influenced by good sustainability practices, and the cost of capital loweredⁱ.

Furthermore, the shift towards ESG really took off in 2020 with mum and dad investors genuinely wanting to invest and buy from companies that are operating to ESG principles. Data from Morningstar found 253 investment funds had switched to an ESG focus during 2020, 87 per cent of them rebranding in the processⁱⁱ. This is not an insignificant shift when we know that globally funds that are managed with an ESG focus is somewhere between \$3T and \$30T (depending on how

‘sustainability’ is defined and measured); and more than \$120B was invested into ESG funds in just one quarter in the US market last year.

Australia’s advantage is that we tend to lag behind the US and the EU in terms of shifts, so we have time to get this right. Last year we saw Shell, who was one of the first to go down the net zero path, ordered by a European court to move faster on their emissions reduction activity. Chevron lost their proposed emissions targets vote to their shareholders who wanted more. And the failure of Exxon Mobil to act on investor demands to tackle climate change saw three activists voted onto their Board. The US trend towards Emissions reduction is quickly being followed by the EU and this pressure will eventually move our way.

This survey highlighted the pressure that ESG will put on businesses to change the way they operate. Those surveyed agreed that investors are focused on the ESG and the industry needs to be too. Some leaders said they noticed the shift overseas, more than here, that more ESG topics were getting voted on by shareholders, and people were losing their jobs.

Others felt the positive story behind gas based economic development was missing. For example, the messaging about what gas is used for and the benefits it brings to communities is strong but doesn’t get out. Several commented that the industry’s expectations are that everyone will need to operate to ESG principles and in the very near future.

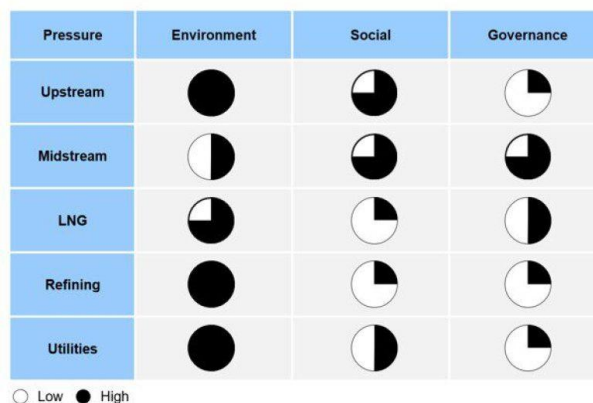
Impact on the Pipeliners

We all know that the gas industry in Australia is working very hard to respond to investor, government and community expectations and that more needs to be done. The industry has committed to net zero and it has an array of climate initiatives in place and technological advancements coming through that will lead to better industry environmental outcomes but we need to align these to the pipeline sector and better communicate these actions.

It has been said that while the gas industry is feeling the pressure of ESG. the upstream sector is facing the most scrutiny for its effect on the environment; but midstream is under scrutiny too and primarily for its social impact and governance structure (figure 2).

Johnson and Turaga’s recent article in the Journal of Petroleum Technology outlines the ESG pressure on each segment of the value chainⁱⁱⁱ. Of course, this does not eliminate environment from the picture – recent spills and methane leaks have become a concern and stakeholders are pushing for uniform reporting of incidences and emissions across pipeline operators.

Figure 2. ESG pressures by gas industry sector



In terms of the shifts in the social expectations. In the US recently, local and national pushback on new pipelines through socially sensitive areas such as those owned by indigenous groups in the northeast was a wakeup call for those who had not sought to understand the social ramifications of their projects.

Finally, with reference to governance - large midstream companies in the US are enhancing corporate governance by simplifying organisational structures, increasing diversity, and reducing conflicts of interest.

This study found that there is appetite amongst leaders to do more, specifically, to reduce emissions and implement better social and governance initiatives, but there's an 'unknown' around how to do this sustainably, and how quickly they have to move.

Some leaders felt they needed to spend more time investigating what ESG meant for their business but didn't really know where to start. The other key issue for some here is that ESG is currently a competitive advantage – but when everyone has it, it will be the norm so some are looking at what this means going forward.

Concluding Statement

This study found that overall, there is a significant amount of positive sentiment amongst gas industry leaders about the future of the industry.

In terms of the impact of COVID-19, it was challenging but the industry got through it reasonably unscathed.

All leaders observed that the environment in which they all currently operate is changing and quickly, and technological advancements will help the industry transform through the transition.

ESG expectations are pressuring the industry to do things differently and while it is relatively new to the Australian setting, the industry can learn from other countries and industries.

Finally, the gas industry reported that some ESG measures are not enough in today's environment; and if we follow in the footsteps of our US and European counterparts the pressure to ramp up efforts will be swift.

Special mention

I would like to thank those who participated. Thank you for your time and frank and fearless feedback, I hope I have reflected your voice accurately and considerately.

ⁱ Brown, S (2020 May 26) Why ESG is here to stay - podcast
<https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/why-esg-is-here-to-stay>

ⁱⁱ Young, D. (2021, June 28) "How environmental, social, and governance reporting grew up: It's a coming-of-age story that will change the way businesses operate"
<https://www.strategy-business.com/article/How-environmental-social-and-governance-reporting-grew-up>

ⁱⁱⁱ Johnson, B and Turaga, U. (2020, July 27) Top ESG Trends in Energy
<https://jpt.spe.org/top-esg-trends-energy>