

YOUR BOARDROOM HAS AN 800LB

GORILLA

ARTHUR STEEL/LAMY

... and it's called an environmental, health and safety issue. How savvy is your business? Does it recognise that proactive management can truly boost shareholder value

GEORGE PILKO/PILKO & ASSOCIATES

THE STORY is that when Moses came down from the mountain, his followers found him holding one stone tablet with a list of 10 items. He was up to his elbows amid a rubble of tablets covered in fine print. "These are the rules," he said, indicating the single tablet in his arms, "and those are the regulations."

Today, 46 years after the start of the environmental movement, we find ourselves awash in regulations that are designed to achieve obvious environmental, health and safety (EHS) "rules", yet we're far from being immune to EHS disasters.

INCREASING ATTENTION

Recent high-profile "oops" cases – BP's Texas City explosion and the pipeline spills in Alaska, for example – have focused attention on EHS corporate governance in much the same way that Enron and related corporate meltdowns drew attention to financial governance.

While the Texas City disaster was officially a refinery incident, it has reverberated throughout the industry, and anybody with a process-industry operation is concerned about the potential for a similar occurrence.

EHS concerns are now the 800lb gorilla in the corporate boardroom. Outside directors are rightly concerned about potential

exposure in the companies they serve, and some of them are taking steps to become more informed.

It seems odd that while directors who sit on board audit committees must have the requisite background, those who sit on EHS committees are under no such constraints. It would be prudent for companies and directors concerned about EHS oversight to rethink this situation.

This is particularly important as public expectations continue to ratchet up. No amount of advertising or slick public relations can compensate for a company's obviously poor EHS performance.

One of the greatest drivers for improving EHS performance is stricter requirements from customers. Manufacturers are starting to dictate not only tougher standards for product safety in the materials they buy, but also more sophisticated EHS governance processes in the companies they buy those materials from.

In the US, class-action lawsuits have been a major driver for improvements in EHS governance, as asbestos, polychlorinated biphenyls (PCBs) and silicone breast implants have made clear.

PREPARING FOR THE NEXT WAR

Generals are notorious for preparing for the next war as if they were fighting the

last one. Likewise, each "oops" incident tends to focus a company on preventing it happening again.

Vince Marchesani, who recently joined Pilko & Associates after retiring as vice president of corporate health, safety and environmental affairs at Basell North America, tells the story of product X, which another chemical company was forced to recall at great cost. At a shareholders' meeting, the chairman explained at length what the company had done to recover from the X fiasco, at which point one of the shareholders stood up and asked, "Is there a son of X?"

It was a question that no-one else had asked, and it engendered an exhaustive audit of worldwide operations. Today, sophisticated senior managers and directors do not need to be prompted by a disaster or a shareholder's question.

It is all about being proactive. In 1989, the environmental policy of one of the largest US oil companies was simply to "stay in compliance with all rules and regulations." Today, this company has an entirely different and far more proactive stance, making it one of the more forward-thinking companies in the energy industry. Some companies are forging ahead, and many more are taking tentative steps in the right direction.

THREE STAGES OF SOPHISTICATION

What we are seeing is an evolutionary process through three stages of sophistication in EHS governance (see table). Stage 1 focuses on compliance, the primary driving force in the 1970s and 1980s. Probably 40–50% of chemicals companies are still stuck at this level. Stage 2 moves beyond compliance to

EVOLVING AN EHS STRATEGY TO CREATE VALUE AND COMPETITIVE ADVANTAGE

| | Stage 1 Compliance | Stage 2 Risk management | Stage 3 Competitive advantage |
|------------------------|--|---|--|
| Thrust | <ul style="list-style-type: none"> ■ Obey the law ■ Stay out of trouble ■ Focus on operational costs | <ul style="list-style-type: none"> ■ Anticipate requirements ■ Get in front of the curve ■ Focus on the costs of risks and liabilities | <ul style="list-style-type: none"> ■ Innovation ■ Aggressive energy management ■ EHS strategic plan |
| Key elements | <ul style="list-style-type: none"> ■ Legalistic ■ Tactical, not strategic ■ Short-time horizon | <ul style="list-style-type: none"> ■ Consistent standards ■ Formal risk management processes ■ Bold stretch goals | <ul style="list-style-type: none"> ■ EHS governance integrated with business plan ■ EHS governance used to differentiate products, reputation ■ Long time horizon ■ Positive contribution to bottom line |
| Unwritten rules | <ul style="list-style-type: none"> ■ Achieve compliance at lowest cost ■ Ensure compliance through audit/oversight | <ul style="list-style-type: none"> ■ EHS is very important to the CEO, so senior executives take ownership | <ul style="list-style-type: none"> ■ Be responsive ■ Make best use of technology ■ Employ creative vision ■ Measure gains achieved |
| Outreach | <ul style="list-style-type: none"> ■ Limited reporting ■ Industry associations ■ Low profile | <ul style="list-style-type: none"> ■ Balanced community engagement programme ■ Public reporting | <ul style="list-style-type: none"> ■ Broad engagement programme ■ Two-way dialogue ■ Sponsorship (climate change initiatives, etc) |

focus on managing risks in a broader context that often involves the board. Perhaps another 40% of chemicals companies operate within this envelope.

Perhaps only 10% have moved on to stage 3, where they run their overall business to create value from EHS issues. Doing this means assessing emerging issues, thinking ahead and taking creative approaches to business processes that will be profitable in the next five to 10 years.

VIRGIN THINKING

One extreme example of “out-of-the-box” thinking is Virgin Airlines. In a recent article in *Newsweek*, Sir Richard Branson, Virgin’s founder, gave a recap of his company’s approach to what he calls Gaia capitalism, which takes into account the whole cycle of energy consumption and carbon output.

The project has culminated in a \$3bn investment plan for the next 10 years in biofuel production, R&D and other investments. The company has concluded that it can operate with 25% less fuel by changing simple procedures, and shown that a lightweight all-carbon-composite jet could improve fuel efficiency dramatically by operating in the thin air at very high altitudes.

There are, of course, companies in the refining and chemicals sector that have made money from a proactive approach to EHS governance in less exotic ways. Contrary to their stereotype of acquiring a business, stripping out costs and running the business into the ground before unloading it, many forward-thinking companies are private equity firms.

Coffeeville Resources is a good example

of how good EHS governance benefits the bottom line. Pegasus acquired a 1940s-era refinery and related assets from a farmers’ cooperative that had gone bankrupt. The private equity firm’s goal was to invest in the business, rehabilitate it, and either sell it on or recognise the gain with a public floatation. Based on due diligence information gathered during the transaction, Pegasus developed a strategic plan and implemented robust EHS governance practices to return the refinery to profitable operations and prepare it for eventual sale. Fifteen months after acquiring Coffeeville, Pegasus sold it, in one of the most profitable private equity transactions in the energy industry.

European and Canadian companies are ahead of those based in the US in terms of their sophistication in EHS governance. These companies have moved ahead of US competitors by looking at the end result they want to achieve and structuring a pragmatic approach to do it. It is ironic that the command and control regulatory environment in the US, combined with plaintiffs’ lawyers, has created such a focus on compliance that companies have been blinded to the competitive opportunities that might be achieved by a stage 3 approach.

ACQUISITION CAVEATS

One issue that deserves special mention is the impact of acquisition on the EHS performance of the facility being acquired. Surprisingly, there is little comment on the fact that a preponderance of the high-profile “oops” incidents have occurred in facilities acquired during the previous decade. The root causes of such incidents are often to be

found in the acquiring company – which may have done proper due diligence to understand the risks and liabilities of the facility – failing to integrate effective governance processes after the deal closed.

All too often, the deal team that understands the EHS risks and liabilities in depth is sent on to another deal after closing, and there is no effective merger of the acquired facility into the governance, oversight and compliance structure of the new parent company.

Typically, the emphasis is on pulling costs out of the new asset, not on spending money for EHS performance management. Five years down the road that can lead to a major tragedy.

This kind of situation is uncomfortably common, even in otherwise well-run companies. Seller’s due diligence often reveals that assets acquired a few years before by a divesting company have never been brought into the corporate fold and are out of compliance with both governmental requirements and the company’s own standards.

EHS should be thought of as a potential source of competitive advantage and profit opportunity. When money is invested in EHS as a potential positive impact to the bottom line – instead of just being “spent” as the price of compliance – long-term benefits always accrue. ■

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