Corporate Social Responsibility Bred from Irresponsibility: A BP Oil Spill Case Study

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by

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Submitted to The Department of Economics

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I hereby recognize and pledge to fulfill my responsibilities as defined in the Honor Code and to maintain the integrity of both myself and the College as a whole.

William Hayslett
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ABSTRACT

BP is a company whose past is shrouded in controversy, from its destruction of the environment to the poor treatment of its employees. The Deepwater Horizon oil spill forced BP to change how it operates by internalizing its external costs, which it promotes as Corporate Social Responsibility (CSR). BP now implements a strategy of covering for its irresponsible actions with CSR engagements, which prove to be a more profitable endeavor than abstaining from its irresponsible activities in the first place. This paper examines multiple facets of BP as a company to prove this observation, including BP’s incident history, public relations strategies, CSR engagements and financial reports.
CHAPTER ONE: INTRODUCTION

For decades, BP has been known as one of the world’s leaders in the oil market. As of April 2010, however, one would be hard-pressed to discuss the oil giant without mention of the Deepwater Horizon oil spill. Although the public now knows that BP has a history of being blatantly ignorant of its unsafe business practices, it wasn’t until this catastrophe that the public took a critical look at the company. Under this newfound scrutiny, BP took many actions to change the public’s view of the company. From the new environmental initiatives established, to the better treatment of its employees and giving bigger payouts to the company’s shareholders, BP did whatever it could to save face in the eyes of the public. BP hoped to make itself the victim in the public eye, and convince the public that it would do anything possible to fix this disaster. Critics looked deeper and saw that all along, BP has only ever engaged in actions of corporate social responsibility in order to detract from its even more serious irresponsible actions. This paper will analyze the actions of BP before, during and after the oil spill tragedy. The incident will serve as a case study that examines BP’s strategy of covering for irresponsible actions by internalizing external costs, which BP presents as CSR. The efficiency of this strategy will also be evaluated. First, a combination of literature discussing the topic of corporate social responsibility and the BP oil spill crisis will be reviewed in order to lay the foundation for the empirical part of the project.
CHAPTER TWO: BACKGROUND AND CONTEXT

To fully understand the topic on hand, it is necessary to have a general understanding of the BP oil spill. Because the event was such a public spectacle, the story was chronicled from many different viewpoints. For the purpose of this exposition, viewpoints will be compiled from multiple scholarly resources such as case studies as well as publicly available articles.

An exhaustive timeline was compiled from multiple viewpoints in the article *BP Oil Spill Timeline*, published by The Guardian. The Guardian’s research team, Guardian Research (2011), states that the event itself occurred on April 20th, 2010. A large BP-licensed drilling rig called Deepwater Horizon located off the coast of Mexico experienced an explosion that led to a large fire. Right away, eleven people were announced missing and seventeen were injured. Less than two full days later, the entire rig sunk 5,000 feet into the Gulf. At this point, the Department of Homeland Security (DHS), along with BP, announced that the spill would have next to no effect on the oil market and that the incident was nothing to be concerned about. After details surfaced that the oil well was actually losing up to 1,000 gallons of oil per day, BP shares fell by roughly two percent due to shareholders’ fear of the cost of cleanup. It is at this point, on April 26th, that 15,000 gallons of dispersant and 21,000 feet of containment boom were placed at the site of the spill. These booms were large domes that were placed in the affected spill sections to process the oil and prevent it from spreading.

DHS then changed its stance on the matter, finally declaring the spill to be a severe environmental hazard. As the government was releasing this statement, BP was actually enjoying a notable rise in profits, as the price of gas increased in the U.S. from an average of
$2.87 to $4.11 in a matter of days. This led to the regaining of lost shares as well as further increase due to the newfound profits. On April 28th, the Coast Guard made the shocking announcement that the well was leaking 5,000 gallons of oil per day: five times the previous estimate. At this point, the State of Louisiana declared a state of emergency due to the threat imposed on their natural resources. President Obama also made his first public statement in which he stated that all possible resources will be used to contain the spill. In this statement, he placed full responsibility of the cleanup on BP. Up to this point, BP’s attempts to close the leak were entirely unsuccessful. In a closed hearing, Congress placed a limit on liabilities to be paid by oil companies.

Due to the laws in place at the time of the incident, BP was assigned liabilities reaching $75,000,000. However, Congress decided that oil companies would be held liable for $10,000,000,000 instead. At the same time this new pressure was being put on BP, the company attempted to assuage public outcries by confirming that three massive domes were to be placed over the spill and absorb the spillage.

BP’s then-CEO Tony Hayward told BBC that the blowout preventer was at fault for the leak, as it was not functioning properly. He stated that BP "will be judged not on the basis of an accident that, you know, frankly was not our accident". This attempt to assign blame to anyone other than the company itself did not sit well with the public. A hearing was held in the Senate in which the heads of three oil giants placed the blame on each other.

Halliburton, an old field company associated with the rig, attempted to alleviate the blame put on them for cementing the blown well by stating that they fit all requirements laid
out by BP. The other company blamed by BP was Transocean, the company that ran the drilling rig. Transocean stated that their blowout preventer was fully functional in a test a week before the spill and assigned the blame to BP for misusing the equipment. The hearing concluded that no party was without blame, and states that all three companies ignored clear warnings in the moments before the incident occurred.

After this hearing, on March 13th, the New York Times chronicled the stories of multiple scientists who worked for the BP that were pressured to falsify or overstate the efficiency and well-being of the equipment they were hired to test. It was reviewed by these testimonies that drilling and other operations were allowed to occur without the necessary permits and inspections.

This article’s widespread popularity among the media cemented the large shift of the public’s view of BP from the victim to the perpetrator of the entire oil spill catastrophe. In response to this news leaking and the shameful hearing that had just taken place, President Obama condemned BP and its partners in their failure to not only clean up and contain the spill, but to take any responsibility for the incident. With this marking one of the lowest points in BP’s public relations, BP was further scrutinized upon the announcement of a criminal investigation being launched by the U.S. government on BP’s negligence that contributed to the spill on the first of June.

BP attempted to retain their shareholders by giving a payout of $10,000,000,000 despite the increasing cost of cleanup and reparations piling up with each passing day. To combat the
public relations damages being caused by the spill, BP begins airing numerous commercials that emphasize the difficulty of cleaning up and the company’s dedication to the project.

Along with this “project” of clean up the gulf, they initiated multiple volunteer programs to organize groups to assist in the effort. The new wave of initiatives and environmental restoration brought on by BP was clearly for public exposure, but in a more positive light than the spill put it in. A few days later, on June 6th, BP announced its progress had allowed it to capture 10,000 gallons of oil per day, approximately half the total leakage per day.

In response to BP’s big announcement, one of the company’s biggest critics, President Obama, claimed that experts had calculated the spillage out 40,000 gallons per day. Soon after this revelation, many BP workers came forward claiming that the oil rig was actually leaking for weeks before the explosion occurred. With this heavy inflow of negative publicity, BP’s shares fell to a 14-year low, despite the profits it was making in the oil market amidst the spill.

As the scandal was further investigated, it was discovered and announced by Associated Press that there were over 27,000 abandoned wells in the Gulf Coast alone, some of them dating back to the 1940’s. It was speculated with a degree of certainty that many of these wells, especially the older ones, were poorly sealed or possibly leaking.

Throughout mid-July, BP saw some success in capping the leak and replacing faulty caps. Due to this success, along with speculation that BP was seeking out foreign investors, BP shares finally begin to rise again. Along with this positive news, BP announced that it had finally fully sealed the leak, but must continue to monitor the integrity of the cap.
To ride this wave of positivity, BP published commercials with Photoshopped footage in order to oversell their vigilance and success on the matter. This blatant lie was quickly exposed by the media, resulting in a decrease of the company’s shares by five percent.

Soon after, it was announced that the warning sirens on the rig had been shut off at the time of the explosion in order to not disturb the workers. With this newest wave of negative coverage by the media, the chief executive of BP, Tony Hayward, left the company. His replacement, Bob Dudley, took the position as BP plunged into the red. The company then booked a $10,000,000 tax credit against the cost of cleaning up the spill and was making a provision of roughly $32,000,000,000 towards it.

Fighting back against BP, Greenpeace forced 46 BP garages to close in central London as their activists continually stole the safety switches at the pump. On the first of August, BP gave out what it called a ‘generous offering’ to those who waved their right to sue and settled matters outside of court. In reality, the money offered by BP was far less than what was called for by the lawsuits brought upon them. After another couple of weeks arguing with the government, rivals, and its partners, BP finally announced it had successfully stopped the spill by pumping mud into the well. Although the physical spilling was dealt with, repercussions from the spill went on for months afterwards. Despite the slow and climbing share prices resulting from the plugging of the well, BP’s legal and public issues continued in full swing until eventually dying down in January of 2011 (Guardian Research, 2011).
Now that a basic understanding of the oil spill has been established, it is possible to draw inferences from it. Numerous works on this topic have surfaced since the time of the oil spill.

Numerous witnesses, whistleblowers and government officials continued to scrutinize BP and seek retribution even after the leak was closed. Guardian Research (2011) states that three months after the explosion, it was revealed that BP had yet to revise its rigs’ emergency plans. It was also announced by BP that the final total cost of the spill totaled more than $40 billion, with $10 billion going to cleanup. Although BP’s partners reluctantly put funds towards the cleanup, most of the cost fell on BP, as well as the U.S. government. In response to numerous questions on the matter, former CEO Tony Hayward stated that the company made up their disaster plan along the way, admitting that it was mostly BP’s fault that the situation occurred. WikiLeaks has since revealed that an identical situation occurred just eighteen months earlier in Azerbaijani, but was kept quiet by the company. The Azerbaijani rig exploded due to the same technological inadequacies and corporate ignorance as the Deepwater Horizon rig. The location in which the rig was located led to much less attention, however. Even so, BP has been reluctant to discuss the Azerbaijani rig explosion in hopes of keeping it under the radar. Although BP’s shares have risen over time, it has been removed from Interbrand’s index for the first time in over a decade (Guardian Research, 2011). To this day, BP’s name remains tainted.
CHAPTER THREE: LITERATURE REVIEW

Much can be theorized in regards to the company’s corporate social responsibility (CSR) policy given information about the oil spill. CSR entails much more than simply following environmental standards. Reinhart (2008) claims that following such government imposed regulation does not count as engaging in CSR. It is only when a company goes above and beyond following the government’s standards for the good of others that a company’s actions are considered CSR. Reinhart states that the official definition of corporate social responsibility boils down to the simple concept of sacrificing profits for social interest. By this standard, it is definitionally impossible to consider CSR as a profitable business model. Reinhart (2008) focuses specifically on the environmental take on corporate social responsibility. In the article, he poses the controversial question: do companies have a moral responsibility to be socially responsible, or do they owe it to shareholders to be as profitable as possible? To maximize profitability, CSR must be ignored. Beyond this, the article examines if maintaining a socially responsible business approach is possible without being overtaken by competitors who do not engage in CSR. Through the observation of real life firms, Reinhart pinpoints relevant examples and constructs standards that answer these questions. He begins by identifying the legality of corporate social responsibility in both developed and undeveloped countries. Using this, he creates six standards that must be followed for a firm to have success while engaging in CSR. Although these standards are certainly agreeable in terms of applicability, they are all quite common sense and do not require exposition, which is the main flaw of this article. Although some may argue that pointing out the obvious is necessary to keep the reader on the same
page with the author, this could be accomplished without patronizing the reader. However, the standards put forth by the author in which corporate social responsibility is feasible and maintainable are noteworthy and very applicable to the topic being studied. These standards include the support of stockholders, the costs associated with socially responsible behaviors, and whether or not customers are willing to pay a premium for a firm’s goods and services. Beyond discussing what is necessary to sustain CSR, Reinhart examines situations in which CSR is reluctantly and voluntarily sustainable. By this, he means that the motivation behind a company’s CSR engagements can influence the level of success they experience.

If administration or employees are reluctant but forced to engage in CSR, quality may suffer as morale declines. If employees believe in the cause and participate in CSR of their own free will, they are inclined to yield greater success in this endeavor. The article goes on to identify other factors that influence the rate of success of CSR operations within a business.

An interesting observation made by the author is that the success of CSR can be subject to the law of diminishing returns. A company may yield public favor or other positive effects from CSR activities. Putting more resources into these activities may yield increased gains at a diminishing rate. Reinhart claims that if resources invested are at an ideal amount in terms of the market in which they operate, CSR essentially “pays for itself”.

The rest of the article continues discussing ideal and non-ideal situations in which a company may engage in CSR. The article does a thorough job in its main purpose, which was to define CSR and evaluate if and when it can be sustainably or even to the firm’s benefit. However, the thoroughness in which this is done also proves to be the article’s biggest downfall,
which is restating the obvious. Although common sense facts are necessary to understand the article, they do not need to be repeated or expanded upon as often as the author did so. Reinhart’s article would have also been much more useful if it included more examples to help illustrate his point. This would provide topics for further research. Overall, this article is useful to my own purposes because it provides a firm definition of CSR and details what a CSR promoting company looks like (Reinhart et al., 2008). All of these standards and assumptions rely on the operational definition that CSR activities are anything a company does that sacrifices profits for social interest. However, this assumption is not held by all economic experts.

In Hong (2012) argues that CSR can actually be profitable for certain companies, if the circumstances allow. Already, this contradicts the previously established standards for CSR activities. Hong explains that even when acting under non-profit motives in the engagement of CSR, there is a chance that profits may be incurred. The methods used in conveying this argument also differ from Reinhart’s methods. From the introduction on, examples of big-name companies are used to support Hong’s argument. The main aim in doing this is to show that successful, bigger companies conduct CSR activities more frequently and yield profit as a result. Firms with tighter budget constraints tend to conduct CSR activities less often, and they are much less successful when doing so. The article begins by discussing these premises, and then presents a study to prove these ideas. The study uses ratings of corporate social responsibility for multiple companies provided by the Kinder, Lyndenberg, Domini, and Co. database along with stock prices and other accounting variables in a model constructed in order to examine the relationship between a manager’s capital and “goodness activities” in the presence of financial constraints. Along with this, they use an established utility/objective
function to process the data. After walking the reader through the construction of the model and each of its variables, the data used is explained and put into context. The results were then discussed, and implications were drawn.

The results themselves revealed that “acts of goodness” are much more sensitive to financial constraints than fields such as research and development and capital. This result is important, as it disproves the idea of ‘doing well by doing good’. This means the author’s initial proposal that firms can profit from CSR activities was partially true. Hong was correct in saying that it is only feasible for more successful companies to maintain CSR engagement, as it is unprofitable if not. Due to the absence of empirical evidence seen in Reinhart’s article, it is safe to say that Hong’s work discredits Reinhart’s views to an extent.

The main emphasis on empirical evidence is one of Hong’s article’s biggest strengths. The data itself is not expected to be proof enough, as Hong provided two methods to prove his point. Each of these methods did involve some relatively complicated mathematics and explanations, but both were made very simple to understand due to the tactfulness of the writing. Another strength of this article lies within the methodology. Not only were two methods used for the research, but one of them was from an established outside source.

Creativity and innovation can be attributed to the author’s own model, and consistency and credibility can be attributed to the use of an outside-source method. Doing this prevents the author from creating a model or forming methods that unjustly steer the results and implications in the author’s favor.
The last major strength of this article is its contrary nature, as most of the existing literature claims that one of the main facets of corporate social responsibility is the trade of profits for social goodness activities. A controversial, contrary opinion like this which is backed up with research and facts is highly valued in the compilation of such literature.

The article does, however, require a minimal amount of background knowledge in order to follow its methodology section. Even though the author does a great job at explaining the methodology, a decent understanding of algebra and ability to put things together is required in order to fully understand the research. The only blatant weakness of the article is the applicability of its results to the actual topic being discussed. Although the research successfully proved that “social goodness activities” are much more sensitive to financial constraints to other branches of spending, such as research and development and capital investment, one could say that this may not necessarily prove a point (Hong et al, 2012). It makes sense that a bigger, wealthier company would invest more money into CSR activities than one with a tighter budget. The author’s research conclusions would certainly prove that companies with less financial constraints tend to be more socially responsible in their activities, but this does not necessarily mean that doing so is profitable. Explanations and reasoning for this are clearly stated by the author prior to the study, but the study did nothing to back up such claims. With such a controversial stance on CSR, reasoning is not enough to make such claims valid. To remedy this, a similar model could be used with the addition of an examination of companies’ financial reports in correlation with the dates in which they engaged in social responsibility. With that being said, Hong’s article is a very valuable resource in the compilation of existing research and provides a much needed contrary perspective on the topic being examined.
There is a concept regarding corporate social responsibility that many works have ignored thus far. Most literature on the matter, including the previous articles mentioned in this paper, ignore one of the most common reasons companies engage in CSR activities. It is proposed by Kotchen (2011) that the main reason firms engage in activities that promote corporate social responsibility is to cover for activities that would be labeled as socially irresponsible. In order to draw attention from or “cover for” irresponsible actions such as pollution or poor treatment of employees, companies will often engage in additional socially responsible activities. Kotchen goes as far as to say that many firms who lead in corporate social responsibility activities still wind up doing more harm than good in the long run. He also goes beyond this in questioning what motivates corporations to engage in CSR, if not to cover up corporate social irresponsibility.

Similar to the previous articles mentioned, Kotchen seeks to find out if engaging in CSR activities is profitable. However, this author goes a step further in asking if CSR activities lead to increased profitability or if large financial resources are what allow companies to partake in CSR activities. This concept ties the previous articles together by asking what defining characteristic causes the other: CSR engagement or a large pool of financial resources?

Fitting with the author’s less optimistic view of CSR, he adopts a more pragmatic and realistic definition of what CSR is. According to this definition, CSR is any set of actions taken to reduce external costs or to avoid distributional conflicts. This fits with the idea that a firm is not seeking to engage in CSR just for the greater good, but for underlying profit seeking motives.
As Hong believes, firms act solely for the sake of profit. This concept does not change when it comes to CSR. There are external costs associated with a firm’s customer base, including environmental pollution and social goodness costs that come up in appeasing the public’s standards. To combat this, a firm may engage in social goodness for which the cost isn’t high in order to take the focus off of the social irresponsibility it will continue to engage in. In adopting those minor costs to maintain this, it avoids the higher cost of living up to the public’s expectations.

Kotchen tests his theory on 3,000 publicly traded companies in the United States, a country in which the public often expects a degree of corporate social responsibility. The data was taken from the same KLD social rating database that Hong took his data from, using the years 1991 through 2005 as the period of observance. Measures are constructed for a company’s overall CSR and CSI (corporate social irresponsibility) while separate measures are constructed for a multitude of specific issue areas like diversity, employee relations, human rights and many more. Using a few multiple regression models that are somewhat similar to these Hong used, each company’s results are compared to one other.

It was evident without dispute that the companies that engage in the largest amount of corporate social irresponsibility are also those who engage in the largest amount of corporate social responsibility. It is also seen in the research of these 3,000 companies that, in the face of outside regulations, by the government for example, companies will also use the examined method to get around such regulations.
For example, if a company must pay a fine due to pollution regulations, they will simply pay the fine instead of changing their methods of waste dumping. This could contribute to a negative image of the company’s overall reputation, so it will respond with a positive CSR activity to take the public eye off of the pollution. Although the fine and cover-up costs add up, it is less than the profits spent by fixing the pollution problem.

This article looks at CSR in a much bleaker light than most other literature on the matter, but adds some believability to the idea that CSR activities can be profitable. By Kotchen’s standards, the profit made from CSR viewed in terms of the opportunity cost of not engaging in them. The results from this study fully support Kotchen’s hypothesis, and also back Hong’s theories.

In the compilation of relevant literature on the topic I am studying, this synchronization with Hong’s work proves to be a strength in Kotchen’s article’s usefulness. Taking Hong’s theory a step further in constructing his own is one of the article’s main strengths, which is complimented by the fact that the hypothesis proves correct by the data examined on 3,000 different companies. The experiment was on a large enough scale to be considered statistically significant, but only holds true for American companies. This is an unfortunate shortcoming as my own examination will involve an examination of companies from multiple countries. However, I can still use Kotchen’s regression models and database sources in the examination of additional companies from different countries. Doing so would lead to the same asterisk on my study that he must put on his: correlation does not imply causation.
Although we draw implications from this study, they must all be considered as theoretical, as they stem from correlation. This can be seen as a minor weakness to the study, but is not enough to harm the credibility of the source due to the nature of the study. In addressing the shortcoming of only being applicable to firms in the United States, examination of a multinational study is required (Kotchen et al., 2011).

When a corporation is dealing in multinational business, domestic focus often falls on the company’s level of corporate social responsibility. Critiques of firms such as Shell, Nike and Walmart claim that although these businesses are loved in the United States, they are menaces in other countries. From the abuse of child labor to the pollution of local lands, companies can legally get away with many things in other countries that they cannot in the U.S.. Similar to Kotchen’s theory that firms only engage is CSR to offset their misdeeds, Blonigen believes that multinational corporations treat CSR and philanthropy as public relations tools which they use with profitable motives.

Blonigen (2012) examines the actions taken by multinational firms when operating abroad and compares them to firms’ local actions. This is done in respect to the multinational’s corporation’s relations with the host- country. The author starts off by examining the existing literature on the matter, primarily on works that analyze multinational corporations’ effect on host- countries’ productivity, growth and wages. From here, the author conducts his own analysis for comparison purposes.

The United Way corporation, a charity based organization in the United States known for assisting local charities, is examined as a basis for philanthropy among firms. United Way is
commonly given donations by companies as a form of CSR, and United Way will then distribute the funds to other charities. Financial records for United Way are examined to find out what types of firms donate the highest amounts of money, and how frequent these donations are made. In researching whether local or multinational firms proved to be the bigger contributors, statistically significant results were discovered.

These results showed that multinational, foreign owned companies donated at a much lower frequency than local firms. However, when they do donate, they do so in a much larger quantity. This conclusion fits along with Blonigen’s initial thesis, and also fits Hong and Kotchen’s theories. In order to increase public exposure and stick out as socially responsible, a company will hold on to funds until it can donate a large enough sum to impress the public. In turn, local firms are just as socially responsible but do not use their CSR activities as public relations tools (Blonigen et al., 2011). This information on its own provides motive for CSR engagements among big corporations. But, among the previously discussed articles, it supports the theory that CSR is used as a tool for profit. Fitting along with Kotchen’s cynical view of CSR engagement, Blonigen’s findings show that there is profit motive behind every “goodness activity” that large firms perform.

Because this article reaffirmed the controversial opinions of the some of the previous articles, it proves very useful, as it adds credibility to the other studies. The majority of existing works on the matter claim that CSR cannot be carried out without a decrease in profits. The cohesion that this article lends to the previously mentioned articles proves to be its greatest strength. However, this article is not flawless in its methods.
Although the result may be statistically significant in the experiment constructed, the results are called into question since all data came from one charity. United Way is a great indicator of philanthropy if only one charity must be used, but in my own study I would use many charities as indicators in order to eliminate confounding variables. This would eliminate this article’s main weakness, and add credibility to the results.
CHAPTER FOUR: ECONOMIC FRAMEWORK

Now that a basic understanding of the Deepwater Horizon oil spill has been established and a thorough background of CSR theory has been constructed, a detour to economic theory will be taken to create a framework for the narrative. What BP calls “CSR engagement” is actually the internalization of external costs.

Mateer and Coppock (2014) define internal costs as the costs of market activity paid by each competitor. Examples of BP’s internal costs would be wages paid to workers, utilities paid on BP factories, and the purchase of raw materials and equipment. Mateer and Coppock define external costs as costs paid by people who are not participating in the market, such as uninvolved bystanders. For BP, external costs include environmental damages caused by oil spills, safety hazards imposed by the company on surrounding towns, and air pollution being breathed in by nearby communities.

With regard to the Deepwater Horizon oil spill, BP has imposed many negative externalities on people who are not participating in the market, such as those living along the Mexican Gulf. Social costs are simply the combination of both internal (or private) and external costs of market activity (Mateer and Coppock, 2014). Up until the day of the spill, BP did nothing to account for external costs and produced at the market optimum. Backlash from customers, shareholders and the government forced BP to begin factoring in these external costs that had been ignored for so long. In terms of economic theory, a supply and demand curve can be used to illustrate the narrative.
In Figure 4.1, S represents BP’s initial supply curve when only taking internal costs into consideration. The initial quantity BP was producing is represented by Q. At the intersection of S and the demand curve, there was the market optimum at which BP was producing. Through multiple scandals, incidents and oil spills it was revealed that BP was overproducing, which was causing such negative events. S1 represents BP’s supply curve, factoring in social costs. After BP experienced the backlash from the Deepwater Horizon oil spill, BP’s supply curve shifted to S1, and the firm experienced success because of it. In taking social costs into account, BP realized that it must produce less, as it needed to consider employee safety and environmental well-being. As seen in Figure 4.1, the leftward shift of the supply curve led to a decreased optimum output quantity represented by Q1. The new intersection created is the social optimum. As is what happened to BP, the decreased production quantity led to an increase in prices which proved profitable to BP. Taking social costs into account is what BP considered as CSR. In other words, the public now pays for BP’s CSR by way of paying a higher price. In this manner, CSR helped BP to recover the public relations standing lost due to the oil spill and allowed it to profit.
Figure 4.1
CHAPTER FIVE: BP’S CORPORATE IRRESPONSIBILITY

BP’s frequent irresponsibility had been known by the public long before the oil spill in the Gulf. Although the disaster brought major media attention to the company and its obvious ethical and moral shortcomings, several activist groups had put BP in their crosshairs long before the Deepwater Horizon spill ever happened. Although BP has always touted itself as a “green” company that promoted environmental preservation, clean energy research, and as superior treatment of employees, many lawsuits and protests launched against it over time more than prove that such self-promotion is nothing more than a façade.

For instance, one major case chronicled by McClure and Richman (2006) that invalidates BP’s environmental activist claim occurred in 2000, when a group of fishermen and environmentalists teamed up to sue BP for expanding their refinery docks off of the coast of Washington. In expanding their infrastructure, BP was moving into an area which is vital to the remaining herring population and would therefore destroy their habitat and put many fishermen out of the job. The lawsuit against BP claimed that the expansion allowed BP to operate past the previously-set limits imposed on it by the previous senator, Warren Magnuson in order to protect Washington’s inland marine life. The goal of these fishermen and activists was not monetary gain, but to leverage BP into implementing anti-spill precautions and leak prevention programs and studies.

BP used their team of lawyers and massive resources to push off the resolution of this lawsuit for over five years. In the meantime, they continued to operate unimpeded by any government interference. It wasn’t until 2006 that the company finally compromised to
implement mandatory precautions against oil spills and leakages, as well as to conduct an environmental study on the area in which they operate. In the compromise that settled the lawsuit, any possibility of injunction was done away with, therefore allowing BP to continue its operations in the area. The study required of BP as per the settlement includes an evaluation of safety factors affecting transportation vessels heading to and from the refinery.

These factors include precautions that should have been taken initially. It mandates that a series of tugboats accompany the vessels in case a malfunction were to occur. Before this mandate, only a single tugboat would accompany the transportation vessel under certain circumstances. In this case, BP was forced to implement measures that would combat a spill or leakage by internalizing its external costs. If it had not been for these concerned fishermen and activists, the Washington coast could have ended up just as the Gulf did in 2010.

This case proves that BP operates irresponsibly, and falsely claims the title “environmental activist” in hopes of fooling the public. Clearly, marine life was not only ignored, but endangered, by the expansion of the refinery dock. BP’s spokesperson in the lawsuit, Bill Kidd, even went on to state after the settlement that BP did not deserve to be forced to compromise, but the company believed that five years was long enough to be forced to deal with the impending suit. He argued that with the company’s full resources being put into their argument, the company could have won the suit without being forced to settle (Mcclure & Richman, 2006).

This goes to show that even when the company did finally implement the proper safety precautions that should have already been common practice, it did so begrudgingly. Although
conducting the mandated study would cost the company one million dollars, this amount pales in comparison to how much it made by not having to shut down the expansion to the dock. This is simply one area in which BP’s environmental corporate social responsibility measures resulted in cost that was less than the price of fixing the root issue.

The Washington coast lawsuit established the fact that BP truly does not care about the environment, and lies about its intentions in order to cover up the damage it caused. However, it is not only the environment that BP lies about protecting, but their own employees as well.

Texas City’s 2005 BP explosion reaffirms BP’s lack of regard for their employees’ wellbeing. According to the final incident report by U.S. Chemical Safety and Hazard Investigation Board (2005), on March 23, 2005, BP’s Texas City refinery experienced what would be known as one of the worst industrial incidents in recent U.S. history. This location was the third biggest oil refinery in the country, which only proved to heighten the level of devastation it caused. The explosion and fires occurred when an isomerization machine was activated, while a raffinate splitter tower was overfilled. Pressure release machines opened, resulting in a flaming liquid geyser to erupt from the site which was not equipped with a flare. This is what caused the explosion, which immediately killed 15 people on location who were close to the incident.

The explosion alone injured an additional 180 people, as damages occurred within a three-fourths mile radius of the explosion. The estimated financial losses exceeded $1.5 billion. It was revealed soon after the explosion that safety hazards contributing to the incident had been well-known and reported for a number of years leading up to the explosion. The company
did not address these concerns in an effort to cut costs, as they are now infamous for doing. To add insult to injury, this explosion did not prompt BP to address the safety concerns that led to the incident. This was made evident when two more serious accidents occurred only months following the Texas City explosion.

First, a pipeline failure caused damages resulting in over $30 million. The second explosion resulted in $2 million of property losses. In both of these accidents along with the original explosion, shelter-in-place orders were announced. After these three accidents occurred, investigators revealed that BP had done little to increase safety over the past 30 years, in which 25 deaths had occurred on site and hazardous amounts of toxic materials had been released. The company defended their lack of action in saying that 25 deaths in 30 years was not an unacceptable death rate, and that is the reason it did not feel compelled to heighten safety levels for its employees’ wellbeing.

Financial analysis reveals that the location’s budget was cut by 25 percent in 1999 then another 25 percent in 2005, despite the company’s awareness that the location’s infrastructure was in a severe state of disrepair. Throughout that time period, operator training and hiring budgets were also cut (U.S. Chemical Safety and Hazard Investigation Board, 2005). BP’s initial lack of action before the explosion shows that it does not promote the wellbeing of its employees, and its lack of action following the explosion shows its outright lack of concern about its employees’ safety.

The largest oil spill that occurred before that of the Deepwater Horizon crisis also belongs to BP. History knows this incident as the Prudhoe Bay Pipeline oil spill. The spill
occurred on March 2, 2006 at Alaska’s Northern Slopes when a pipeline began gushing oil as the pressure became too much for the corroded pipeline to handle. The corrosion which caused the massive leakage was previously reported to the company, but no measures were taken to reinforce the rusty infrastructure. The resulting spill resulted in the loss of 212,252 gallons of crude oil to leak into the bay before the accident could be corrected. The evidence that BP had ignored all warning signs and red flags on the matter was so great that the company was forced to plead guilty to negligent discharge of oil, a misdemeanor offense under the Clean Water Act. BP was fined a total of $20 million for their negligence.

In April of 2011, BP paid $25 million as a result of a civil suit which, at the time, was the largest per barrel penalty to date. As part of the terms resulting from the civil suit, the company was forced to develop additional maintenance and inspection measures in regards to its infrastructure in the Northern Slopes. In November of 2012, it was decided that the state of Alaska would collect $255 million related to BP’s pipeline burst and subsequent shutdown in 2006. This incident that resulted from the negligence of BP only further reinforces the observed pattern that BP would sooner pay reparations and contribute aid opposed to actually addressing the matter at hand.
CHAPTER SIX: BP’S PUBLIC RELATIONS STRATEGY AND CSR INITIATIVES

With these oversights and criticisms against BP, one would naturally wonder what public relations strategies have been adopted in order to address public discontent. Anyone who watches television will bring up BP’s commercials, and others would bring up the ads that it airs on its website. BP has always had an advertisement campaign to promote its care for the environment, love for its employees, its interest in alternative energy, and the appreciation that it has for its customers and supporters. These commercials were used as key public relations tools during the height of the Deepwater Horizon oil spill tragedy.

For example, BP’s reemphasis on its “beyond petroleum” advertising campaign, which had actually kicked off in 2000, proved to be vital in restoring the public’s opinion of it after the incident. Barrage and associates (2014) aimed to identify just how vital this “beyond petroleum” campaign was to the recovery of BP in the public’s eyes. Although the initial hypothesis of a simple “yes” was questionable once the results were gathered, certain conclusions and implications relating to this case specifically prove that the campaign was a success.

It was not only the commercials during the height of the spill that saved the company’s public standing, but also the commercials that it had aired for years leading up to it. Barrage examined retail price per gallon during the oil spill, google search intensities, and advertisement spending to find a relation between advertisement and public opinion specifically for BP. It was found that the advertisements that had aired for years before the spill created a cushion for the negative public relations effects of the spill. It is true that the Deepwater Horizon spill was far from the first strike against BP in the eyes of the public. The image of an eco-friendly, “green”
company that was built helped ease the criticism that many would argue BP clearly deserved. Although these commercials did nothing in the way of proving BP’s devotion to the green cause, or even outline what its “green initiatives” were, the public simply took BP’s word. Barrage states that these commercials leading up to the spill allowed for the public to see the Deepwater Horizon oil spill as more of an unfortunate event that happened to BP, opposed to a tragedy caused by it. This phenomenon is astounding, and goes against common sense. However, it perfectly outlines how shallow the public is in its judgment of character. Barrage claims that the success of this deceptive tactic creates an incentive for companies to spend money on CSR for the purpose of insurance. If a firm experiences a tragedy like the Deepwater Horizon oil spill, the previous expenditures dampen the negative effect of the disaster in the long run. And because the claims made by BP in these commercials have little substance behind them, BP is not forced to go out of its way to promise anything or back up its claims. Simply saying that a company possesses these green intentions, and aims to protect or help the environment without actually carrying out such propositions is known as “greenwashing” in the world of true environmental activists. Barrage suggests, as many environmental activists do, that the government establishes some sort of rating or certification system to ensure that such lies are not taken as truth by the ill-informed public (Barrage et al., 2014). With such a system in place, BP would not be able to use its advertising campaigns as insurance for future negligence-based incidents. Although this system is very deceptive, it does prove to be a successful practice for BP. Although such a large media campaign is costly, it would cost BP much more to actually address their dangerous practices and inadequate infrastructure. This concept reinforces BP’s
pattern of paying to cover up their blunders instead of paying to address the sources and causes of them.

Another key public relations strategy that BP has made full use of over time is the controversial practice of shifting away any of the blame or criticism that may befall it. In nearly every scandal it has been involved in, BP has done its best to assign blame to either its rivals, its partners, rogue employees, or even the government. An example of this can best be seen when examining the Deepwater Horizon oil spill.

Even in the face of the mounds of evidence that proved its negligence on the matter, BP argued to the end that the fault of the spill fully fell on all other parties involved. Guardian Research (2011) chronicles BP’s public relations during the oil spill crisis. The past-CEO, Tony Hayward, stated after leaving the company that BP was responsible in part for the disaster, but no official claim from BP backed his statement. According to the company, it was instead the fault of the concrete contractor that it had used on the Deepwater Horizon, Halliburton.

BP also made a strong effort to blame Transocean, the owner of the Deepwater Horizon drilling rig. In all official court hearings, BP assigned the blame to these two companies. During the hearings in which the other two companies had representatives present, all companies blamed each other for the oil spill. U.S. District Judge Carl Barbier attributed 67% of the blame for the disaster to BP; 30% to Transocean and 3% to Halliburton. BP did not accept such an evaluation and went on record in stating that it was being used as a scapegoat.

Perhaps even more heinous in nature, BP even demonized some of the victims of the spill. As much as BP likes to act as though such serious issues never happened, and that they did
not have much of an effect on anyone, the courts demanded reparations for the families of victims as well as reparations for the numerous other legitimate victims of the Deepwater Horizon oil spill. BP CEO, Bob Dudley, stated in an interview that the multitude of lawsuits that it had become a part of was unjust, and that BP was more than generous in its repayment to those who it felt were truly victims of the situation. He stated that all others were unjustly trying to take advantage of the situation by cashing in on BP’s misfortune.

BP has even gone so far as to say that those seeking compensation were impeding the cleanup effort by making the company divert its resources (Guardian Research, 2011). In this manner, BP tries to frame itself as a victim. Unlike the “beyond petroleum” ad campaign, this public relations strategy is not an effective one. As a matter of fact, the media’s coverage of BP’s victim act has been known to insult many people, and critics take notice. Multiple journals, newspapers, and websites have criticized BP for this practice. It is for this reason that such a strategy evidently appears to do much more harm than good. In this example, BP ignores social and external costs. Compared to other public relations strategies where BP internalizes external costs, this method is a failure.

BP does not rely on its commercials alone to win over the public’s opinion. A primary public relations strategy adopted by BP includes the implementation of what they refer to as CSR activities. The company has doubled down on its efforts to appear as a responsible, caring business. In hopes of separating itself from rival firms, BP released its Invigorate gasoline. According to BP Products North America Incorporated, this gasoline contains an additive that was found to fight dirty and harmful buildup in vital parts of a car’s engine. Additionally, the higher level of detergent in the gasoline makes the gas itself burn off cleaner. This puts the burn
off requirements past the minimum benchmark demanded by the EPA, which is not common in the gasoline industry. Upon incorporating this new chemical compound into every grade of gasoline in its gas stations, BP claimed that this new additive would not have any major effect on what the consumer would have to pay.

Although some argue that this is what causes their gas to cost a few cents more expensive than other rival gas stations, the company does not stand behind this statement. The company hoped to release this innovation as proof of its intent to be a green company, which it had been working very hard to establish due to its history of destroying the environment. Not only does this make BP seem environmentally conscious, but it also shows its care for the company’s consumers.

This intention was well conveyed to the public through yet another commercial campaign touting the company’s “best-ever gas” as far superior to any other company’s gasoline. In these commercials, the company also stressed how using this gas was good for the environment. A green orb (shown in Figure 6.1) with a cartoon face was created as a mascot for the new product, and was very well received in the media.
An objective analysis of this product’s performance shows that BP made a great public relations move in implementing this form of CSR. Going above and beyond what the EPA requires of gasoline manufacturers without charging the public a premium is a truly socially responsible move. Whether or not BP secretly pushed a few extra cents per gallon on the public is debatable, and would still be acceptable from an environmental standpoint.

One could argue that BP would be justified in doing so since it is not only providing an extra degree of environmental protection, but it is also providing a service to the customer by cleaning out his/her engine’s dirt and plaque. Although it is not being argued that such an action is truly socially responsible, it is clear that the implementation of this new product hides ulterior motives. BP was experiencing major media backlash from the Prudhoe oil spill that had occurred in the previous year from both customers and environmental activists. The introduction of this product was a major success in scoring positive feedback from both demographics. As is the nature of the media, BP went from a hated destroyer of the environment to an environmental-conscious industry leader. In this manner, BP has successfully covered up their corporate social irresponsibility with responsible actions. This was done through the internalization of the external cost of environmental protection. BP was
forced to factor in social costs to change the public’s view, which is what BP treats as CSR. As repeatedly seen, this internalization of external costs has proven successful for BP.

When discussing BP’s CSR actions that have arisen from their irresponsible actions, one would be remiss not to discuss the actions adopted in response to the Deepwater Horizon oil spill. According to BP’s website (2017), the company has funded multiple early restoration projects to clean up the Gulf of Mexico. As for damages it has already caused, the company has pledged $7.1 billion to the five states that possessed natural resources related to the Gulf over the course of the next 15 years. On the company’s website, it claim this action as a CSR engagement despite the fact that this is partially due to a settlement made by the company in court. Up to this point, BP has spent around $14 billion on the 100,000 employees that have put over 70 million hours of work into restoring the coastline. BP claims to have greenlit another 64 early restoration projects to continue cleaning up the coast. The combined cost of these 64 early restoration projects add up to roughly $832 million which BP has paid for. The company has pledged up to one billion dollars to continue funding these projects, and claims that any unused funds will be donated to the trustees of the settlement approved in April 2016.

In this settlement, BP pledged to pay for the restoration projects, and the trustees pledged to pay for implementation. In addition to these early restoration projects, BP has also pledged to fund multiple Natural Resource Damage Assessment (NRDA) studies.

As of July, BP had spent $1.3 billion to fund 240 studies. In addition to this $1.3 billion, BP has committed to pay $500 million over 10 years to conduct independent research through the Gulf of Mexico Research Initiative (GoMRI). So far, the company has already put forward
$391 million in research grants. The goal of this independent research is to “improve society’s ability to understand, respond to and mitigate the potential impacts of oil spills to marine and coastal ecosystems” (BP United States, 2017). This is another case in which BP has internalized the external costs of environmental protection. In the matter of the Deepwater Horizon oil spill, this proved to be one of BP’s most useful tactics in regaining the positive opinion of the public.

It may seem that BP really has put forth a significant sum of resources to make up for the damage that it caused during the Deepwater Horizon oil spill. One would wonder why BP would take risks that could result in the company having to put forth such large amounts of resources towards cleanup and reparations. To understand this, one must realize the choice that BP makes when it makes these risks.

In the case of the Deepwater Horizon oil spill, BP’s official final incident report (2010) states that BP would have needed to make numerous key repairs to the rig before it could continue drilling safely. First, BP would have had to pay a larger fee for further cement integrity testing. Next, BP would have had to pay to repair or replace the rig’s shoe track barriers, which is not only costly to buy, but is very costly to install due to the difficulty of reaching the installation area. The fire and gas venting systems were also found to be inadequate, and would have had to be upgraded to prevent failure. Because of how intertwined these systems are throughout a drilling rig, this kind of repair is not only costly in price but also time. There was also an emergency sealing system that is used when the previously mentioned systems fail. If this sealing system was up to par, the incident could have been prevented. However, there were multiple weak points in the sealing system that gave way to the pressure and allowed the explosion. Beyond this, the testing system that evaluates the integrity of the rig was inadequate,
as yielded mixed feedback during the tests leading up to the spill. Had the system been
optimized and fully functioning, the tests results would have prevented the rig from drilling and
prevented the explosion.

Although the dollar cost to fix these systems in the rig would have been immense, it is
the time factor that BP could not afford to commit. The rig was already two months behind
schedule, and fixes to these necessary systems would have taken far to long for the rig to
remain profitable and for the company to retain the investors of the project (BP United States,
2010). This cost-benefit analysis is what caused BP to take the risk opposed to taking the safe
route and fully fixing the rig. In BP’s perspective, it would be cheaper to cover any shortcomings
with CSR and advertising than it would be to pay to correct its inadequacies. Of course it would
have been outlandish for BP to plan for such a monumental disaster, but it was prepared to
counter any smaller shortcomings with public relations moves and other previously discussed
tactics.

Many companies make the same decision for the same reasons. Some firms will set
aside funds for lawsuits or public relations cover ups instead of paying to fix a certain issue. In
many cases, it is cheaper to treat the outcome than to fix the problem. Despite the fact that BP
underestimated how poorly the Deepwater Horizon rig would operate, it purposefully made the
choice to knowingly operate in an unsafe condition. In terms of cost- benefit analysis, this is a
profitable business tactic, as it often leads to lesser expenses for the company. In terms of
corporate responsibility, however, it is clearly the immoral and unethical approach.
CHAPTER SEVEN: FINANCIAL ANALYSIS AND CONCLUSION

It has been established that BP has internalized external costs in the form of CSR in order to gain favor in the public eye. An analysis of BP’s financial reports will examine if the CSR expenditures after the spill proved to be a successful tactic in the long run. To examine if this has been successful, multiple variables will be evaluated and compared next to BP’s environmental expenditures. The measures of success that will be used include return on assets, return on equity, share price, and revenues. Environmental expenditures, will be used as BP’s CSR expenditures as it most closely relates to the Deepwater Horizon oil spill.

First, BP’s environmental expenditures will be examined. All data has been gathered from BP financial reports compiled by Mergent Online (2016). Using BP’s reported environmental expenditures as one measure of corporate social responsibility expenditure, one can compare the impact of CSR activities on the company’s financial reports. Expenses included in the environmental expenditure category include environmental and spill related costs, environmental operating and capital expenditure; clean-ups; and additions to the remediation and decommissioning provisions. In other words, this group of expenditures represents what BP spends on protecting and restoring the environment, therefore internalizing the external costs of environmental protection. As can be seen in Figure 8.1, 2010 stands out as a point of interest, as this is when the Deepwater Horizon oil spill occurred.

If BP’s strategy is to be considered successful, these environmental expenditures should be followed by increases in certain areas of BP’s financials. Figure 8.2 plots BP’s share price over time. In 2010, the company’s lowest share price is observed, but it very quickly recovers going
in to 2011 and 2012. After 2012, the company’s share price is relatively stabilized. Figures 8.3 and 8.4 refer to BP’s return on assets (ROA) and return on equity (ROE), respectively. These are common measures of a company’s health and efficiency, and are often of key value to shareholders as they state how efficiently their money is being used. BP’s ROE and ROA mimic one another. In 2010, at the time of the incident, both values dropped dramatically. However, after BP’s investments in environmental CSR, one can see an increase in both ROE and ROA. This same observation can be seen in BP’s revenues in Figure 8.5. After the environmental expenditures occurred in Figure 8.1, an increase is revenues occurred as a result. In internalizing the cost of environmental protection, BP saw an increase in revenues which therefore backs the initial theory that their strategy works.

Figure 8.1

![Environmental Expenditure Graph](image.png)
It should be noted that there are some limitations in the methods used in this financial analysis. The primary limitation is how deeply one may attribute environmental expenditures to the other values examined. There are, of course, many variables that influence a company’s revenues. In this case, the Deepwater Horizon spill drove up the price of oil which was quite profitable BP. This was no doubt an influence in the increase of revenues and share price. However, the influence of environmental expenditures as CSR cannot be ignored, especially in the long run. I believe this is what allowed BP to recover to a stable share price, as the initial revenue increase from increased oil prices would even out over time. Lastly, part of the environmental expenditures was government mandated and therefore not truly done of BP’s own volition, even though the company still touts this as CSR.

These observations back the idea that BP’s strategy of internalizing external costs proved successful, as they helped the company recover financially after the spill. These findings help back a strategy that has been used by companies long before BP adopted it in 2010. Perhaps even more so in today’s age of easy communication and media, many companies have adopted the strategy of internalizing external costs as CSR in order to cover for past irresponsible actions. Because it costs less to engage in CSR than to work to cease or fix irresponsible engagements, it is, economically speaking, a smart business move. This paper’s intention is not to discuss whether this strategy is moral or ethical in any way, as most people would agree that it is not. Empirically speaking, however, companies are able to recover high public standing while spending less, which makes this strategy a smart one. This does take away from companies that engage in CSR for purposes other than covering up irresponsible actions, as it adds the incentive of being corporately irresponsible. Engaging in CSR can benefit both
companies who do and do not behave irresponsibly, leaving less of a reason for a company to be responsible. As ease of communication and media coverage continues to increase over time, I speculate more firms will adopt this strategy.

BP’s history is riddled with incidents of pollution, lack of safety, and environmental destruction. It was not until the Deepwater Horizon oil spill that BP was forced to internalize their external costs, which it portrayed as CSR. In doing this, BP experienced a much greater deal of success than it had been by constantly ignoring external costs. Through examining multiples facets of BP, such as its incident history, public relations strategies, CSR engagements, and financial reports, it has been proven that BP has thrived by covering up its irresponsible engagements with CSR activities. This business practice can be applied to numerous other industry leaders in all sorts of markets. BP’s future success will depend on how closely it is able to stick to this strategy, and whether it continues to internalize its external costs.
Bibliography


