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What does divestment mean for the valuation of fossil fuel assets?

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08 Oct 2013, Ben Caldecott , BusinessGreen

There are a wide range of environment-related risks that could result in "stranded assets", where assets suffer from unanticipated or premature write-offs, downward revaluations or are converted to liabilities. These risks range from physical climate change, through to new environmental regulations, developments in clean energy technology, evolving social norms and litigation.

These risks are poorly understood and are regularly mispriced by the market, which has resulted in a significant over-exposure to environmentally unsustainable assets throughout our financial and economic systems. Today Oxford University's Stranded Assets Programme has published new research that investigates the fossil fuel divestment campaign, a current and rapidly growing social phenomenon that could be one such risk to fossil fuel assets.

In July 2012 *Rolling Stone* magazine published an article by Bill McKibben titled *Global Warming's Terrifying New Math*. In order to have an 80 per cent chance of keeping global warming below 2°C he called for divestment from fossil fuel companies to "spark a transformative challenge to fossil fuel...[by] moral outrage". Inspiration for the fossil fuel divestment idea leans heavily on the perceived success of the South Africa divestment campaign in the 1980s in putting pressure on the South African government to end apartheid.

Divestment campaigns typically evolve over three waves. The first wave begins with a core group of investors divesting from the target industry. Previous divestment campaigns have tended to originate in the United States and in the first phase focus on US-based investors and international multilateral institutions. The amounts divested in the first phase tend to be very small but create wide public awareness about the issues.

Both in the case of tobacco and South Africa the campaigns took some years to gather pace during the first wave until universities such as Harvard, Johns Hopkins and Columbia announced divestment in the second phase.

Previous research typically credits divestment by these prominent American universities as heralding a tipping point that paved the way for other universities, in the US and abroad, and select public institutions such as cities to divest as well. In the third wave, the divestment campaign can go global and begins to target very large pension funds and market norms.

Like all previous divestment campaigns, the fossil fuel divestment campaign has started in the US and in the short term focused on US-based investors. In recent months, the campaign has attempted to build global momentum by targeting other universities with large endowments such as the universities of Oxford and Cambridge in the UK.

From the perspective of the three waves of divestment the fossil fuel campaign has achieved a lot in the relatively short time since its inception: six colleges and universities have committed to divest, along with 17 cities, two counties, 11 religious institutions, three foundations and two other institutions. The campaign can be said to be entering the second wave of divestment.

Of the $12tr assets under management among university endowments and public pension funds-the likely universe of divestment candidates-the plausible upper limit of possible equity divestment for oil & gas companies is in the range of $240-$600bn and about another half that for debt.

University endowments in the US have two to three per cent of their assets committed to fossil fuel stocks, while the proportion in the UK is higher with an average of five per cent largely because the FTSE has a greater proportion of fossil fuel companies. Public pension funds, likewise, have two to five per cent of their assets invested in fossil fuel related public equities.

In our research we find that the direct impacts of fossil fuel divestment on equity or debt are likely to be limited. The maximum possible capital that might be divested by university endowments and public pension funds from the fossil fuel companies represents a relatively small pool of funds. Even if the maximum possible capital was divested from fossil fuel companies, their shares prices are unlikely to suffer precipitous declines.

But even if the direct impacts of divestment outflows are meagre in the short term, our research shows that a campaign can create long-term impact on the value of target firms through a process of stigmatisation. The outcome of this stigmatisation process, which the fossil fuel divestment campaign has now triggered, poses a far-reaching threat to fossil fuel companies and the vast energy value chain. Any direct impacts of divestment pale in comparison.

As with individuals, a stigma can produce negative consequences for an organisation. For example, firms heavily criticised in the media suffer from a bad image that scares away suppliers, subcontractors, potential employees, and customers. Governments and politicians prefer to engage with "clean" firms to prevent adverse spill-overs that could taint their reputation or jeopardise their re-election. Shareholders can demand changes in management or the composition of the board of directors of stigmatised companies. Stigmatised firms may be barred from competing for public tenders, acquiring licences or property rights for business expansion, or be weakened in negotiations with suppliers. Negative consequences of stigma also include cancellation of multibillion-dollar contracts or mergers/acquisitions. Stigma attached to merely one small area of a large company may threaten sales across the board.

One of the most important ways in which stigmatisation could impact fossil fuel companies is through new legislation. In almost every divestment campaign we reviewed from adult services to Darfur, from tobacco to South Africa, divestment campaigns were successful in lobbying for restrictive legislation affecting stigmatised firms.

As fiduciaries, managing long-term savings on behalf of their beneficiaries, endowments, pension funds and similar institutional investors have a duty to understand and respond to challenges posed by the fossil fuel divestment campaign-whether considering fossil fuel divestment or not. The divestment campaign could pose considerable reputational risk to fossil fuel companies even if its immediate direct effects are likely to be limited.

Ben Caldecott is director of the [stranded assets programme at Oxford University's Smith School](#)

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