Climate change in 2020

Opinion **The FT View**

The slow death of Big Oil

The industry must reinvent itself to survive in a low-carbon era

THE EDITORIAL BOARD

America's majors, notably ExxonMobil, have so far resisted moves to cut back hydrocarbon investments but may need to change course eventually © Carina Johansen/Bloomberg

The editorial board SEPTEMBER 17 2020

Oil and gas companies used to measure their success by how good they were at finding new reserves. The unforgiving rule by which they were judged was the "reserve replacement ratio", a metric of how successful a company was at replacing the oil and gas it extracted with new supplies. Today, that view is being turned upside down. Bernard Looney, chief executive of BP, believes the future lies in producing less hydrocarbons, not more. He wants BP to cut its production of oil and gas by 40 per cent over the next decade.

The ambition marks the profound shift gripping the energy industry. Big Oil has to reinvent itself if it wants to survive in a low-carbon world. BP said this week it believes the global demand for oil may peak within the next few years and that consumption may never recover from the pandemic. Such a bleak assessment from one of the world's largest oil companies would have been unthinkable just a few years ago.

The world was changing even before Covid-19. Climate change has moved to the forefront of the public's consciousness. Pressure on the oil industry to adapt has come from all sides even as companies have yet to figure out how to generate revenues from lower-carbon businesses. Investors are more vocal, urging the likes of BP and Royal Dutch Shell to recognise the financial impact that global warming could have on their operations.

At the same time, banks and governments are more willing to finance action against climate change; the market for debt linked to spending on environmental projects has soared. Goldman Sachs predicts that spending on renewable power will outstrip oil and gas exploration and production for the first time next year. The shift is being driven by a widening gap in the cost of capital, with rates of up to 20 per cent for oil and gas investments, compared with 3 per cent to 5 per cent for renewables.

These trends have only accelerated during the pandemic. The lockdowns imposed by governments to help contain the spread of the virus forced millions to work from home. The resulting shift in behaviour as people realised working remotely was possible holds long-term implications for economies built on fossil fuels. Some governments are, rightly, putting in place tighter regulation and incentives to promote a green economic recovery. The European Commission is pushing for a new 2030 climate target plan.

Among their peers, BP and its European rivals are at the forefront of the revolution but success will be slow. The scale of the investment required for Big Oil to pivot towards renewables is immense; analysts at Rystad Energy estimate that new goals announced so far, including BP's aim to build 50 gigawatts of renewable capacity by 2030, will require $200bn of investment. America's majors, notably ExxonMobil, have so far resisted moves to cut back hydrocarbon investments but may need to change course eventually. National oil companies, which account for more than half of global oil production, have unsurprisingly been reluctant to change tack.

The future shape of oil demand remains unclear. Consumption could stay robust at tens of millions of barrels a day for decades to come even in the most dramatic shift to cleaner energy. The world also still relies heavily on oil as a source for other products, notably petrochemicals. Some analysts predict a supply shortage could emerge in the next few years, boosting prices and leading to a surge in new investment. Low-cost producers will keep on pumping for as long as they can. But the beginning of the end is here.