

BP: lessons learned

The BP oil disaster in the Gulf of Mexico offers some hard lessons for risk managers. It also shows the essential importance of the rule of law and how easily it can be threatened by the court of public opinion, argues David Rowe

After recently returning to the US following six years living in the UK, I have watched daily coverage of the BP oil spill with morbid fascination. Few recent events have provided such an extended object lesson in risk management, and much of what can be learned has implications for financial institutions – although traditional distributional tools such as value-at-risk have little to offer in response.

The simple fact is that offshore oil drilling has been remarkably successful for the past 30 years. The only example comparable to the BP blowout was a well in Mexican waters that flowed into the Gulf of Mexico for some 10 months. As a result, there was no meaningful statistical approach for gauging the likelihood of such an event. But what could have been assessed in advance was at least a rough estimate of the crippling financial consequences of such a disaster. One central lesson from this tragedy is that some contingencies have such dramatic consequences that no reasonable cost should be spared to prevent them. Without clear visibility and awareness of the potential consequences, however, organisations can inadvertently play dice with their own survival.

Another lesson is the difficulty inherent in changing behaviour in a large organisation. My knowledge of the situation at BP is that of an outside observer, but it strikes me the media coverage of Tony Hayward has been misguided. I understand he has an engineering background and came to the job of chief executive with a firm desire to elevate safety as a priority. This apparently contrasted with earlier chief executives, whose backgrounds were primarily in finance and who were not as well versed in the engineering realities. In this limited sense, Hayward was a logical choice for chief executive if the board wanted to address the company's poor record of safety violations.

Unfortunately, it appears the problem could not be corrected quickly using a consensual approach. Despite Hayward's

announced "laser focus" on safety, the relatively poor performance, as reflected in the number of regulatory citations, continued. In this context, good intentions alone are never enough. It seems to me Hayward's failure was not that he downplayed safety, but that he was not able to force the needed behavioural change on the organisation in a timely fashion. The key lesson is that a quick shift in the culture of a large organisation requires a leader with 'big karma'.

It will be interesting to see how markets react. It seems likely a poor record of safety violations will elicit a more severe penalty in the form of a higher cost of capital to cover the increased risk of catastrophic losses. A greater focus on safety may thereby be forced on the industry. In the broadest

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sense, this is clearly a good thing, although it is certain to increase the cost of exploration and put some upward pressure on energy prices.

Another somewhat frightening consequence of the oil spill was a widespread populist reaction, characterised by calls for the US to "seize BP". The fact there was no shred of legal basis for such an action did not seem to give much pause to some prominent promoters of this radical idea. I can only characterise this as the modern media equivalent of a lynch mob. It is disheartening in a society as steeped in the rule of law as the US that more than a lunatic fringe could take such nonsense seriously. In fact, there was virtually no chance this idea would actually be implemented. It does highlight, however, that maintaining the rule of law requires constant vigilance. In an earlier column written more than nine years ago, I quoted John Heimann, former head of the US Office of the Comptroller of the Currency, to the effect that no-one should even consider investing in a country without a demonstrably independent judiciary. If the US or any other country ever allows an angry mob to undermine the rule of law, it will inflict far more damage on its economy than was caused by the BP oil spill. ■

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