Environmental risks – “antisocial activities” or “events”

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“antisocial activities” or “events”?

- **Companies have <u>activities</u> that some people disapprove of, yet are legal:**
  - *Opencast coal and minerals mining*
  - *Cigarette manufacturing*
  - *Fur farming*
  - *Commodity or CDS trading*
  - *Coal-fired power generation*
  - *Nuclear power generation*
  - *Hydro-electric generation*
  - *Production of “I’m a Celebrity …”*

  Some are considered environmental risks, others just antisocial – and whether they are antisocial at all is often subjective.

- **Companies suffer major financial damage by single accidents, decisions or <u>events</u>:**
  - *Cruise lines*
  - *Mineral water bottlers*
  - *Pharmaceutical manufacturers*
  - *Jewellers*
  - *Banks*
  - *Oil companies*

  The event may be a consequence of the business, but not an expected outcome

“antisocial activities”

- *Cigarette manufacturing*
- *Coal mining*
- *Fur Farming*
- *Weapons manufacturing*
- *Alcohol marketing*
- *Nuclear power generation*
- *Commodity or CDS trading*
- *Production of “I’m a Celebrity …”*

- These activities are fundamental to the business the companies do
  - The risk is not that the activities happen, but:-
    - that the activity becomes (legally) unacceptable; or
    - that constraints on the business make it uneconomic; or
    - outrage by minorities makes the business not worth continuing.

- Judging the risk is very difficult – more political than environmental:-
  - Generally subjective – why ban mink farming but not sheep farming?
  - Can be acceptable to the majority, but a sufficiently aggressive minority can win
  - Society has to balance between the need for a product and consequences of supplying it

- But in the meantime, the businesses can be very profitable for over half a century
  - Worth lending money to – though NGOs may not be happy
    - ***BAT*** *EV ~ £70bn* *D ~ £10bn* *BBB+*

“events”

- *Cruise lines*
- *Airlines*
- *Pharmaceutical manufacturers*
- *Jewellers*
- *Banks*
- *Oil companies*

- Events should not occur, but will (with low probability and maybe at random)
  - It can happen to almost any type of business
  - It can be of many types
    - environmental, reputational, safety, financial, etc.
  - Often possible to predict from history the overall damage
    - but public response can change dramatically depending on many things
  - Very difficult to predict where it will happen
    - a significant element of chance for where, when and to whom it happens
    - “tail events” – so difficult to forecast
    - lessons will be learnt, so each event will be different to the previous ones
    - event should be independent of other things happening

Credit risk management

“antisocial activities”

- Is it really antisocial? Will society turn against it, or does society need the output?
- If the activity really is antisocial, society will eventually force change. The danger of change increases with time.
  - Tenor of debt is important – keep it short relative to society’s timetable
  - Key skill of not being fooled by whim or by either sides’ arguments
- Stay diversified across sectors – to restrict damage if you are wrong

“events”

- Stay diversified across companies – it can hit anywhere
- Imagine the size of the damage – is there equity to cover that damage?
  - How robust are companies to unexpected events?
  - Cash for liquidity, low gearing for solvency

Robust companies

No company can forecast the unknown. But the consequences of the unknown can be unpleasant:-

Liquidity – immediate problem

- Cash leaves the company to repair damage
- Long-term and short-term debt markets close
- Banks do not want to take credit risk
- Equity prices drop and equity markets are difficult, slow, and may close
- Reputation damage may mean income disappears
- Reputation and news stories may mean suppliers won't give credit

You need to have liquidity (cash, saleable assets) beforehand

Solvency – long-term problem

- Value leaves the company permanently
- Equity prices fall on reputation (recoverable), and on cost (not recoverable)

Gearing needs some slack for loss of equity value and possible debt raising