Arve Johnsen (left) had to resign as Statoil CEO November 1987 after cost overruns. The same had Harald Norvik spring 1999. But the consequences for Eldar Sætre, current CEO, after the spring impairments are difficult to spot, says the author. Photo (from left): Bjørn Sigurdåsen, NTB Scapix, Øyvind ELVSBORG and Klauða Lech read more

Opinions

Friday Chronicle

Sinners in the summer sun

If you first will lose money, then it is better to write down than to stride over.

Ola Kvale
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November 1987: CEO Arve Johnsen, Statoil must go after cost overruns of seven billion at the Mongstad refinery.

- Statoil board's decision to appoint a new CEO after Mongstad scandal was the only correct output on this matter, said the Conservatives' former chairman Jan P. Syse.

- Such overruns could not pass without consequences for those responsible, he continued, and received broad support.
Spring 1999: CEO Harald Norvik in Statoil goes after overruns 18 billion on the Åsgard field. Bondevik government throws Board and all parliamentary parties believe that remediation of Statoil's management is required As in 1987, the massive media coverage. Scandal Fountain commissioned.

Spring 2015: Statoil make write-downs of 46.1 billion, the majority related to investment in unconventional oil and gas fields in North America. No leaders must go. The politicians are silent. Large media mentions it barely. Critics consists of a handful of oil analysts, who reminds us that the total write-downs last year and a half is 73 billion (!).

What caused these contrasts between 1987 and 1999 on one side, and 2015 on the other? There could be many reasons; not least amended IPO in 2001 the model for corporate governance and monitoring. But I will here point out another factor, namely the difference between overruns and impairments. There are several reasons why the former are perceived as more serious than the latter. No reason is good.

Imagine following two prospects:

A. You invest 100. You will get back 150. But with 20 percent probability must pay 100 extra.
B. You invest 100. With 80 percent probability get back 150. With 20 percent probability you get back 50.

Both prospects are the 80 percent probability that you win 50, and 20 percent probability that you lose 50. However, despite the relative loss is greatest in B, the loss in A more painful. It's worse to have to fork out more than you intended, as in exceedence in A, than to just take an abstract loss, as in the depreciation B. Transgressions are more tangible, a loss most people can relate to. The impairment however, it is a dry and technical affair.

But it is not only this so-called "framing effect" that makes the transgression worse than impairment. The reasons for the overrun is apparently different from the causes of impairment. In the former, there is something in the organization that has gone wrong. Lack of control, short project planning, poor monitoring, and so on.

In the latter, the impairments, there is no organization and the people in it who gets the blame. Then it is the market and its invisible hands that makes one just needs to take losses into consideration. Oil prices are falling, assets lose value, one must write down, walk out, get a grip, look ahead. By linking write-downs to market conditions, it is simply easier to wriggle out of responsibility.

Disclaimer market characteristics have been documented in several experiments. Among other things shown that market mechanisms undermines people and companies willingness to take responsibility for decisions that lead to other losses.

But the disclaimer is not necessarily correct. Impairments due to market failure often come in the wake of poor decisions. Decisions which not only appears bad in hindsight, but that never ever has been favorable.

An authorative study of Ilzhak Ben-David, John Graham and Campbell Harvey shows that American executives and CFOs make systematic errors when considering their own and others investment projects. They are over-optimistic, and they underestimate the uncertainty in the stock market in general and in their own investment projects. If they are asked to create a price range that they are 80 percent confident that a security will fall within, as they hit only 53 percent of cases.

Scientists also point out that directors "over-confidence", ie exaggerated belief in their own reviews, the extra high because the risk appetite and consequent lack is selected in prominent positions, and in addition has rarely made painful loss experiences.

It is hard to believe that Statoil impairments spring 2015 is not a result of the kind of over-confidence described herein. But the consequences for leaders who have been responsible for a billion losses are difficult to spot. The write-downs came typically after Helge Lund had abandoned ship.

The media yawned and wrote rather about the new CEO's green commitment. And now it's summer.

Ola Kvaale. Professor of Economics, Business School at the University of Stavanger and NHH

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