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The effect of ESG criteria on company valuation: A quantitative approach applied to the O&G Company

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Abstract

The integration of ESG criteria means that they are explicitly introduced into valuation models and investment decisions. Socially Responsible Investment (SRI) does not take this integration into account, then there is a need to know the real impact that ESG criteria have on stock valuation to carry out effective investment decisions. This need increases when dealing with highly controversial sectors such as the O&G industry. The approach used is the Value Drivers Adjustment (VDA) through the Discount Cash Flow (DCF) model, allowing the selection and valuation of those material ESG criteria that have the greatest impact on the valuation of the business model. Shell PLC has been selected for the analysis as one of the most influential players in the energy transition within the O&G industry. The results reveal that the introduction of ESG criteria in Shell's valuation increases the target price by 5%. The company's competitive position as well as its response to ESG criteria explain these results. A more exhaustive valuation method is thus achieved, where ESG criteria cease to be complementary information and become indirect financial items.

Keywords: Discount Cash Flow, Energy transition, Shell PLC, Socially Responsible Investment, Stock valuation.