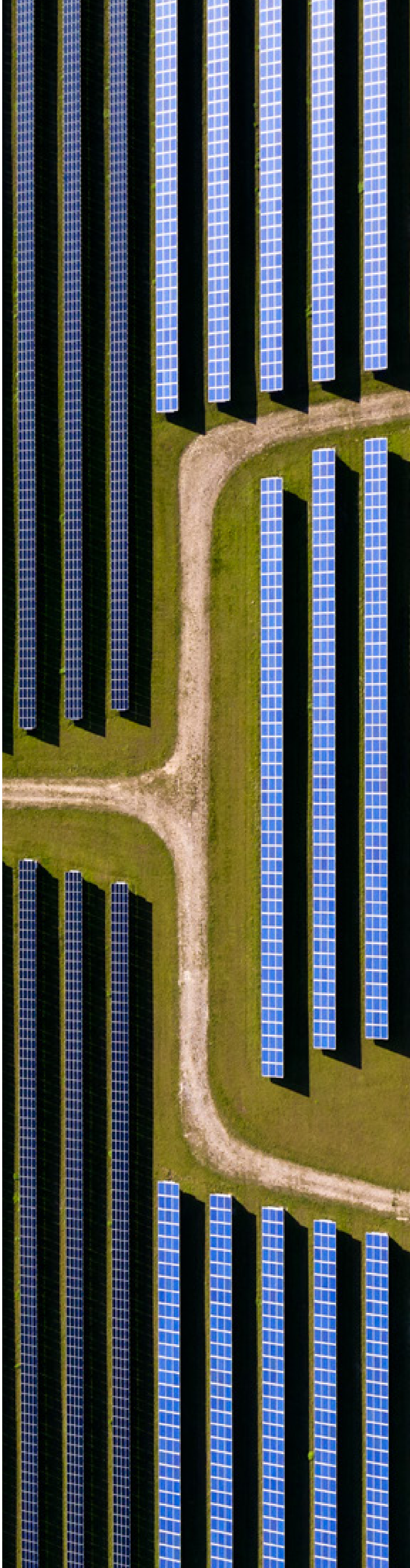
SpencerStuart

Energy Practice

Eyeing renewables

Oil and gas majors start bridging the gap to renewable energies



Executive summary

A green revolution is shaking up the global energy sector. There is a clear market opportunity that needs to be addressed and pressure from investors and stakeholders will only increase with time. Leaders of oil and gas companies seeking to create value in renewables will need to do the following:

1. Be attractive to top talent

Oil and gas companies already have many of the skills and capabilities necessary to be successful in renewables. However, there are some areas in which companies will need to acquire additional leadership talent. Companies will have to invest in best-in-class talent. The energy transition will only happen if the right people are in place to oversee it.

2. Create a more nimble culture

Energy transition and culture change go hand-in-hand. The strategic shift towards renewables requires an entrepreneurial, fail-fast-and-learn culture and a purpose-driven workforce. Leaders will need to have a clear understanding of the current culture and be able to articulate the desired, target culture in order to make the strategy work.

3. Acquire and integrate new businesses

Despite efforts to retrain and redeploy existing talent, oil and gas companies may find they can only transition quickly enough through acquisition. As businesses are acquired and new talent comes into the organization, creating synergies and ensuring successful execution will require seamless integration.

Oil and gas majors are uniquely placed to take advantage of the growth in renewable energies, but to make a success of the energy transition they will need to increase their attractiveness to top-quality, next-generation talent, develop more nimble cultures, and acquire and successfully integrate new businesses.

In 2015, 195 countries agreed to reduce greenhouse gas emissions to stop global temperatures rising by more than 1.5-2°C above pre-industrial levels at the landmark UN climate change meeting in Paris. This marked a turning point for the oil industry. The carbon-heavy fuel is responsible for around a third of current emissions and its replacement by electricity and clean energies will be crucial to meet this global target.

The speed of change will depend on how regulatory bodies, the community and markets react to the global warming issue and will vary according to geography. Recent reports from the Intergovernmental Panel on Climate Change (IPCC) stress the world is not doing enough to avoid a climate crisis. Young climate ambassadors, such as Sweden's Greta Thunberg, and new global movements, like Extinction Rebellion, are keeping up the pressure.

Oil production is expected to continue rising over the next decade in line with demand, but the oil and gas sector's long-term outlook is challenging from both a financial and human capital perspective. Between 2009 and 2019 the number of oil and gas companies in the S&P 500 fell from 39 to 29 and the sector's proportion of market cap declined from 11.9% to 5.1%.[1]

The financial markets are voicing their impatience and applying serious pressure. The growing focus on environmental, social and governance (ESG) issues means that a reduction in investment is inevitable. In his January 2020 letter to CEOs, BlackRock CEO Larry Fink declared that "in the near future — and sooner than most anticipate — there will be a significant reallocation of capital." Human capital is a major concern, too; it is proving more difficult to attract the best talent into the industry.

Oil and gas companies are starting to respond, making pledges to achieve carbon neutrality in existing operations, but they will need to adapt to a new landscape in which growth is weighted towards the power value chain, in particular renewable energies. Some oil and gas majors are starting to shift into alternative energies but investments are still relatively small.[2] Annual reporting by oil and gas companies often disguises how little the level of investment is by combining renewables with investments in gas, the least carbon-intensive fossil fuel, or "other businesses".

Renewables do not yet have the scale to enable deployment of capital at a level that oil and gas companies are used to. Nor do they offer the same kind of returns. Finding an alternative business model that can deliver sufficient profits for investors poses a major dilemma for leaders in the oil and gas sector. New leadership skills will be necessary to tackle the energy transition effectively; few of today's oil and gas leaders will have been exposed to the low margins inherent in renewables or will be used to the speed of change needed. The metamorphosis of Dong into Ørsted shows what can be done, albeit on a smaller scale.

We talked to company executives from five major oil and gas companies about the challenges that lie ahead and their strategies to adapt to changing times.

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1 Spencer Stuart research
2 According to Wood Mackenzie, "the Majors spent less than 5% on renewables strategies between 2016-2018". https://www.woodmac.com/news/feature/can-women-speed-up-the-energy-transition/

How Covid-19 is affecting the energy transition

While it is still early to be able to determine what impact the Covid-19 crisis will have on the speed and extent of the transition to renewables, a mixed picture is emerging across the globe.

On the one hand, energy transition has fallen out of the spotlight, ceasing to be quite the political priority it was before the crisis began. On the other hand, falling oil prices have resulted in investors showing more support for the transfer of investments to renewables, comforted by the double-digit returns available.

What is clear is that the Covid-19 crisis will accentuate regional differences in the energy transition. In Europe, for example, many governments are prioritizing support for renewables as part of their economic recovery plans, bolstered by the EU's Green Deal roadmap. In the US, decarbonization is far less federal government-driven. For governments in developing countries, energy transition is bound to drop down the order of priorities as they tackle Covid-related increases in poverty and starvation.

Most oil and gas leaders are agreed that widespread progress towards renewables will be largely dependent on inter-governmental collaboration over carbon pricing.

Eyeing renewables

Oil and gas majors are adopting a range of strategies to adapt to a net carbon-zero future. These plans involve reducing direct emissions from their own operations, capturing carbon (either naturally in forests, for example, or through capture and storage technologies) and increasing the share of lower or zero emission energies, such as gas and renewables, in their portfolios.

"Our strategy needs to both satisfy increasing energy demand and lower emissions. We designed an industrial strategy to 2050 that will see our company as a leader in the market, to which it will supply decarbonised energy products, thus actively contributing to the energy transition," says Claudio Descalzi, CEO of Italy's Eni, a multinational energy company. The first step is to replace coal with gas in the power sector and also to invest in R&D to provide "clean" fossil fuels and "continuous" renewables, he says. Gas-fired power plants will be necessary to support intermittent renewables, like photovoltaic panels and turbines which depend on sunlight or windy conditions, according to Descalzi.

"We see our role as helping the energy transition along," says Maarten Wetselaar, Integrated Gas and New Energies Leader for Dutch group Shell. The company is assisting the transition to electrification and renewables by scaling up charging facilities for electric and hydrogen vehicles at its petrol stations, he says. Like Eni, the company also includes power generation from low-emission sources such as wind and solar as well as natural gas in its portfolio.

Other oil and gas producers, such as Brazil's state company Petrobras, which has one of the world's largest oil and gas reserves, are focused on improving the efficiencies of their core O&G business. But it is keeping a close eye on breakthrough technologies, such as energy storage, that might change the fuel-demand scenario, says Anelise Lara, the company's EVP for Downstream, Gas and Energy.

The share of power generation from renewables is expected to rise from 25% today to around 40% in 2040, according to the International Energy Agency.

25% → 40%

today → in 2040

As photovoltaic solar and wind energy technologies have improved and costs have dropped, they are becoming increasingly attractive investments. Meanwhile, demand for electricity — increasingly generated by renewables — is growing faster than for other fuels, driven by buildings, transport and industry.[3] If O&G companies do not make the transition into these sectors, other competitors, such as tech companies, will enter the renewables and electric utility business.

Lord Browne, executive chairman of L1 Energy and chairman of the supervisory board of DEA, believes that every effort will be made to get rid of hydrocarbons where possible, especially in the West, but for the industry to fully embrace energy transition it has to have the right signals. "What's missing is public policy," he says. "So, shall we or shall we not charge people for emitting carbon into the atmosphere, either by way of taxes, requirement for permits, regulation, or outright prescription? I do think carbon will be taxed very severely."

A nimble culture

The speed and depth of technological and disruptive change — including renewables but also increased electrification and the digital revolution — is transforming the energy sector. The right culture will help oil and gas companies position themselves for the energy transition and to implement a strategic shift into renewables and the electric utility sector.

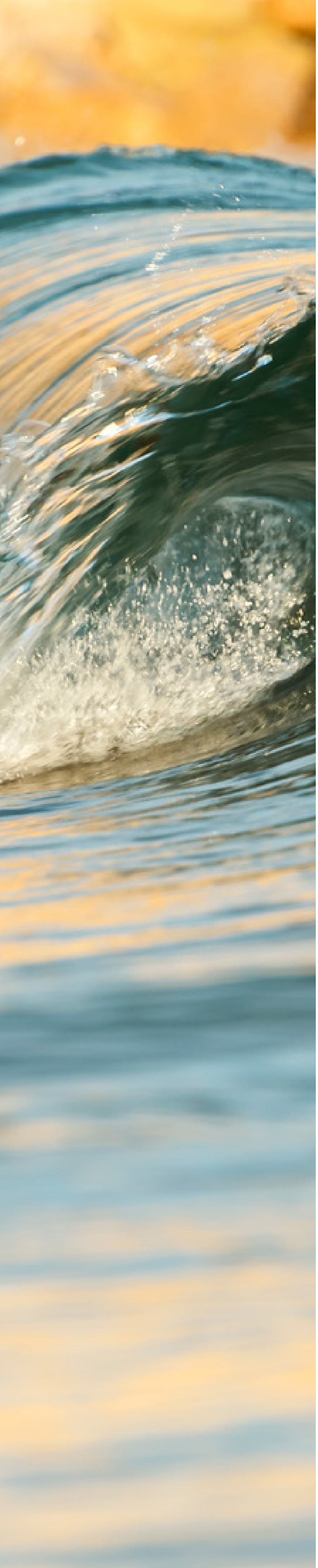
"The energy world is evolving in an accelerated manner and there is clear discontinuity ahead," says Philippe Sauquet, the president of Gas, Renewables and Power at French multinational Total. The lack of certainty means the industry needs people "who are not afraid of jumping into the water" and taking gambles, he says. Total's 'Pioneer Spirit' value encourages this kind of bold thinking, according to Sauquet. The French major aims for its low-carbon business to account for almost 20% of its portfolio within 20 years and is investing in solar, wind and hydraulic power as well as in energy storage technology. The Covid-19 crisis and the accompanying fall in the price of oil have not interrupted Total's long-term strategy for energy transition. Since the crisis began it has announced its ambition to get to net-zero emissions by 2050 and has entered several new partnerships and acquisitions in utilities, wind and solar.

The right culture will help oil and gas companies position themselves for the energy transition and to implement a strategic shift into renewables and the electric utility sector.

In today's energy maelstrom, "we need an agile, learning, entrepreneurial culture," says Dev Sanyal, CEO Alternative Energy, for British oil and gas multinational BP. The main challenges will be integrated energy systems and far greater consumer control, forcing business models to change across the market, according to Lightsource BP's chief strategy officer, James Brooks.

Digitalization, distributed generation (small generation units rather than centralized systems), and the zero marginal costs of clean energies will change consumer behavior: companies will need to analyze how. Ultimately, it will boil down to what technology saves the customer the most money and is the easiest to use, the two BP executives agree.

3 Fueling the energy transition: Opportunities for financial institutions, McKinsey & Company, May 2019. https://www.mckinsey.com/industries/electric-power-and-natural-gas/our-insights/fueling-the-energy-transition-opportunities-for-financial-institutions



Oil and gas companies that prioritize learning and agility as core cultural traits will be better placed to face the future.

An early champion of renewables under Lord John Browne, who ran the company between 1995 and 2007, today BP is focused on biofuels, biopower, wind energy, solar energy, renewable products and digital energy. The oil and gas and renewables industries are not so different, Sanyal argues. “Renewables has a very similar culture: to succeed, you need scale, great project execution and risk management skills.” Meanwhile, at the customer-focused end of the business, selling electricity or hydrogen at filling stations is similar to selling petrol (although margins are low). Sales of renewables are mostly into regulated markets with marginal upside, requiring even more discipline in project execution.

Brazilian giant Petrobras is preparing for the energy transition by creating a more agile, transparent and market-focused culture. It is encouraging the regeneration of the organization through specific lay-off programs offering incentives and directly hiring talent for managerial positions and above. This is creating a significant cultural change, says Lara, the company’s EVP for Downstream, Gas and Energy.

In these fast-moving times, a fail-fast-and-learn culture would help companies respond to a less predictable and more complex business environment. Oil and gas companies that prioritize learning and agility as core cultural traits will be better placed to face the future.

This may require a cultural change that starts from the top including mission statements that clearly express the vision and path to a low-carbon future. Enlightened, purpose-driven people, who want their companies to drive the solution to climate change, will need to be represented on boards of directors and in senior management positions. Otherwise O&G companies may find events overtaking them.

Critical skills

The oil and gas sector is a highly specialized industry characterized by major capital expenditures, long lead times, difficult operating conditions and the need to manage significant safety and environmental risks.

Despite clear differences between the exploration and production cycle of an oil or gas field and that of a wind turbine or solar farm, there are nevertheless plenty of overlaps in terms of capabilities — for example in project execution, risk management, marketing and trading. "There are lots of synergies for an oil and gas company used to building offshore platforms that is looking to build wind farms offshore -- lots of expertise that could be redeployed,” says Lord Browne. “But here's the problem: it's just a different business, different supply chain, different market, different contracting to market. You'd better be good at it and you need many more entrepreneurial skills. Right now, it's a grand experiment. Unfortunately, the track record of diversification is very poor for large resource-based companies."

Because of these differences in technologies, markets, players and returns, oil and gas companies will have to attract additional capabilities if they are to compete strongly in the broad renewables segment — for example in the areas of technology, finance and deal structuring. They will need to use financial leverage to enhance the returns available in power generation; when applied to renewables, the metrics used by oil and gas companies will not deliver sufficient return on equity.

"Competence, passion, inclusiveness and listening skills are critical skills to lead the change," says Descalzi. Through transparent, strong communications, leadership must create a sense of "ownership" among employees to develop commitment to the company's values and strategy as well as to encourage participation, according to the Eni CEO. The development of interdisciplinary skills and an overall vision of the energy transformation context will help companies seize and even anticipate the opportunities brought by change.

Oil and gas company executives agree that digital skills and expertise in the decarbonization of the energy system are crucial. Digital capabilities will be a very important enabler as software solutions will be a core part of new business models, says Shell's Wetselaar.

Oil and gas companies tend to be focused on large-scale upstream projects. As direct-to-consumer activity increases and consumer choice grows, client-based skills used in B2B and retail will also be required. Among other capabilities, oil and gas companies will be looking for product developers to reduce the intermittency of renewables (ranging from creating storage systems to financial hedge products); data analysts and engineers; and financing specialists to create a differentiated cost of capital, he says.

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In-house nurturing or buying the skills?

Oil and gas companies are using a variety of mechanisms to obtain the skills they need for the energy transition.

Italian multinational Eni prefers to organically develop internal capacities. "The company's first priority is to enhance and value its internal skills," says Descalzi. These capabilities are built with time and dedication, aligned with business objectives, and guided by the new opportunities offered by the latest technologies deployed by the company, and by digitalization, he says. The company promotes interdisciplinary skills and a broad understanding of the energy sector by encouraging the mobility of people between Eni's different business areas.

The company fills competence gaps by upskilling or retraining employees but also by implementing turnover plans, according to Descalzi. Eni works with universities to ensure the development of the new professional profiles required; it has also created a network of partnerships with academic institutions to promote synergies and the cross fertilization of skills. Targeted hiring is used to fill specific roles, especially in the renewables and digital space.

Likewise, Total's organization is driven by sourcing and training executives to become the next leaders, with succession plans in place for the next 5-10 years. "We manage the company so that we generate our own future leaders," says Sauquet. External hiring is focused on under-35-year-olds and working with universities to attract young talent by offering development opportunities.

Older, experienced employees are brought into the company via acquisitions, according to Total's head of Gas, Renewables and Power. For example, Total's acquisition in 2018 of a 73% stake in Direct Énergie gave the company an important share in the French retail electricity market. This allowed it to enter the business-to-consumer utility market, gain a critical mass and manage millions of clients, says Sauquet. "These acquisitions are also a means to attract talents."

British multinational BP forms partnerships to build on its own skills in the areas of project execution, risk management and trading. In 2017, it acquired a 43% stake in Lightsource Renewable Energy (now Lightsource BP), Europe's largest solar developer, with an investment of US$200 million. Other alliances include a battery-storage venture with Tesla at one of its US windfarms and a biofuels joint venture in Brazil with US agri-commodities giant Bunge. "We bring capital, sizeable financing and project execution capabilities and form alliances that allow us to scale up our alternative energies business," says BP's Sanyal.

Conclusion

A green revolution is shaking up the global energy sector. Electrification and renewables are expected to replace fossil fuels as the cornerstones of future energy systems, providing an answer not only to climate change but also pollution. There is a clear market that needs to be addressed and pressure from investors and stakeholders will only increase with time.

Leaders of oil and gas companies seeking to create value in renewables will need to do the following:

1. Be attractive to top talent

Oil and gas companies already have many of the skills and capabilities necessary to be successful in renewables. However, there are some areas in which companies will need to acquire additional leadership talent, namely in digital and data analytics, downstream markets, deal structuring & corporate development. With thinner margins available in renewables, companies will have to invest in best-in-class talent and provide a purpose-driven culture that attracts millennials.

2. Create a more nimble culture

Energy transition and culture change go hand-in-hand. The strategic shift towards renewables requires an entrepreneurial, fail-fast-and-learn culture and a purpose-driven workforce. Leaders will need to have a clear understanding of the current culture and be able to articulate the desired, target culture in order to make the strategy work.

3. Acquire and integrate new businesses

Despite efforts to retrain and redeploy existing talent, oil and gas companies may find they can only transition quickly enough through acquisition. As businesses are acquired and new talent comes into the organization, creating synergies and ensuring successful execution will require seamless integration. In addition to developing a single, coherent culture, companies will need to assess the suitability and cultural fit of their senior executives and invest in enhancing the effectiveness of senior leadership teams.

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