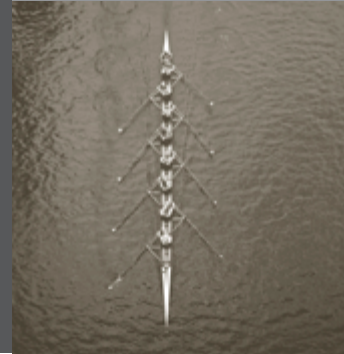


Organizational Restructuring within the Royal Dutch Shell Group

case 8



At the beginning of 2000, the Royal Dutch Shell Group of Companies (Shell) was emerging from one of the most ambitious and far-reaching organizational restructurings of its 93-year history. The restructuring had involved the shift from a geographically based to a business sector-based structure, the elimination of over 1,000 corporate positions, the sale of much of its London headquarters, and the redesign of its systems of coordination and control. The restructuring had been precipitated by the realization that Shell would need to change the way it did business if it was to retain its position as the world's largest petroleum company and offer an adequate return to shareholders in an increasingly turbulent industry environment.

By the end of 1999, it was clear that the changes were bearing fruit. Head office costs had been reduced and the increased coordination and control that the new sector-based organization permitted were helping Shell to control costs, focus capital expenditure, and prune the business portfolio. Return on capital employed (ROCE) and return on equity (ROE) for 1999 were their highest for ten years. However, much of the improvement in bottom-line performance was the result of the recovery in oil prices during the year. Once the benefits of higher oil prices were stripped out, Shell's improvements in financial performance looked much more modest.

At the same time, Shell's competitors were not standing still. BP, once government-owned and highly bureaucratized, had become one of the world's most dynamic, profitable, and widely admired oil majors. Its merger with Amoco quickly followed by its acquisition of Atlantic Richfield had created an international giant of almost identical size to Shell. In the meantime, Shell's longtime archrival, Exxon, was merging with Mobil. Shell was no longer the world's biggest energy company – its sales revenues lagged some way behind those of Exxon Mobil. Other oil and gas majors were also getting caught up in the wave of mergers and restructurings. In particular, Shell's once-sluggish European rivals

were undergoing extensive revitalization. The merger of Total, Fina, and Elf Aquitaine in September 1999 had created the world's fourth "super-major" (after Exxon Mobil, Shell, and BP). Also asserting itself on the world stage was Italy's recently privatized Eni SpA.

The reorganization that had begun in 1994 under chairman of the Committee of Managing Directors, Cor Herkstroter, and continued under his successor, Mark Moody-Stuart, had transformed the organizational structure of Shell. From a decentralized confederation of over 200 operating companies spread throughout the world, a divisionalized group with clear lines of authority and more effective executive leadership had been created. Yet, Shell remained a highly complex organization that was a prisoner of its own illustrious history and where corporate authority remained divided between The Hague, London, and Houston. Had enough been done to turn a sprawling multinational empire into an enterprise capable of deploying its huge resources with the speed and decisiveness necessary to cope with an ever more volatile international environment?

History of the Royal Dutch Shell Group

The Royal Dutch Shell Group is unique among the world's oil majors. It was formed from the 1907 merger of the assets and operations of the Netherlands-based Royal Dutch Petroleum Company and the British-based Shell Transport and Trading Company. However, the two parents remained legally separate corporations. It is the world's biggest and oldest joint venture. Both parent companies trace their origins to the Far East in the 1890s.

Marcus Samuel inherited a half share in his father's seashell trading business. His business visits to the Far East made him aware of the potential for supplying kerosene from the newly developing Russian oilfields around Baku to the large markets in China and the Far East for oil suitable for lighting and cooking. Seeing the opportunity for exporting kerosene from the Black Sea coast through the recently opened Suez Canal to the Far East, Samuel invested in a new tanker, the *Murex*. In 1892, the *Murex* delivered 4,000 tons of Russian kerosene to Bangkok and Singapore. In 1897, Samuel formed the Shell Transport and Trading Company, with a pecten shell as its trademark, to take over his growing oil business.

At the same time, August Kessler was leading a Dutch company to develop an oilfield in Sumatra in the Dutch East Indies. In 1896, Henri Deterding joined Kessler and the two began building storage and transportation facilities and a distribution network to bring their oil to market.

The expansion of both companies was supported by the growing demand for oil resulting from the introduction of the automobile and oil-fueled ships. In 1901 Shell Transport and Trading began purchasing Texas crude, and soon both companies were engaged in fierce competition with John D. Rockefeller's Standard Oil. Faced with the might of Standard Oil, Samuel and Deterding (who had succeeded Kessler as chairman of Royal Dutch) began cooperating, and in 1907 the business interests of the two companies were combined into a single group, with Royal Dutch owning a 60% share and Shell Transport and Trading a 40% share (a ratio that has remained constant to this day).

The group grew rapidly, expanding East Indies production and acquiring producing interests in Romania (1906), Russia (1910), Egypt (1911), the US (1912),

Venezuela (1913), and Trinidad (1914). In 1929 Shell entered the chemicals business, and in 1933 Shell's interests in the US were consolidated into the Shell Union Oil Corporation. By 1938, Shell crude oil production stood at almost 580,000 barrels per day out of a world total of 5,720,000.

The post-war period began with rebuilding the war-devastated refineries and tanker fleet, and continued with the development of new oilfields in Venezuela, Iraq, the Sahara, Canada, Colombia, Nigeria, Gabon, Brunei, and Oman. In 1959, a joint Shell/Exxon venture discovered one of the world's largest natural gas fields at Groningen in the Netherlands. This was followed by a series of major North Sea oil and gas finds between 1971 and 1976.

During the 1970s, Shell, like the other majors, began diversifying outside of petroleum:

- In 1970 it acquired Billiton, an international metals mining company, for \$123 million.
- In 1973 it formed a joint venture with Gulf to build nuclear reactors.
- In 1976–7 it acquired US and Canadian coal companies.
- In 1977 it acquired Witco Chemical's polybutylene division.

By the beginning of the 1980s, Shell had built global metals and coal businesses and established several smaller ventures including forestry in Chile and New Zealand, flower growing in the Netherlands, and biotechnology in Europe and the US.

The 1980s saw a reversal of Shell's diversification strategy, with several divestments of "non-core businesses" and a concentration on oil and gas – especially upstream. One of Shell's major thrusts was to increase its presence within the US. After acquiring Beldridge Oil of California, it made its biggest investment of the period when it acquired the minority interests in its US subsidiary Shell Oil for \$5.4 billion.

Shell's Organization Structure Prior to 1995

Shell's uniqueness stems from its structure as a joint venture and from its internationality – it has been described as one of the world's three most international organizations, the other two being the Roman Catholic Church and the United Nations. However, its organizational structure is more complex than either of the other two organizations. The structure of the Group may be looked at in terms of the different companies that comprise Royal Dutch Shell and their links of ownership and control, which Shell refers to as *governance responsibilities*. The Group's structure may also be viewed from a management perspective – how is Royal Dutch Shell actually managed? The day-to-day management activities of the Group, which Shell refers to as *executive responsibilities*, are complex, and the structure through which the Group is actually managed does not correspond very closely to the formal structure.

The Formal Structure

From an ownership and legal perspective, the Royal Dutch Shell Group of Companies comprised four types of company:

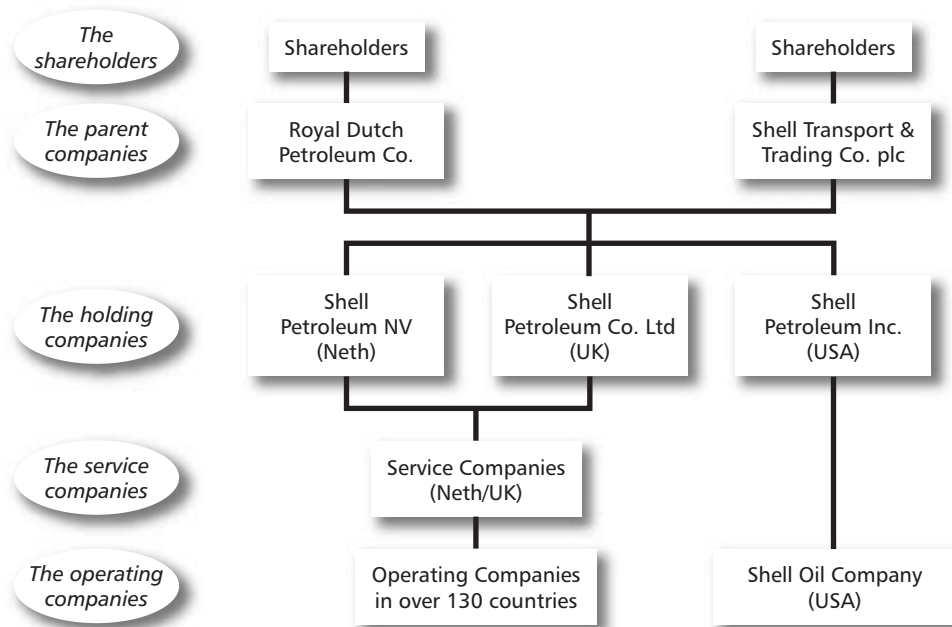
- *The parent companies.* Royal Dutch Petroleum Company N.V. of the Netherlands and the Shell Transport and Trading Company plc of the UK owned the shares of the group holding companies (from which they received dividends) in the proportions 60% and 40%. Each company had its shares separately listed on the stock exchanges of Europe and the US, and each had a separate Board of Directors.
- *The group holding companies.* Shell Petroleum N.V. of the Netherlands and The Shell Petroleum Company Ltd of the UK held shares in both the service companies and the operating companies of the Group. In addition, Shell Petroleum N.V. also owned the shares of Shell Petroleum Inc. of the US – the parent of the US operating company, Shell Oil Company.
- *The service companies.* During the early 1990s, there were nine service companies located either in London or The Hague. They were:
 - Shell Internationale Petroleum Maatschappij B.V.
 - Shell Internationale Chemie Maatschappij B.V.
 - Shell International Petroleum Company Limited
 - Shell International Chemical Company Limited
 - Billiton International Metals B.V.
 - Shell International Marine Limited
 - Shell Internationale Research Maatschappij B.V.
 - Shell International Gas Limited
 - Shell Coal International Limited.

The service companies provided advice and services to the operating companies but were not responsible for operations.

- *The operating companies* (or “opcos”) comprised more than 200 companies in over 100 countries (the 1993 annual report listed 244 companies in which Shell held 50% or more ownership). They varied in size from Shell Oil Company, one of the largest petroleum companies in the US in its own right, to small marketing companies such as Shell Bahamas and Shell Cambodia. Almost all of the operating companies operated within a single country. Some had activities within a single sector (exploration and production (E&P), refining, marketing, coal, or gas); others (such as Shell UK, Shell Canada, and Norske Shell) operated across multiple sectors. Figure 8.1 shows the formal structure of the Group.

Coordination and Control

Managerial control of the Group was vested in the Committee of Managing Directors (CMD), which forms the Group’s top management team. The Committee comprised five Managing Directors. These were the three-member Management Board of Royal Dutch Petroleum and the Chairman and Vice Chairman of Shell Transport and Trading. The chairmanship of CMD rotated between the President of Royal Dutch Petroleum and the Managing Director of Shell Transport and Trading. Thus, in 1993, Cor Herkstroter (President of Royal Dutch) took over from J. S. Jennings (Managing Director of Shell Transport and Trading) as Chairman of CMD, and Jennings became Vice Chairman of CMD. Because executive power was vested in a committee rather than a single chief executive, Shell lacked the strong individual leadership that characterized other majors (e.g., Lee Raymond at Exxon and John Browne at BP).

FIGURE 8.1 The formal structure of the Royal Dutch Shell Group

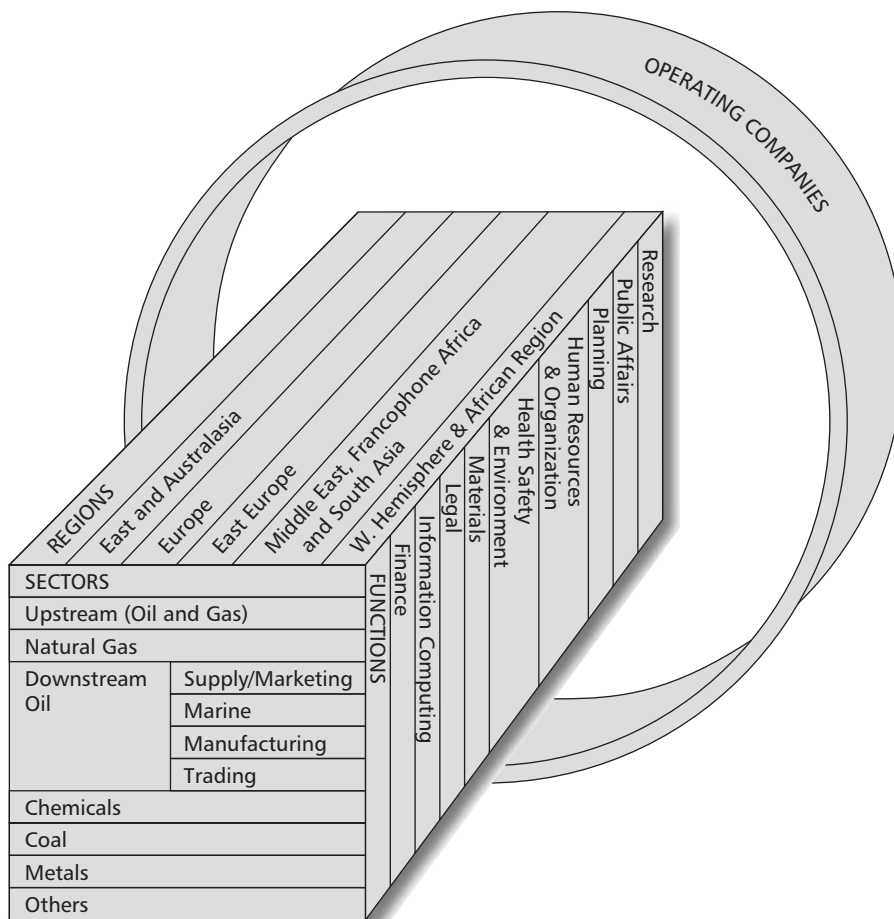
The CMD provided the primary linkage between the formal (or *governance*) structure and the management (or *executive*) structure of the Group. The CMD also linked together the two parent companies and the group holding companies.

The combination of diffused executive power at the top together with operating authority and financial responsibility dispersed through 244 operating companies meant that, compared with every other oil major, Shell was highly decentralized. However, the technical and economic realities of the oil business limited the autonomy of each operating company – interdependence resulted from linkages between upstream and downstream, between refining and chemicals, and from common financial and technological needs. It was the job of the service companies to provide the necessary coordination. During the early 1960s, Shell created, with the help of McKinsey & Company, a matrix structure within its service companies to manage its operating companies. This structure was viewed as a critical ingredient of Shell's ability to reconcile the independence of its operating companies with effective coordination of business, regional, and functional commonalities. This matrix organization continued into the 1990s (see figure 8.2).

The three dimensions of this matrix were represented by the principal executives of the service companies, who were designated “coordinators.” Thus, the senior management team at the beginning of 1995 included the following:

Committee of Managing Directors

- Chairman
- Vice Chairman
- three other Managing Directors.

FIGURE 8.2 The Shell Matrix (pre-1996)

Principal executives of the service companies

- Regional coordinators:
 - Europe
 - Western Hemisphere and Africa
 - Middle East, Francophone Africa, and South Asia
 - East and Australasia
- Sector coordinators:
 - E&P Coordinator
 - Chemicals Coordinator
 - Coal/Natural Gas Coordinator
 - Metals Coordinator
 - President – Shell International Trading
 - Marine Coordinator
 - Supply and Marketing Coordinator

- Functional coordinators:
 - Director of Finance
 - Group Treasurer
 - Group Planning Coordinator
 - Manufacturing Coordinator
 - Group HR and Organization Coordinator
 - Legal Coordinator
 - Group Public Affairs Coordinator
 - Group Research Coordinator
 - Director of The Hague Office
 - Director of the London Office

Strategic Planning at Shell

Within this three-way matrix, the geographical dimension was traditionally the most important. The fact that the operating companies were national subsidiaries provided the basis for the geographical emphasis of operational and financial decision making. This was reinforced through the strategic planning process, which put its main emphasis on planning at the national and regional levels.

Shell's planning system lay at the heart of its management system. It was viewed as one of the most sophisticated and effective of any large multinational. It was much discussed and widely imitated. Its main features were the following:

- A strong emphasis on long-term strategic thinking. Shell's planning horizon extended 20 years into the future – much further than the four- or five-year planning that most companies engage in. Unlike most other companies, the basis for these strategic plans was not *forecasts* but *scenarios* – alternative views of the future that allowed managers to consider strategic responses to the different ways in which the future might unfold.
- A breadth of vision, and emphasis on the generation and application of ideas rather than a narrow focus on financial performance. Shell's planning department was receptive to concepts and ideas drawn from economics, psychology, biochemistry, biology, mathematics, anthropology, and ecology. As a consequence, Shell pioneered many new management techniques, including multiple scenario analysis, business portfolio planning, cognitive mapping, and the application of organizational learning concepts to planning processes.
- More generally, Shell was in the vanguard of the transition from the role of the strategy function as *planning* towards one where the primary roles of strategy were encouraging *thinking about the future*, developing the capacity for *organizational learning*, promoting *organizational dialogue*, and facilitating organizational *adaptation* to a changing world.

Planning at Shell was primarily bottom-up. The CMD identified key issues, set strategic direction, and approved major projects, and the planning department formulated the scenarios. However, most strategic decisions and initiatives originated among the operating companies. The role of the planning staff and the regional and sector coordinators was to coordinate the operating company strategic plans.

Forces for Change

Between the early 1970s and the early 1990s, the world petroleum industry was transformed by a number of fundamental changes.¹ The growing power of the producer countries was seen not just in the sharp rise in crude oil prices during the first oil shock of 1974, but even more fundamentally in the nationalization of the oil reserves of the international majors. By the 1990s, the list of the world's top 20 oil and gas producers was dominated by state-owned companies such as Saudi Aramco, Petroleos de Venezuela, Kuwait Oil, Iran National Oil Company, Pemex (Mexico), and Russia's Gasprom and Lukoil. In addition, the old-established majors faced competition from other sources. The "new majors," integrated oil companies such as Elf Aquitaine (France), Total (France), Eni (Italy), Nippon Oil (Japan), Neste (Finland), and Respol (Spain), were expanding rapidly, while in North America and the North Sea independent E&P companies such as Enterprise Oil, Triton, and Apache were becoming significant global players. Between 1970 and 1990, the share of world oil production of the "Seven Sisters" fell from 31% to 7%.² The loss of control over their sources of crude oil was a devastating blow for the majors – their whole strategy of vertical integration had been based around the concept of controlling risk through owning the downstream facilities needed to provide secure outlets for their crude oil. As market transactions for crude oil and refinery outputs became increasingly important, so prices became much more volatile. Between 1981 and 1986, crude prices fell from \$42 a barrel to \$9 before briefly recovering to \$38 in the wake of the Iraqi invasion of Kuwait, and then resuming their downward direction.

Between 1985 and 1993, almost all the world's oil majors underwent far-reaching restructuring. Restructuring involved radical simultaneous changes in strategy and organizational structure in a compressed time-frame. Key features of restructuring by the oil majors were:

- Reorienting their goals around shareholder value maximization.
- Greater selectivity in their strategies, involving the divestment of unprofitable businesses, refocusing around core petroleum and gas businesses, withdrawing from countries where investments were not justified by the returns being earned, and outsourcing those activities that could be performed more efficiently by outside suppliers.
- Cutting back on staff, especially at the corporate level. (Table 8.1 shows changes in numbers of employees among the majors.)
- Reducing excess capacity through closures of refineries and filling stations.
- Decentralization of decision making from corporate to divisional levels and from divisional to business unit levels at the same time as giving divisions and business units full profit and loss responsibility.
- Shifting the basis of organizational structure from geographical organization around countries and regions to worldwide product divisions (many of the majors formed worldwide divisions for upstream activities, downstream activities, and chemicals).
- "Delaying" through eliminating administrative layers within hierarchical structures. For example, Amoco broke up its three major divisions (upstream, downstream, and chemicals) and had 17 business groups reporting direct to

TABLE 8.1 Employment among the oil majors ('000)

	1985	1990	1993	1996	1999
Shell	142	136	117	101	99
Elf Aquitaine ^c	78	92	94	85	81
ENI	125	128	106	83	79
Exxon ^a	147	101	91	79	79
Total ^c	41	43	50	57	57
BP ^b	132	118	73	53	99
Mobil ^a	72	68	62	43	–
Amoco ^b	48	53	46	42	–
Chevron	62	50	48	41	39
Texaco	57	40	33	29	25
Arco ^b	31	28	25	23	17

^a Exxon merged with Mobil in 1998.

^b Amoco merged with BP in 1997. BP acquired Arco in 1999.

^c Total merged with Fina in 1998 and with Elf Aquitaine in 1999.

SOURCE: FORTUNE GLOBAL 500, 2000, 1997, 1994, 1991, AND 1986.

the corporate center. Mobil also broke up its divisional structure, and created 13 business groups. (The Appendix shows the organization structure of several of the majors.)

Shell in the Early 1990s

Shell was the only major oil company that did not undergo radical restructuring between 1985 and 1993. The absence of restructuring at Shell appeared to reflect two factors:

- Shell's flexibility had meant that Shell had been able to adjust to a changing oil industry environment without the need for discontinuous change. For example, Shell had been a leader in rationalizing excess capacity in refining and shipping, in upgrading its refineries with catalytic crackers, in establishing arm's-length relationships between its production units and its refineries, in moving into natural gas, and in taking advantage of opportunities for deep-water exploration.
- Because of Shell's management structure, in particular the absence of a CEO with autocratic powers, Shell was much less able to initiate the kind of top-down restructuring driven by powerful CEOs such as Larry Rawl at Exxon, Jim Kinnear at Texaco, Serge Tchuruk at Total, or Franco Bernabè at Eni.

Nevertheless, during the early 1990s, a combination of forces was pushing the CMD towards more radical top-down change. The most influential of these pressures was dissatisfaction over financial performance. The early 1990s were difficult years for the industry. The fall in oil prices to the mid-teens meant that returns from the traditional fount of profit – upstream – were meager. At the same time, refining and

TABLE 8.2 Royal Dutch Shell Group: performance data, 1992–9

	1992	1993	1994	1995	1996	1997	1998	1999
Gross sales (\$ bill.)	128.4	125.8	129.1	150.7	172.0	171.7	138.3	149.7
Operating profit (\$ bill.)	9.2	8.9	9.6	12.5	17.1	15.3	3.1	15.2
Net income (\$ bill.)	5.4	4.5	6.2	6.9	8.9	7.8	0.4	8.6
Cash flow from operations (\$ bill.)				14.9	16.6	16.7	14.7	11.1
ROCE (%)	9.0	7.9	10.4	10.7	12.0	12.0	2.8	12.1
ROE (%)	9.7	8.7	11.5	11.8	15.1	12.8	0.7	15.4
Capital expenditure (\$ bill.)	10.4	9.5	10.5	11.8	12.1	13.4	12.9	7.4
Employees ('000)	127	117	107	106	104	105	102	99

(The data are for continuing operations only. Hence, Shell's numbers of employees shown in table 8.1 differ from those here because of acquisitions and disposals.)

chemicals suffered from widespread excess capacity and price wars. Meanwhile, investors and the financial community were putting increased pressure on companies for improved return to shareholders. The CMD was forced to shift its attention from long-term development to short-term financial results. Against a variety of benchmarks, Shell's profit performance looked less than adequate:

- Cost of capital was the most fundamental of these – during the early 1990s Shell was earning a return on equity that barely covered the cost of equity.
- Long-term stability was a further goal. Top management asked, “What rate of return is needed to provide the cash flow needed to pay dividends and replace assets and reserves?” The returns of 1990–4 were somewhat below this figure.
- Shell's rates of return, margins, and productivity ratios were below those of several leading competitors.

Table 8.2 shows Shell's financial performance during the 1990s.

Evidence of the potential for performance improvement through restructuring was available from inside as well as from outside the Group. During the late 1980s and early 1990s, several Shell operating companies – notably those in Canada, the US, UK, South Africa, Germany, Malaysia, and France – showed the potential for organizational restructuring, process redesign, and outsourcing to yield substantial cost savings and productivity improvements.

The operating company executives that had been in the vanguard of cost cutting were increasingly resentful of the corporate structure. By 1994, Shell employed 6,800 people in its central organization (in London and The Hague) and in its corporate research and support functions. Even allowing for the differences in organizational structure between Shell and its competitors, this was bigger than the corporate and divisional administration of any other oil and gas major. As the operating companies struggled to reduce their own costs and improve their bottom-line performance, so they became antagonistic towards what they saw as a bloated corporate center whose support and services offered little discernable value. A major gripe was the failure of

Shell's elaborate matrix structure to provide effective coordination of the operating companies. Lack of coordination in Europe resulted in UK refineries selling into Spain and Portugal, the Marseilles refinery supplying Belgium, natural geographical units such as Scandinavia split between different operating companies, and difficulties in launching Europe-wide initiatives such as the Shell credit card.

As Chairman Cor Herkstroter noted:

Many Operating Companies are sending us clear signals that they feel constrained by the management processes of the Service Companies, that the support and guidance from them is ineffective or inefficient, and that the services are too costly. They do not see the eagerness for cost reductions in the Operating Companies sufficiently mirrored in the center.³

The essential issue, however, was to prepare Shell for an increasingly difficult business environment:

While our current organization and practices have served us very well for many years, they were designed for a different era, for a different world. Over the years significant duplication and confusion of roles at various levels in the organization have developed. Many of you notice this on a day-to-day basis.

We anticipate increasingly dynamic competition. We see the business conditions of today, with flat margins and low oil prices continuing into the future. In addition, there will be no let up on all players in the industry to strive for higher productivity innovation quality and effectiveness.

Our vision of the future is one of increasing competitive surprise and discontinuity, of increasing change and differentiation in skills required to succeed; and of increasing demands by our people at the front line for accountability within a framework of clear business objectives, and with access to a global source of specialist expertise.⁴

The Change Process

Within Shell, proponents of organizational change, including the heads of several of the operating companies, the finance function, and Group Planning, had had little success in persuading the Committee of Managing Directors of the need for large-scale change. In May 1993, Cor Herkstroter took over as Chairman of the CMD. A Dutch accountant, who had spent his entire career at Shell, Herkstroter was an unlikely pioneer of change. Fellow executives described him as a private, Old World personality without much charisma, and with a preference for written communication. Nevertheless, Herkstroter was widely respected for his intelligence and courage. "He's Shell's Gorbachev," said Philip Mirvis, a consultant working with Noel Tichy at Shell.⁵

Faced with growing evidence of suboptimal financial performance and an over-complex, inward-looking organizational structure, Herkstroter called a meeting of Shell's 50 top managers at Hartwell House, an English country manor, in May 1994. The meeting was a shock for the CMD. The request for frank discussions of the reasons for Shell's lagging return on capital provided a series of barbed attacks on top management and sharp criticism of the service company organization. The corporate center was castigated for taking months to approve operating company budgets and for the general laxness of financial controls. E&P coordinator Robert Sprague tossed a blank transparency onto the overhead projector and commented, "I don't know

what to report, this issue is really a mess.” The meeting had a powerful impact on the CMD: “We were bureaucratic, inward looking, complacent, self-satisfied, arrogant,” observed then Vice Chairman John Jennings. “We tolerated our own underperformance. We were technocratic and insufficiently entrepreneurial.”⁶ The outcome was the appointment of a high-level team to study Shell’s internal organization and come up with options for redesign.

The team, set up in July 1994, was headed by Ernst van Mourik-Broekman, the head of HR, together with Basil South from Group Planning, Group Treasurer Stephen Hodge, an executive from Shell France, and the head of Shell’s gas business in the Netherlands. The internal team was joined by three senior consultants from McKinsey & Company: two from the Amsterdam office and one from the London office.

The starting point for the internal team was a program of interviews with 40–50 managers at different levels within the company. This provided a basis both for assessing the existing structure and for generating ideas for change. The role of the McKinsey consultants was to provide perspective, to challenge the ideas of the Shell team, to introduce the experiences of other large multinationals (ABB for instance), to provide the backup research needed to refine and test out ideas and concepts, and to organize the program of work and consultation.

By October 1994, the group had prepared a diagnosis of the existing Shell structure together with a suite of options for reorganization. During October and November, a series of workshops was conducted, mainly in London, to explore in greater detail the specific dimensions of change and to clarify and evaluate the available options. Each workshop team provided input on a specific area of change. The results of this exercise were written up towards the end of November, and a report was submitted to the CMD. It identified the areas for change and the options.

During December 1994, the team spent two “away days” with the CMD to identify the objects of change and how the different options related to these. The result was a blueprint which the team wrote up mid-December. After six or seven drafts, the report was approved by the CMD during the weekend of Christmas. At the beginning of January, the report was circulated to the chief executives of the main opcos and the coordinators within the service companies with a request for reactions by the end of January. In the meantime, Chairman Herkstroter gave a speech, directed to all company employees, to prepare them for change, but without any specifics as to the organizational initiatives that were likely to occur.

The driving force behind the redesign was the desire to have a simpler structure with clearer reporting relationships, thereby allowing the corporate center to exert more effective influence and control over the operating companies. A simpler structure would help eliminate some of the cost and inertia of the head office bureaucracies that had built up around Shell’s elaborate committee system. There was also a need to improve coordination between the operating companies. This coordination, it was felt, should be based on the business sectors rather than geographical regions. Globalization of the world economy and the breakdown of vertical integration within the oil majors had meant that most of the majors had reorganized around worldwide business divisions. As was noted above, most of the majors formed upstream, downstream, and chemicals divisions with worldwide responsibility. For Shell, achieving integration between the different businesses within a country or within a region was less important than achieving integration within a business across different countries and regions. For example, in exploration and production, critical issues related to the

development and application of new technologies and sharing of best practices. In downstream, the critical issues related to the rationalization of capacity, the pursuit of operational efficiency, and the promotion of the Shell brand.

By the end of January, a broad endorsement had been received. In February a two-day meeting was held with the same group of Shell's 50 senior managers that had initiated the whole process some ten months earlier. The result was a high level of support and surprisingly little dissent. The final approval came from the two parent company Boards. On March 29, 1995, Cor Herkstroter, Chairman of the Committee of Managing Directors, gave a speech to Shell employees worldwide outlining the principal aspects of a radical reorganization of the Group, which were to be implemented at the beginning of 1996.

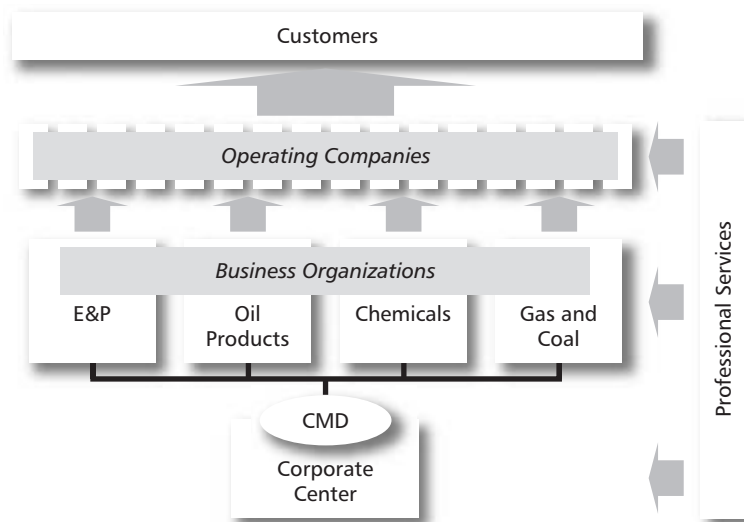
In the meantime, two totally unexpected events only increased the internal momentum for change. While Shell faulted itself on its ability to produce a return on capital to meet the levels of its most efficient competitors, in managing health, safety, and the environment and in responding to the broader expectations of society it considered itself the leader of the pack. Then came the Brent Spar incident. A carefully evaluated plan to dispose of a giant North Sea oil platform in the depths of the Atlantic produced outcry from environmental groups, including Greenpeace. Consumer boycotts of Shell products resulted in massive sales losses, especially in Germany. Within a few months, Shell was forced into an embarrassing reversal of its decision.

A few months later the Nigerian military regime executed Ken Saro-Wiwa, a prominent Nigerian author who had protested Shell's poor environmental record in his country. Again, Shell was found to be flat-footed and inept at managing its public relations over the incident. The handling of the Brent Spar and Nigerian incidents convinced many that Shell's top management was both unresponsive and out of touch. "We had to take a good look at ourselves and say, 'Have we got it right?'" said Mark Moody-Stuart, then a Managing Director. "Previously if you went to your golf club or church and said, 'I work for Shell,' you'd get a warm glow. In some parts of the world that changed a bit."⁷

The New Shell Structure

The central feature of the reorganization plan of 1995 was the dismantling of the three-way matrix through which the operating companies had been coordinated since the 1960s. In its place, four business organizations were created to achieve closer integration within each business sector across all countries. It was intended that the new structure would allow more effective planning and control within each of the businesses, remove much of the top-heavy bureaucracy that had imposed a costly burden on the Group, and eliminate the power of the regional fiefdoms. The new structure would strengthen the executive authority of the Committee of Managing Directors by providing a clearer line of command to the business organizations and subsequently to the operating companies, and by splitting central staff functions into a Corporate Center and a Professional Services Organization. The former would support the executive role of the CMD; the latter would provide professional services to companies within the Group. Figure 8.3 shows the new structure.

At the same time, the underlying principles of Shell's organizational structure were reaffirmed:

FIGURE 8.3 Shell's management structure, 1996

- The decentralized structure based on the autonomy of the Shell operating companies vis-à-vis the Group was to be maintained.
- The new structure continued the distinction between *governance* and *executive responsibility* which was described above. Thus, the formal structure of parent companies, holding companies, operating companies, and service companies was continued without significant changes. The Boards of these companies discharged the governance functions of the Group, including exercise of shareholder rights, the fulfillment of the legal obligations of the companies, and the appointment and supervision of the managers who fulfill executive responsibilities. It was the management structure where the major changes occurred, especially within the service companies.

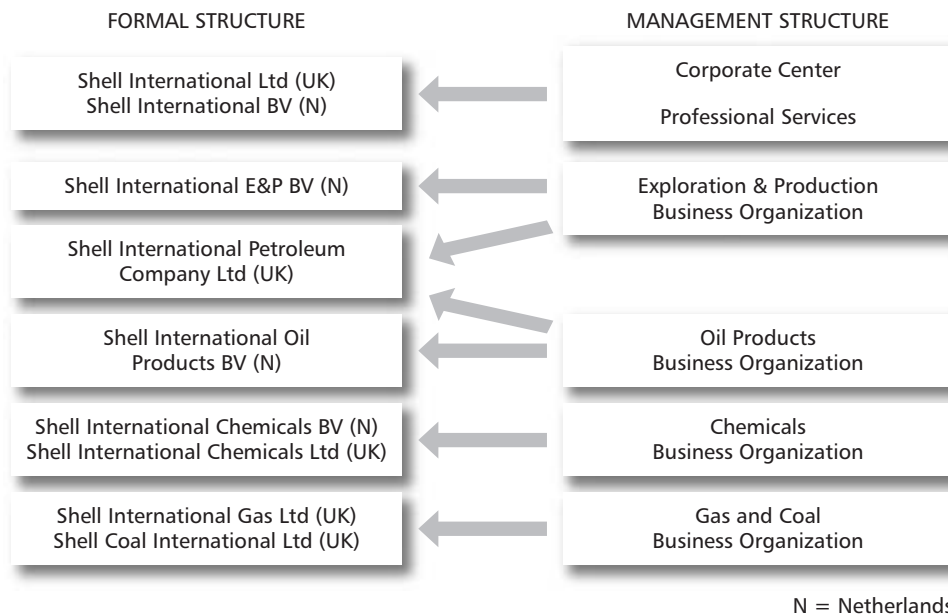
The Formal Structure

As noted, the formal corporate structure shown in figure 8.1 was little changed. The principal changes in the formal structure were changes involving the identities and roles of the service companies to create a closer alignment with the new management structure. Thus, the new Corporate Center and Professional Services Organization were housed within Shell International Ltd (in London) and Shell International B.V. (in The Hague). Other service companies housed the new Business Organizations. Figure 8.4 shows the relationship between the new management structure and Shell's formal legal structure.

The Management Structure

The new organizational structure can be described in terms of the four new organizational elements – the Business Organizations, the Corporate Center, Professional

FIGURE 8.4 The service companies in 1996: links between the formal structure and the management structure



Services, and the Operating Units – together with the two organizational units that continued from the previous structure, the operating companies and the Committee of Managing Directors.

The Business Organizations The central features of the new organization structure were the new Business Organizations. The CMD was supported by four Business Organizations: E&P (“upstream”), oil products (“downstream”), chemicals, and gas and coal. The Business Organizations were headed by Business Committees made up of a number of Business Directors appointed by the CMD. These Business Directors included:

- Business Directors with responsibility for particular business segments. For example, among the members of the E&P Business Committee in 1998 were J. Colligan, Regional E&P Business Director for Asia-Pacific and South America, H. Roels, Regional E&P Business Director for Middle East and Africa, and R. Sprague, Regional E&P Business Director for Europe.
- Certain of the operating companies were so important that their Chief Executives were also Business Directors. For example, in 1998, the E&P Business Committee included A. Parsley, Managing Director of Shell E&P International Venture B.V., while the Oil Products Business Committee included M. Warwick, President of Shell International Trading and Shipping Co. Ltd, and P. Turberville, President of Shell Europe Oil Products B.V.
- A Business Director for Research and Technical Services.
- A Business Director for Strategy and Business Services.

The Business Committees were accountable to the CMD for:

- the strategy of their business area;
- endorsing the capital expenditure and financial plans of the operating companies and business segments within their business area;
- appraising operating company and business segment performance; and
- the availability of technical, functional, and business services to the operating companies within their business sector.

Chairing each of the Business Committees was a member of the CMD. Thus, in early 1998, E&P reported to Managing Director P. B. Watts, Oil Products to Managing Director S. L. Miller, Chemicals to Vice Chairman M. Moody-Stuart, and Gas and Coal to Managing Director M. van den Bergh.

The Corporate Center This supported the CMD in its role in:

- setting the direction and strategy of the Group;
- growing and shaping the Group's portfolio of investments and resources;
- enhancing the performance of Group assets;
- acting as custodian of the Group's reputation, policies, and processes; and
- providing internal and external communication.

Apart from supporting the work of the CMD, the Corporate Center assisted the parent companies and the Group holding companies in managing their financial, tax, and corporate affairs. The Corporate Center represented the other two dimensions of Shell's former matrix organization. For example, the Director for Planning, Environment and External Affairs chaired the meetings of Shell's Technology Council and Health, Safety and Environment Council. Also, the Corporate Advice Director undertook ad hoc country reviews.

The Corporate Center comprised six directorates:

- Planning, Environment and External Affairs
- Corporate Advice (supporting each of the Managing Directors in their regional roles as well as responsibility for IT, security, contracting and procurement)
- Group Treasurer
- Group Controller
- Human Resources
- Legal

In addition to these directorates, the Corporate Center also included the Head of Group Taxation, the Chief Information Officer, the Head of Intellectual Property, the Head of Contracting and Procurement, the Head of Group Security, the Head of Learning, and the Secretary to the CMD.

Professional Services These new units provided functional support for the operating companies and service companies within the Group. They offered their services on an arm's-length basis and competed with external service providers for the business of the operating companies. They were also able to provide services to third-party customers outside the Group. The services provided included:

- Finance (e.g., treasury services, accounting, tax advice)
- HR (e.g., recruitment, training)
- Legal
- Intellectual property (intellectual property protection, licensing)
- Contracting and procurement
- Group Security (security advice)
- Shell Aircraft Ltd (corporate jets)
- Office services (e.g., accommodation, personnel services)
- Health (medical services, environmental and occupational health advice)

Each Professional Services unit was headed by the relevant director from the Corporate Center. For example, HR was headed by the HR Director; legal and intellectual property services were headed by the Legal Director.

The Operating Companies In the new organizational structure, the operating companies retained their role as the primary business entities within Shell. Each operating company was managed by a Board of Directors and a Chief Executive. The Chief Executive of an operating company was responsible to his/her Board and to his/her Business Director for the effective management of the operating company. The Chief Executive's responsibilities included the following:

- setting the company's strategic aims against the backdrop of any guidelines established by the Business Committee;
- providing leadership to put the strategic aims into effect and instill an entrepreneurial company culture;
- setting internal financial and operating targets and overseeing their achievement;
- supervising the management of the business and setting priorities;
- effective reporting on the company's activities and results to the Group.⁸

Operating Units The superimposition of the Business Organizations on top of the operating companies created a problem for Shell because the operating companies were defined by country rather than by business sector and included activities which crossed business sectors. Hence, to achieve alignment between the new Business Organizations and the operational activities of the Group, Operating Units were created:

In the context of the Group organizational structure, Operating Unit refers to the activities in one of the Group Businesses which are operated as a single economic entity. An Operating Unit can coincide with an Operating Company, be a part of an Operating Company or straddle part or all of several Operating Companies.⁹

Thus, where an operating company was in one business only, the operating company was the relevant Operating Unit. However, multibusiness operating companies, such as Shell UK and Shell Australia, which included upstream, downstream, chemical, and gas businesses, were divided into separate Operating Units to align operating activities with the new Business Organizations. Each of these Operating Units was headed by a manager with executive responsibilities who reported to the relevant Business Director. Where several Operating Units operated in a country under different Chief

Executives, the Managing Director with responsibilities for that particular region appointed one of them as a “country chairman” to fulfill country-level responsibilities (with regard to matters of taxation, conformity with national legislation, national government relations, and the like).

In addition, some Operating Units spanned several operating countries. To achieve more effective integration across countries and to save on administrative and operating costs, the trend was to form Operating Units that combined businesses in several countries. Thus, in Europe there was a desire to run chemicals and oil products as single business entities.

Changing Culture and Behavior

Changes to the formal organizational structure were only one dimension of the organizational changes of this period. If Shell was to improve its operational and financial performance and improve its responsiveness to the multitude of external forces that impacted its many businesses, then change needed to go beyond formal structures. The criticisms leveled at Shell for being bureaucratic, inward looking, slow, and unresponsive were not about organizational structure, they were about behavior and attitudes. In any organizational change, a new structure may provide the right context, but ultimately it is the effects on individual and group behavior that are critical.

During 1996 and 1997, the Shell management development function moved into a higher gear. Organizational development and change consultants included Noel Tichy from Michigan Business School, Larry Selden from Columbia, McKinsey & Company, Boston Consulting Group, and Coopers & Lybrand. These were in addition to Shell’s internal change management team, known as LEAP (Leadership and Performance Operations). The result was a substantial increase in Shell’s management development and organizational development activities. *Fortune* magazine reported:

This army has been putting Shell managers through a slew of workshops. In early February, teams from the gasoline retailing business in Thailand, China, Scandinavia and France spent six hours in a bitter Dutch downpour building rope bridges, dragging one another through spider webs of rope, and helping one another climb over 20-foot walls.

The Shell managers especially liked Larry Selden. He teaches people to track their time and figure out whether what they’re doing contributes directly to growth of both returns and gross margins. Selden calls this “dot movement,” a phrase he has trademarked and which means moving the dot on a graph of growth and returns to the north-east. “The model is very powerful,” says Luc Minguet, Shell’s retail manager in France. “It’s the first time I’ve seen such a link between the conceptual and the practical. And I realized I was using my time very poorly.”

In a particularly revealing exercise, the top 100 Shell executives in May took the Myers–Briggs personality test, a widely-used management tool that classifies people according to 16 psychological types. Interestingly, of its top 100 managers, 86% are “thinkers,” people who make decisions based on logic and objective analysis. Of the six-man CMD, 60% are on the opposite scale. They are “feelers” who make decisions based on values and subjective evaluation. No wonder all those “thinkers” had such a hard time understanding the emotion behind Nigeria and Brent Spar. And no wonder the CMD gets frustrated with the inability of the lower ranks to grasp the need for change.¹⁰

Further Developments, 1996–1999

Cost Cutting and Restructuring

The most evident short-term impact of the reorganization was a substantial reduction in Service Company staffs. Towards the end of 1995, Shell began shrinking its head offices in London and The Hague in anticipation of the introduction of the new organizational structure at the beginning of 1996. During 1996, the downsizing of central services and administrative functions within the Service Companies accelerated. Also in 1996, one of the two towers at the London Shell Centre was sold and was converted into residential apartments.

The quest for cost reductions did not stop at the Service Companies but extended to the operating companies as well. Between 1995 and 1997, unit costs were reduced by 17% in real terms, and between 1994 and 1997, savings in procurement costs amounted to \$600 million each year. A priority for the Group was rationalization of capacity and reductions in operating costs in its downstream business. To facilitate this, Shell embarked on three major joint ventures:

- the amalgamation of Shell Oil's downstream assets in the western US with those of Texaco;
- the amalgamation of Shell's European downstream businesses with those of Texaco; and
- the merging of Shell's Australian downstream business with that of Mobil.

Restructuring in Shell's other businesses included a swap of oil and gas properties with Occidental and the creation of a single global chemicals business. The chemicals business demonstrated clearly the benefits of global integration. In addition to cost savings of around 7% each year, investment decisions became better coordinated. "The Center's full control over chemicals, for instance, led Shell to put a new polymer plant closer to customers in Geismar, Louisiana, instead of near the existing plant in Britain. Two years ago that plant automatically would have been added to the UK fiefdom."¹¹

Further Organizational Changes under Moody-Stuart

In June 1998, Mark Moody-Stuart succeeded Cor Herkstroter as Chairman of the CMD against a background of declining oil and gas prices and weakening margins in refining and chemicals. With Shell's operating profit and ROCE falling well below the projections for 1998, it was clear that further organizational change and cost reduction would be essential. In September he announced a series of restructuring measures aimed at reducing Shell's cost base while reaffirming Shell's commitment to the target of 15% ROACE (return on average capital employed) by 2001. Refinery cutbacks included the closure of Shellhaven refinery and partial closure of Berre refinery in France. The national head offices in the UK, Netherlands, Germany, and France would be closed.¹²

A key element of the organizational changes pushed by Moody-Stuart was the desire to replace Shell's traditional consensus-based decision making with greater individual leadership and individual accountability. To this end, the Business Committees that had been set up to manage the new business sectors were replaced by Chief Executives:

From today we have CEO's and executive committees running each of our businesses. We have entered a new period where executive decisions have to be made rapidly and business accountability must be absolutely clear. So we have changed our structures.

The major change we announced is establishing executive structures, with CEO's, in Oil Products and Exploration and Production. CEO's already run our other businesses: Gas and Coal, Chemicals and Renewables, as well as Shell Services International. Now we are structured to make rapid progress to our objective in each of our businesses.

Business Committees served us in good stead in a period of transition but as from today they are a thing of the past. We will still have discussion, but we will make business decisions rapidly.¹³

The trend towards executive power and personal accountability was also apparent in the Committee of Managing Directors. In place of the traditional "committee of equals," Moody-Stuart recast the CMD more as an executive group where individual members had clearly defined executive responsibilities.

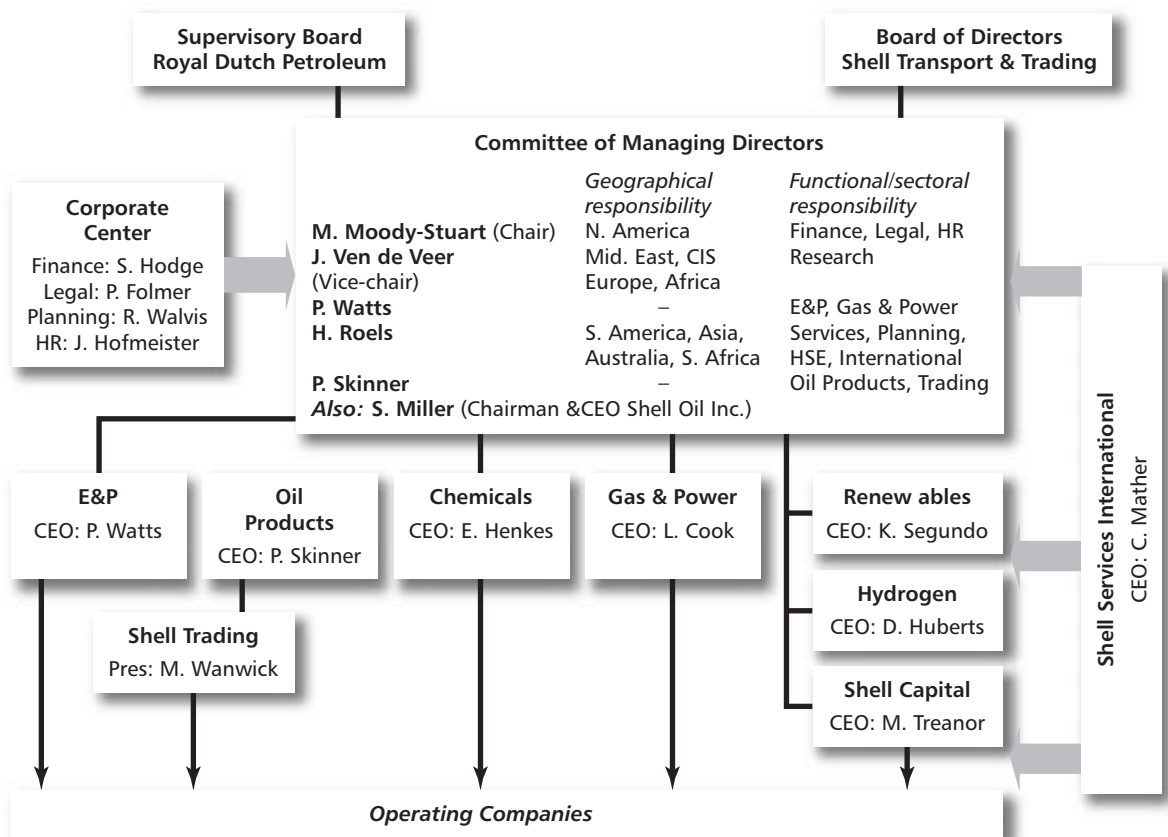
Moody-Stuart also accelerated the integration of Shell's US subsidiary, Shell Oil Inc., into its global structure. By the end of 1998, the chemicals sector was a truly global division and by early 1999 upstream operations in the US had been integrated into the global exploration and production sector. During 1999, the historically separate Shell Oil corporate office in Houston became integrated within Shell's Corporate Center and Professional Services organization. Thus, Shell Oil's Human Resource function staff became part of a new global Shell People Services organization, while Finance, Tax, Legal, and Corporate Affairs also integrated with their counterparts in London. The President and CEO of Shell Oil, Inc. became a de facto member of the CMD.

Figure 8.5 shows Shell's management structure under Mark Moody-Stuart's leadership.

Towards a Second Century

As Royal Dutch Shell approached the second century of its corporate life, there was a clear consensus within the company that the organizational changes made during 1995–9 had created a structure that was much better able to respond to the uncertainties and discontinuous changes that affected the oil industry. Outside the company, Shell-watchers both in the investment community and in other oil companies had little doubt that the 1996 reorganization had contributed substantially to the efficient and effective management of the Group. The stripping away of much of the administrative structure in the Group head offices in London and The Hague, the elimination of the regional coordinating staffs, and the closure of some of Shell's biggest national headquarters not only reduced cost, but seemed to be moving Shell towards a swifter, more direct style of management. The restructuring of chemicals and downstream businesses revealed both a tough-mindedness and a decisiveness that few had associated with the Shell of old.

The former vice chairman of the CMD outlined the way in which the changes in organization had impacted Shell's business portfolio and its strategic management:

FIGURE 8.5 Shell's management structure, 2000

We used to have a complex regional matrix system – with multiple reporting lines. In compensation relatively modest annual raises were awarded – and more often than not expected – without being strictly tied to performance. Our businesses were tightly linked to national markets and then to regions. Accountability was, through the matrix system, diffuse. It wasn't a bad system. When it was launched – in 1958 – it was an excellent system. But, by the early '90s, it had definitely reached its "use by" date. Hurdle rates were used – good guides – but they allowed unbridled investment growth, which tended to exacerbate portfolio weaknesses. Jobs were for life in the old Shell and virtually all recruitment was internal.

By the early '90s we had a problem. There was no crisis – which in some ways was part of the problem. But ROACE was not good enough and it was obvious that something needed to be done. In the middle of the '90s we instituted something we called "transformation." As you can see here there were results, things were improving, but not really as quickly as they should have been. Then, in 1999 we had a particularly difficult environment, which galvanized us to

rapidly complete the transformation process. Tough decisions were made, write-downs taken, and the whole process accelerated.

As a consequence, today we have global businesses, headed by personally accountable CEOs. Reporting lines are direct, uncomplicated. Incentive pay and stock options are the norm. Every project has to compete globally for capital. Everyone in the organization can compete for any job – and we also actively hire from outside.

This has resulted in a significantly improved profile. Earnings are up on basically stable net revenues. Oil production is up, as are gas, chemical and oil product sales. The number of employees required has declined.

Capital has moved away from the poor performers and declining areas to new opportunities.¹⁴

The new organization had permitted far-reaching restructuring of Shell's downstream and chemicals businesses:

In the early 1990s we operated refineries in all parts of the world and our refining cover was over 80%. We have been closing or selling refineries . . . Our goal in this effort is twofold – one is to reduce our refinery cover to a range of 65%–70% by 2001. The other is to achieve a return on average capital employed of 15% by 2001 . . .

At the beginning of the '90s we had [chemical] plants scattered across the globe with 30 plants in Europe, 7 in Asia Pacific, and 17 in America. The plants produced products that were sold through some 22 different product groups, each having profit and loss responsibility. Today we are concentrating on a few, world-scale plants and a much more limited product line. We will have 7 plants in Europe, 6 in Asia Pacific and 4 in America and products will be sold through 12 product groups.¹⁵

The question in most people's minds was whether Shell was moving ahead of the pack or playing catch up. For all Shell's pride in being a pioneer of modern management ideas – from scenario analysis to organization learning – Shell had created by year 2000 a business-sector-based organization of a kind that most other diversified multinationals had created decades before. Moreover, some of Shell's leading competitors were moving away from such structures. BP – hailed by many to be the most dynamic and responsive of any of the petroleum majors – had abandoned its traditional divisional structure in favor of a flatter structure in which individual business units reported directly to the corporate center.

In addition, Shell still retained some relics of the old structure that could compromise the new philosophy of responsiveness and single-point accountability. For example, Shell was still a joint venture rather than a single corporation. Its Committee of Managing Directors was still composed of board members from its dual parent companies. The principle of rotating leadership between the two parents with fixed single terms of office for the CMD Chairman was still intact. While Shell had been consumed with its internal restructuring, other companies had been transforming themselves through mergers and acquisitions. Had Shell missed out on the Great Oil Patch M&A Boom? Probably, but if Royal Dutch Shell was to get serious about mergers, its first priority should be to merge with itself, noted the *Financial Times*' Lex column.

Appendix The Organizational Structures of Other Oil Majors

FIGURE 8.A1 Exxon Mobil

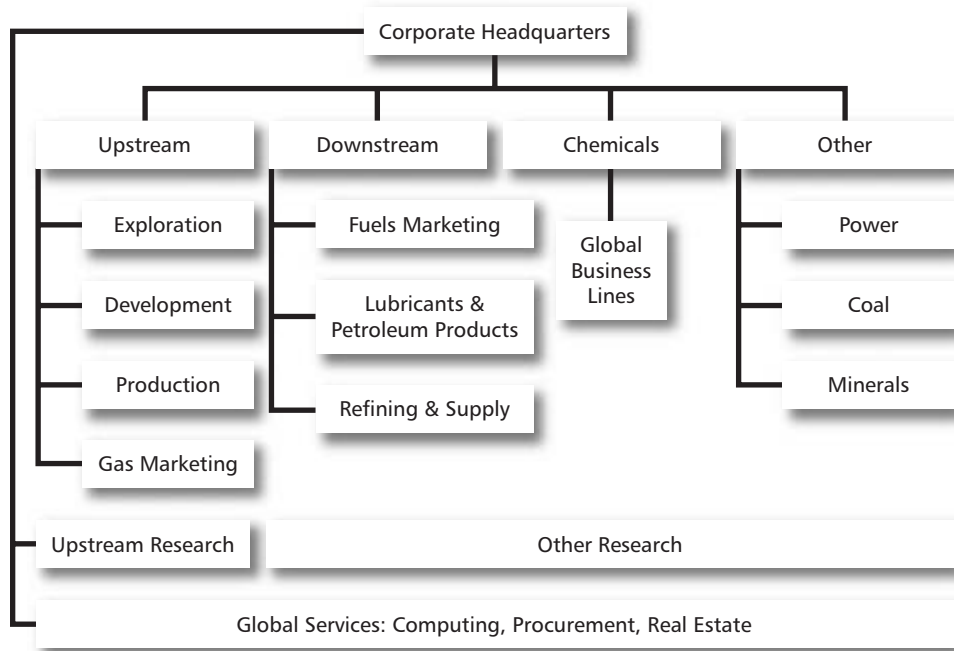


FIGURE 8.A2 Mobil (prior to merger with Exxon)

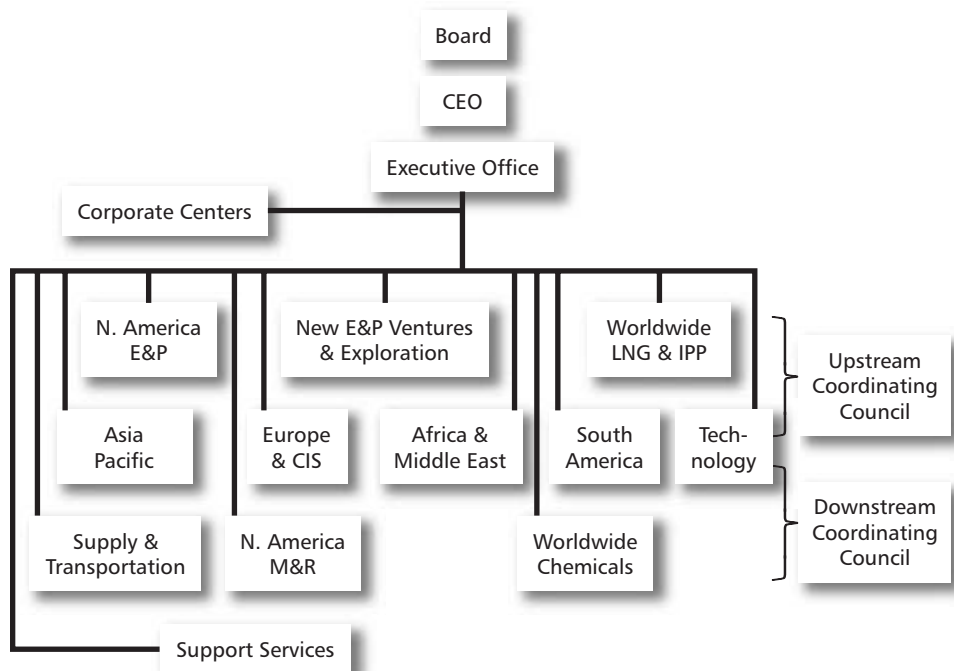


FIGURE 8.A3 BP

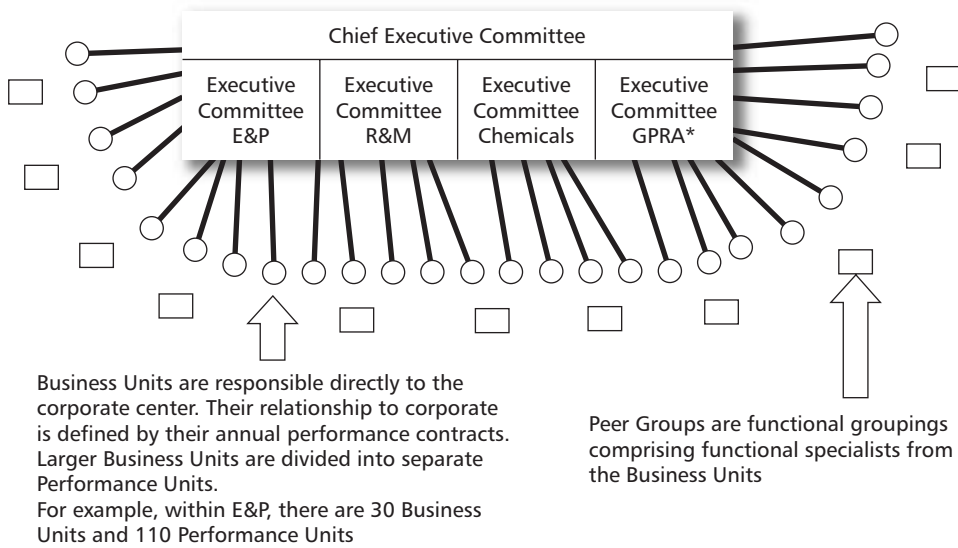
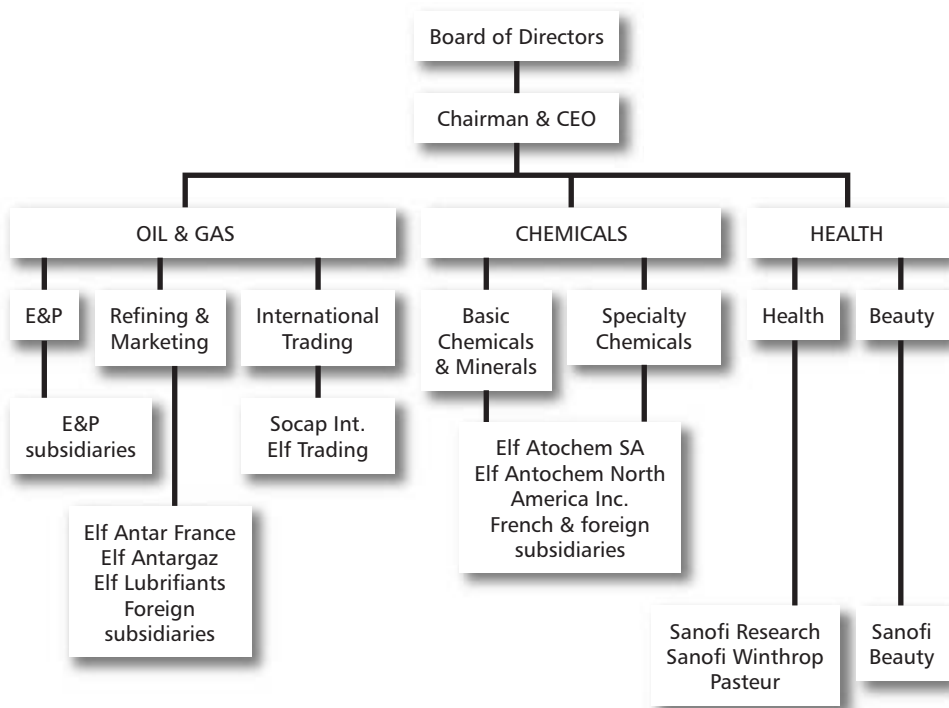


FIGURE 8.A4 Elf Aquitaine (prior to merger with Total-Fina)



Notes

- 1 This section draws from R. Cibin and R. M. Grant, "Restructuring among the world's largest oil majors," *British Journal of Management*, December 1996.
- 2 The "Seven Sisters" were the original international oil majors: Shell, Exxon, Mobil, BP, Chevron, Texaco, and Gulf. (Gulf was acquired by Chevron in 1984.)
- 3 C. A. J. Herkstroter, "Right for the times and right for Shell," Speech delivered in London, March 29, 1995.
- 4 Ibid.
- 5 "Why is the world's most profitable company turning itself inside out?" *Fortune*, August 4, 1997, pp. 121–5.
- 6 Ibid.
- 7 Ibid.
- 8 *Reference Guide to Group Organizational Structure*, Shell International Ltd, August 1996.
- 9 Ibid., p. 17.
- 10 "Why is the world's most profitable company turning itself inside out?" *Fortune*, August 4, 1997. pp. 121–5.
- 11 Ibid.
- 12 "Shell shapes up for future," Speech by M. Moody-Stuart, San Francisco, September 18, 1998 (www.shell.com).
- 13 M. Moody-Stuart, Changes in Shell's organization: comments to the Shell Global Leadership Conference, London December 10, 1998.
- 14 Marten van den Bergh; "Strengthening the Portfolio," Shell Press Release, April 3, 2000.
- 15 Ibid.