case twelve

Eni SpA: Building an International Energy Major

TEACHING NOTE

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■ SYNOPSIS ■

Eni is Italy's largest and most profitable company. The case traces Eni's 50-year history from its founding as a state-owned oil and gas company, through its privatization and restructuring during the 1990s, to its growth and success under its present CEO, Vittorio Mincato. The case surveys the state of Eni during the early part of 2003 and considers some of the challenges facing Mr. Mincato as he seeks to sustain and continue Eni's outstanding financial and operating performance under a strategy of "disciplined growth" and "core business focus."

The case deals with the analysis of corporate strategy for a large corporation. (By 2003, Eni was among the top-50 global corporations whether measured by sales or market capitalization.) Eni is vertically integrated, international, and diversified across several industrial sectors. The case requires students to identify and analyze the rationale behind Eni's current corporate strategy and make recommendations for how Eni should allocate its resources across its different vertical levels, business sectors, and geographical areas of operation in the future.

A key challenge of the case is that Eni is currently performing exceptionally well. Hence, there is a tendency among many students to recommend "Keep up the good work, Mr. Mincato" without looking deeply at the company and its business. In fact, Eni faces a number of key challenges, which must be addressed if Eni's recent success is to be sustained.

■ TEACHING OBJECTIVES ■

I use this case to develop students' skills in the following:

- Identifying, articulating, and analyzing a company's corporate strategy.
- Analyzing the fit between a company's corporate strategy and (a) its external environment and (b) its resources and capabilities.
- Combining quantitative, qualitative, and historical information to build a profile of a company's resources and capabilities.
- Examining the structure, systems, and culture that an organization needs to support its corporate strategy.

■ POSITION IN THE COURSE ■

I have used the case to introduce the corporate strategy part of my strategic management courses. It is particularly suitable for exploring the relationship between corporate strategy and the resources and capabilities of a company. I also use the case as a comprehensive strategy case with which to conclude my section of the course dealing with corporate strategy.

■ ASSIGNMENT QUESTIONS■

1. What is Eni's corporate strategy?

2. Evaluate Eni's corporate strategy. How well aligned is Eni's strategy with (a) the characteristics and requirements of its industry environment and (b) Eni's resources and capabilities?
3. Looking ahead over Eni's next four-year planning period (2004–7), what are the main issues that face the company? How should Eni allocate its resources across its different businesses and between different geographical areas? In particular:
   a) Should Eni divest its chemicals business? What about its engineering, construction, and oilfield services subsidiaries?
   b) Should Eni seek to establish itself as a major supplier of electrical power? Should it invest in renewable energy sources (e.g. wind power)?
   c) What should Eni's international strategy be – especially in relation to its downstream businesses (Refining and Marketing; Gas and Power)?
4. What organizational changes should Mincato pioneer, especially with regard to organizational structure, management systems, and corporate culture?

■ READING ■

R. M. Grant, *Contemporary Strategy Analysis* (6th edn), Blackwell Publishing, 2008, Chapter 13. Chapter 5 is also relevant in analyzing Eni's resources and capabilities.

■ CASE DISCUSSION AND ANALYSIS ■

Eni's Corporate Strategy

I begin by asking students to describe Eni's corporate strategy. The tendency is for students to use Mincato's own articulation in terms of "core business focus" and "disciplined growth." Certainly this describes the main directions of Eni's development under Mincato – Eni has shrunk Chemicals and Refining and Marketing, divested other businesses, and invested heavily in E&P. However, it does not describe very clearly what the main features of Eni's corporate scope are (where is it competing?), on what basis Eni is attempting to establish competitive advantage (how is it competing?), and what the rationale behind Eni's strategy is.

In describing Eni's corporate strategy I find it useful to take a static approach to outlining the scope of Eni's activities and seeing how this differs from the other majors. In reviewing the allocation of Eni's assets and capital expenditures across sectors, vertical activities, and geographical areas, the following observations can be made:

1. One of Eni's most distinctive features is the size of its downstream presence in gas. Most of the oil and gas majors have only small downstream gas businesses; for Eni, gas distribution and marketing has always been a core business. This is part of Eni's long association with natural gas – unique among the international oil and gas majors, Eni's original business was based on gas not oil.

2. Eni is vertically integrated from exploration to retailing. Eni can claim to be among the most integrated of the oil and gas majors. In particular, it is highly vertically integrated in gas, where it owns a large downstream business as well as upstream reserves and pipelines linking the two. Recently, Eni has extended forward integration in gas through building power plants. Also, Eni has not outsourced engineering, construction, and oilfield services as have most of its competitors. In particular, Eni has majority ownership of Snamprogetti, which designs refineries, chemical plants, and a range of other energy facilities, and Saipem, which undertakes subsea drilling and construction.

3. Unlike Exxon Mobil, Shell, and Total, Eni has limited involvement in chemicals and is seeking to divest its remaining chemical activities.

4. In terms of geographical scope, Eni is one of the least international of the oil and gas majors. Its E&P activities are primarily focused on Europe (Italy and North Sea), Africa, and the former Soviet Union (Kazakhstan in particular). It has a limited presence in North and South America and the Middle East. Downstream the great majority of its business is in Italy.

From a dynamic perspective, we can look at where Eni is going and what type of company it is seeking to become. The general direction of Eni's strategy under Mincato has comprised the following thrusts:

- *Eni as an energy company*. The definition of Eni as a petroleum-based energy company has involved cutting back on petrochemicals and investing in electricity (in addition to traditional oil and gas businesses).
- *Growth*. Eni is strongly focused on growth of output, especially at the upstream level. Such growth is primarily organic, augmented by "bolt-on" acquisitions. Downstream, Eni's growth ambitions relate primarily to growing its position within the European gas market.
- *Vertical integration*. In gas in particular, Eni is seeking to use its pipeline expertise to link upstream gas supplies with downstream markets.
- *Financial discipline*. Mincato and his team have put a heavy emphasis on superior financial performance. This involves an emphasis on cost control, on disciplined capital expenditure decisions, and avoiding surprises.

Evaluating Eni's Strategy

1. ***Eni's performance.*** As a starting point to evaluating Eni's strategy, I begin by asking the class how well Eni has performed under Mincato's leadership. The obvious answer is: extremely well. Not only is Eni Italy's most profitable company, it is also one of the best performing of the international oil and gas majors, with a ROCE close to that of Exxon Mobil – the leading oil and gas major in terms of financial performance.

   But what are the sources of Eni's outstanding financial performance? As Table 12.4 reveals, Eni's profits are generated primarily by two of its divisions: E&P and Gas and Power. In both cases, these high returns appear to be the result of industry attractiveness rather than any competitive advantage held by Eni. In the case of E&P, high profitability during 2000–3 has been driven mainly by high oil prices – a result of OPEC output quotas, political uncertainty, and growing world demand. Compared with its peers, Eni's costs of finding oil and gas reserves are relatively high. In the case of Gas and Power, Eni's profits derive primarily from its near-monopoly position in the Italian gas market. This strong position within its domestic market is common to all Eni's downstream businesses – in Refining and Marketing, the great majority of Eni's sales are also within Italy where again its profits derive from market power and economies of distribution density.

2. ***Strategic fit.*** To appraise Eni's strategy at a deeper level we need to examine the extent to which Eni's strategy *fits* with the industry environment and with its resources and capabilities. For example:

   - Eni's sectoral allocation of resources:
     a) Eni's emphasis on E&P is justified by the attractiveness of this sector. So long as oil prices exceed $20 a barrel, it seems as though investments in E&P will generate attractive returns. Also, Eni appears to have strong technical capabilities in several E&P activities – especially in offshore exploration. However, it is not apparent that Eni has particular competitive advantages upstream: Eni is a high-cost producer relative both to the national oil companies (Saudi Aramco, Kuwait Oil., PDVSA) and the other majors.
     b) Plans to exit chemicals are also justified by similar considerations of industry attractiveness – petrochemicals have been a low-profit industry in recent years. Moreover, Eni has few advantages in chemicals – it lacks scale, global reach, and cost efficiency (its feedstock is relatively high cost); nor does it possess any particularly strong proprietary technologies.
     c) Downstream gas is a profitable sector – especially for Eni. However, it's not clear that new investments will offer anything like the return on existing investments, especially investments outside Italy.
     d) Electricity is an interesting area of new business for Eni. The Italian electricity market is certainly attractive in 2003 (Italian wholesale prices are among the highest in Europe). However, one of the greatest benefits to Eni from its power generation is that this provides an outlet for gas supplies that are not included in official calculations of Eni's share of the Italian gas market (Eni is being required to lower its market share).

   - Vertical integration. Vertical integration is a traditional feature of the energy sector – however, does vertical integration continue to add value?
     a) In the case of oil this is doubtful – there are few technical economies form integrating processes, competitive efficient markets exist for crude and refined products, the capabilities required at different stages of the value chain are very difficult, and the benefits of spreading risk by operating across upstream and downstream sectors are dubious.
     b) Gas is a different story. Gas is technically difficult to transport and store, offering technical economies from integrating processes. Markets for gas are less well developed than markets for oil. Hence, as a vertically

integrated gas company, Eni has key advantages over the downstream gas companies (Gas de France, British Gas/Centrica) or the other oil and gas majors, which are primarily upstream companies.

c) For Eni a key issue is its substantial presence in engineering and oilfield services through Snamprogetti and Saipem. Should Eni keep these in-house or spin them off? This issue raises some interesting points. If these companies were independent, what would Eni lose? Do they work harder for Eni than for third party clients? The key issue is whether Eni gains superior coordination by having these services through sister companies. For example, in considering exploration projects or pipeline projects, Eni can draw upon this in-house expertise at an early stage in the decision-making process. This may be particularly important in planning large, risky projects. Thus, in Eni's vertically integrated gas business, Eni has benefited greatly from its capacity to build major subsea pipelines such as the Transmed and Blue Stream. On the other side, Eni's ownership of Saipem and Snamprogetti may discourage Eni's competitors (Exxon, Shell) from giving business to these companies.

- International scope. As a latecomer to the oil and gas business, Eni was shut out of the major oilfields that were opening up during the 1940s and 1950s – the Middle East in particular. As a result, Eni had to find oil and gas in new places using innovative approaches. In gaining access to oil and gas reserves, Eni has shown skill, creativity, and flexibility. Eni has done well in locations that are difficult either physically (offshore) or politically – Nigeria, Libya, Algeria, Iran, Russia, and Kazakhstan.

  Eni has also exploited its Italian location: its vertically integrated approach to its oil and gas business has encouraged it to seek oil on the southern side of the Mediterranean (Egypt, Libya, Tunisia, Algeria) and supply it to the northern side of the Mediterranean (Italy, Spain, Portugal, Croatia, and Greece) using its expertise in subsea pipelines to link the two.

  However, on the downstream side of the business (both in oil and gas), Eni has experienced little international success. Its downstream profitability (as noted above) is dependent on its dominance of its domestic market. Outside of Italy it has struggled to build critical market share and to generate profits. This raises questions about Eni's international management capabilities.

Emerging Challenges

Mincato's intended strategy over the next four-year period may be summed as "more of the same" – a continued focus on investing in E&P while also expanding Eni's downstream position in European gas markets. In both businesses, Eni's approach is to combine internal expansion with bolt-on acquisitions. Given Eni's successful performance since 2000, it is difficult to argue that Eni should be pursuing a radically difficult strategy; at the same time, it is important to consider the potential pitfalls of the strategy and the assumptions upon which the strategy is based. Three issues appear to be particularly important:

1. *Competition in downstream gas*. European rules on competition in natural gas place ceilings on Eni's market share in primary and secondary gas distribution in Italy. As a result, Eni has sought to grow into other European gas markets (mainly through acquiring local gas distribution companies). How well equipped is Eni to prosper in competitive gas markets? Eni's downstream gas heritage is as a monopolist, it has little experience of competitive marketing.

2. *Future industry attractiveness*. Eni's strategy has been strongly influenced by the belief that the most attractive sector for new investment is upstream. Certainly the events of 2000–4 and escalating oil prices have done little to contradict this belief. However, current high prices are primarily a reflection of supply shortages resulting from political instability and lack of infrastructure in a number of leading producers – Iraq, Iran, Venezuela, and Russia. One possible scenario for the upstream industry is that the stability and new investment might result in major increases in supplies from these countries. The result might well be lower prices and profits (especially for high-cost producers like Eni). Conversely, the traditional low margins earned downstream might change. Consolidation of the refining in marketing and the reduction in excess capacity in Europe might result in an upswing in downstream profitability. (Such a trend was already occurring during 2003–4.)

3. *The benefits of size*. Eni has placed a big emphasis on growth. But how important is size in this business? Eni is big compared with independent oil and gas companies, but is much smaller than the supermajors (Exxon Mobil, BP, Shell, ChevronTexaco). Although major E&P and LGN projects cost several billions of dollars each, it's difficult to see that majors such as Eni or RepsolYPF are at a severe disadvantage to the supermajors. To the extent that Eni's new investment projects are not likely to be as profitable as its existing investments, there is a case for arguing that Eni should focus more on profitability than on growth.

If Eni is to combine growth and profitability, in seeking new opportunities it will need to exploit the advantages that stem from its differences from its leading competitors in resources and capabilities. In sheer size, in many areas of technology, in global reach, in brand equity, and in a range of commercial and management capabilities, Eni is at a disadvantage to its leading rivals – Exxon Mobil, Shell, BP, and ChevronTexaco. But what are the distinctive features of Eni's resources and capabilities that it can exploit for advantage?

Some of the obvious factors are:

- Eni's Italian nationality. To begin with, Eni is not American. While Eni does not have the clout of the US federal government behind it, it can take advantage of the anti-Americanism prevalent in much of the world – especially in Islamic countries. Eni's Italian origins may also give it advantages in relationship building and collaboration (in contrast to the more contract-driven approach of US companies.).
- Eni's technical skills in pipelines and subsea engineering. Eni has been responsible for several large-scale, long-distance subsea pipelines. Within the context of a vertically integrated gas strategy, such pipeline projects offer a critical linkage between upstream and downstream activities. Blue Stream offered an interesting departure from Eni's previous projects in that the pipeline linked Gazprom's gas production to Turkey's downstream gas distribution. Blue Stream might offer a model for similar collaborative projects.
- Eni's vertical integration, smaller size, and relative national homogeneity (most employees are Italian) may offer Eni the potential to offer highly integrated energy development projects to producer countries. For example, for Angola or Kazakhstan, Eni has the potential to offer comprehensive development projects that embrace not just E&P, but also pipeline construction and the development of refineries and chemical plants.

Organizational Development

Eni's transformation has involved not just its external strategy, but also its internal organization. From a highly politicized holding company with weak corporate power, Eni has emerged as a shareholder-orientated, multidivisional corporation with financial discipline and strong cost control.

Yet, it still has some way to go in aligning its internal structure, systems, and culture to the requirements of the changing energy industry and its own strategy. Some of the key priorities appear to be the following:

- *Internationalization*. Eni is becoming increasingly international – especially in E&P – as a result of a series of acquisitions. Yet its top management is almost wholly Italian and Italian is its common language in an industry where English is the norm. Compared with other leading oil and gas companies, Eni lacks diversity in terms of nationality, ethnicity, gender, and educational background.
- *Structure*. Eni has moved from a holding company structure to a multidivisional structure several decades after its peers. Yet several other companies have been breaking up their divisions, declaring that divisional structures are insufficiently nimble and entrepreneurial. For example, BP replaced its divisional structure by much smaller business units each reporting to the corporate center.
- *Openness, flexibility, and decentralized initiative*. Eni operates a system of lifetime employment. Most of its managers began working for Eni directly after graduation and a small minority have experience gained from working for other companies. The culture and management systems tend not to encourage risk taking and initiative. Communication is primarily vertical. Eni lags behind most of its peers in the adoption of systems of knowledge management. Eni's vertical integration strategy in gas and its upstream strategy of collaboration with governments and national oil companies is likely to require substantial coordination and collaboration across Eni's different divisions and associate companies – this will inevitably require flexible approaches to horizontal communication and cooperation.

Eni's initiatives in changing its approach to human resource management and developing its internal culture ("Eni's Way") are interesting developments. The challenge for Eni is whether its preeminence within its home country in terms of financial performance and effective governance will support a continual striving to improve its internal management.