case seven
Organizational Restructuring Within the Royal Dutch/Shell Group

Teaching Note

Synopsis

The Royal Dutch/Shell Group of Companies (Shell) is the world's second biggest petroleum company (after Exxon Mobil). It is also one of the world's most international business organizations, with operations in nearly 200 countries of the world. Its present structure is a consequence of its historical development. Shell is a joint venture between the Royal Dutch Petroleum Company and the Shell Transport and Trading Company. Both parent companies were formed with European bases and their main activities in the Far East. The case looks at Shell's organizational structure at the beginning of the twenty-first century.

Shell has developed as a highly decentralized, highly international group of national operating companies coordinated and controlled from the head offices in London and The Hague. From the mid-1960s it was managed through a three-way matrix structure. The dimensions of this matrix were the regional coordination structure, the business coordination structure, and the functional coordination structure.

During the early 1990s, pressure for change had built up within Shell. As competition in the industry increased, and as oil prices slid, there was strong pressure on the Group to improve its level of profitability. Most of the other oil majors had

This note was prepared by Robert M. Grant.

undergone radical restructuring involving cost cutting, refocusing, and outsourcing. Several of the larger operating companies within Shell had led the way in implementing radical restructuring and cost cutting. These operating companies were now putting pressure on the corporate structure. The McKinsey-designed matrix structure was increasingly regarded as costly, slow moving, and top-heavy.

The case describes the redesign of Shell's organization structure over the period 1994–2000. The central issues concern the local autonomy and adaptability versus global integration, the role and structure of corporate management and corporate services, and the implementation of effective financial management within an international, multibusiness corporation. The solution adopted was to dismantle much of Shell's matrix structure (in particular, to downgrade the role of the previously dominant regional organization) and concentrate strategic and financial control and decision-making authority on the new business sector organizations.

Although the result was to increase global coordination and integration at the business sector level, the 1995–6 reorganization left Shell with an idiosyncratic and (compared with the other oil majors) highly decentralized structure. The national operating companies still retained considerable autonomy and the power and effectiveness of the top management team were still constrained by its committee structure and the rotation of the chairmanship between Shell Transport and Trading and Royal Dutch Petroleum. The public relations disasters of Shell's involvement in Nigeria and the Brent Spar platform raised questions as to whether Shell's reorganization had gone far enough.

During 1997–2000, organizational changes continued. In particular, chief executives rather than committees were appointed to head up the business divisions, and the US businesses became merged into the global business divisions.

The result was a structure that offered much more effective global coordination and integration within each business area together with a significant reduction of internal complexity. The question was, given the increasing need for cost efficiency, effective strategic direction, and flexible responsiveness and coordination, whether Shell's organizational changes had gone far enough.

TEACHING OBJECTIVES

The Shell case deals with strategy implementation, specifically with the design of organizational structure and management systems. The case forces students to recognize and comprehend the key elements of a company whose organizational structure is unusually complex. Indeed, the Group's structure is almost impossibly complex – the combination of the Group's joint-venture structure, its three-way matrix, and the 200 operating companies has meant that few outside of Shell (and certainly not everyone within it!) have been able to comprehend how Shell operates. Hence, this case is certainly challenging for students. Having recognized the central features of the old Shell structure and the new Shell structure, the task is to apply the principles of rational organizational design to evaluate the old and new structures. The goal of a matrix structure is to permit coordination across multiple dimensions: within geographical areas, business sectors, and functions. But the critical issue is the allocation of controls and decision-making powers in relation to these three dimensions of the matrix. Given the characteristics of the oil industry, where is coordination most important: within countries and regions, within business sectors, or within functions? In the old Shell, the countries and regions were dominant. However, industry change has increased global integration and reduced the importance of vertical integration. At the same time the critical strategic priorities for Shell are to boost financial performance through cost reduction. What does this mean for the balance between centralized/decentralized powers? The case allows students to evaluate the new Shell structure against these criteria.

The Shell case also raises issues of organizational change. In particular:

- To what extent is large-scale organizational change possible in the absence of a crisis that threatens the very survival of the organization?
- What are the relative roles of top management, divisional/subsidiary management, task forces, and outside consultants in the change process?
- What are the relative roles and effectiveness of top-down and bottom-up organizational change, and how is consensus built in the change process?
- If large-scale change is an inevitable but highly infrequent occurrence, and if considerable forces for inertia exist in the prevailing structure, how can an organization ensure that change will be sufficiently radical?

Position in the Course

The Shell case draws mainly upon chapter 6 of the Grant text ("Organization Structure and Management Systems"). This occurs in part II of the text – the part that deals with the fundamental tools of strategy analysis. The rationale for this is that organizational design – like industry analysis and the analysis of resources and capabilities – constitutes a core area of basic strategic analysis. I acknowledge that this is a somewhat unusual positioning – most strategy texts introduce "strategy implementation" after "strategy formulation." Hence, this case can also be introduced later in the course. The argument for introducing the case later in the strategy course is strengthened by the fact that the questions of organizational structure that the case raises are linked with the corporate strategy of the company – the fact that Shell is a vertically integrated, multibusiness, multinational enterprise, will mean that most instructors will probably wish to use this case in the later stages of their courses. Positioning later in the course also allows the instructor to take advantage of the material in chapter 16 of the textbook ("Managing the Multibusiness Corporation").

Assignment Questions

1. What were the distinctive features of Shell's organizational structure prior to 1995?

2. How well suited was Shell's structure to the competitive conditions and key success factors in the world oil, gas, and chemicals industry?
3. To what extent did the 1995–6 reorganization remedy the deficiencies of Shell's structure and systems?
4. How far did the further organizational changes of 1997–2000 resolve the remaining problems of Shell's 1995–6 reorganization?
5. What additional changes to Shell's organizational structure and management systems would you recommend to the current chairman of the Committee of Managing Directors, Mark Moody-Stuart?

READING

R. M. Grant, *Contemporary Strategy Analysis* (5th edn), Blackwell Publishing, 2005, chapter 6.

ANALYSIS

1. *What were the distinctive features of Shell's organizational structure prior to 1995?*
   Because Shell's structure is so complex and so unusual, it is important to spend some time documenting the central features of the Shell structure prior to the reorganization. These features include:
   - The distinction between the legal structure and the management structure of the Group. The legal structure is based upon the company entities (the parent companies, the operating companies, and the service companies and their ownership links). The management structure is based upon the exercise of management control from the Committee of Managing Directors, through the regional, business sector, and functional coordinators, to the operating company heads.
   - The joint-venture structure: ownership is by Royal Dutch Petroleum (60 percent) and Shell Transport and Trading (40 percent). This structure accounts for the unusual top management organization: a Committee of Managing Directors comprising the executive board members of the two parent companies, with chairmanship of the committee alternating between the two parents.
   - The large number of nationally based operating companies, each with a tradition of autonomy and strong identity with its host country.
   - The headquarters structure which, in terms of ownership, was based upon the service companies and, in terms of control, was based upon the three-way matrix and the roles of the different coordinators.
   - Although coordination and control are split three ways between the regions, the sectors, and the functions, it is the geographical dimension that is most important in terms of strategic and financial control.

2. *How well suited was Shell's structure to the competitive conditions and key success factors in the world oil, gas, and chemicals industry?*

   The key features of the industry environment are:

   - It is a highly competitive, commodity business, subject to excess capacity in many activities and strong downward price pressures. Cost efficiency is critical to profitability. Cost efficiency is achieved through exploiting scale economies, avoiding duplication, keeping overheads low, and deploying the latest technologies.
   - It is fast moving: decision making needs to be decentralized, and lines of communication short.
   - It has become increasingly global: almost all products are internationally traded, and companies exploit opportunities throughout the world, while being geographically selective in their deployment of assets.

   These conditions have encouraged radical restructuring among most of the oil majors. This restructuring has involved the break-up of vertically integrated structures, downsizing of corporate headquarters, decentralization of decision making, increased geographical focus (especially in upstream and downstream), and the sale of less profitable assets and businesses. Shell is unusual in that it was the only one of the majors not to undergo radical restructuring. Why was this? Was it because it was already well adjusted to the new environment of the oil business, because its decentralized structure allowed gradual adaptation without the need for radical restructuring, or because the diffusion of power in Shell's top management group prevented large-scale organizational change? It was probably a combination of these. However, what became increasingly clear during the early 1990s is that Shell is not well adapted to the key success factors in this increasingly hostile business environment. In particular:

   - Shell is not delivering a return on capital that clearly exceeds its cost of capital. The implication is that its costs are too high.
   - Shell combines decentralization with a top-heavy administrative structure. Shell's service companies in London and The Hague have a total employment that is greater than the corporate and divisional administration of any other oil company. Moreover, the cumbersome three-way matrix means that the advantages of decentralized decision making are compromised by Shell's slow-moving bureaucracy, while, simultaneously, effective central control is absent.
   - Diffused control is especially apparent in relation to financial control and performance management. Apparent among the other oil majors has been powerful top-down pressure for profitability and shareholder value creation. Shell's parental influence has traditionally been oriented around long-term strategic planning, scenario analysis, and creative thinking, rather than the more immediate drive for cost reduction and shareholder return.
   - Globalization is becoming increasingly important while the advantages of vertical integration between upstream, downstream, and chemicals in each country and region are becoming less important. The implication is that coordination within each business sector is more important than within

each country/region. While the other majors have moved to global business divisions, Shell still has a predominantly geographical structure.
- Shell Oil, the US operating company, does not fit into the overall Shell structure. Although now fully owned by the Group, it lies outside the control and coordination structure of the service companies.
- The Shell Committee of Managing Directors and the four-year rotating chairmanship are not conducive to dynamic leadership or organizational change. The managing directors are distinguished by their age and long careers at Shell. The four-year limit on any chairman's tenure makes a long-term program of organizational change difficult to implement.

3. *To what extent did the 1995–6 reorganization remedy the deficiencies of Shell's structure and systems?*
   - The downgrading of the regional organizations in favor of the new business sector organizations is conducive to a more global focus and increased emphasis on the elimination of duplications between countries.
   - The business sector organizations are run by committee – reaffirming Shell's traditional propensity to manage by committee rather than individual executives.
   - The operating companies are largely untouched. Yet these are defined primarily by country, and many span different business sectors. It appears that the new business organizations will not be able to operate either strategically or financially as global business enterprises. The establishment of operating units within and across the operating companies did little to resolve the lack of clarity between the responsibilities of the business organizations and those of the operating companies.
   - Shell Oil of the US still remained outside the main organizational structure of the Shell Group.
   - The top management structures (the CMD) and the role of the chairman remained unchanged.
   - The new structure still lacked the simplicity and logic of many of Shell's leading competitors.
   - Despite the downsizing of the corporate-level staffs, Shell retained three headquarters: London, The Hague, and Houston (Texas).
   - It was not apparent that the new structure supported stronger financial controls or the imposition of a more profit-oriented management approach.

4. *How far did the further organizational changes of 1997–2000 resolve the remaining problems of Shell's 1995–6 reorganization?*
   During the final three years of the decade, the initial reorganization was extended in several important ways:
   - The business organizations were strengthened. The committees that headed up the businesses were replaced by chief executives. Hopefully this would increase the effectiveness of their strategic and financial control and improve entrepreneurial vigor.
   - Shell Oil of the US was incorporated into Shell's worldwide organization. Chemicals was the first of Shell's truly global business divisions.

- Executive authority and accountability was increased. Shell moved increasingly from collective responsibility to individual responsibility. At the business level the new business CEOs had clear strategic and financial responsibility; at the corporate level, Moody-Stuart redefined the position of chairman of the CMD to be less of "first-among-equals" and more of a corporate chief executive.

5. *What additional changes to Shell's organizational structure and management systems would you recommend to the current chairman of the Committee of Managing Directors, Mark Moody-Stuart?*
One of the observations offered by organizational change experts is that large-scale, radical organizational restructurings can only occur infrequently. The fear is that Shell's reorganization has addressed some of the key problems of Shell's structure and management systems, but has not gone far enough. Most of the other majors underwent radical restructuring during the period 1986–92. Now, many of them are moving on to access additional sources of shareholder value – notably through acquisitions and mergers (BP Amoco Arco; Exxon Mobil; Chevron Texaco; Total Fina Elf). Some possibilities for further organizational change might include:
   - Merging the two parent companies to transform Shell from a joint venture into a unitary corporation. This might reinforce top-level decision making and permit the appointment of a conventional CEO.
   - Investing greater executive responsibility and leadership potential within the position of chairman of the CMD. This would probably require abandoning the fixed four-year term for chairpersons.
   - Breaking the huge global business organizations into more narrowly defined global businesses and allowing these businesses to report directly to the corporate HQ (similar to BP's structure).

   Note that, in response to low oil prices and poor profit performance, Shell has continued to cut costs, divest assets, and implement further organizational changes. In an effort to further strengthen the new business organizations, chief executives were appointed early in 1999. Efforts have also continued to increase global integration. The Chemicals sector is the first of the Shell businesses to be truly global (i.e., to include the US chemicals within the sectoral organization).

UPDATES ON SHELL

The Royal Dutch/Shell web site (www.shell.com) has up-to-date reports, financial statements, press releases, and copies of speeches by senior managers. Despite the progress made during the 1990s in establishing an organizational structure that facilitated global coordination and financial control, Shell's structure and management systems came under renewed criticism in 2004 following the overbooking of proven oil reserves. One of the issues raised by critics was whether Shell's joint-venture status and the presence of dual boards of directors weakened transparency and accountability (see "Shell insiders defend dual boards," *Financial Times*, April 23, 2004). By August 2004, Shell was considering alternative options for strengthening relations between its two parent companies – including the possibility of merging them ("Shell's Anglo-Dutch Conundrum," by Ian Bickerton, James Boxell, and Carola Hoyos, *Financial Times*, August 12, 2004).