Case 8 BP: Organizational Structure and Management Systems

When John Browne stepped down as CEO at BP plc in January 2007, he was credited with having transformed a formerly inefficient, bureaucratic, state-owned oil company into the world's most dynamic, entrepreneurial, performance-focused, and environmentally aware oil and gas major. Since taking up the job in 1995, BP's market capitalization had increased fivefold and its earnings per share by 600%.

Even before Browne's departure, BP's fall from grace had already commenced. Concerns over BP's HSE (health, safety, and environmental) management had been circulating for years. However, in March 2005 disaster struck: an explosion at BP's Texas City refinery killed 15 employees. This was the first of a series of catastrophes that destroyed the company's reputation and threatened its very survival.

In 2006, a corroded pipeline from BP's huge Alaskan oilfield caused a leakage of 4800 barrels of oil. Then in March 2009, BP was fined for safety violations at its Toledo refinery. The next month, an explosion on Transocean's *Deepwater Horizon* oilrig drilling BP's Macondo oil well in the Gulf of Mexico killed 11 workers and caused one of the worst environmental disasters in US history. The company took an accounting charge of $37.2 billion to cover the likely costs of the cleanup, compensation, and legal penalties, but by 2013 these costs had already exceeded $42 billion.

BP's troubles extended beyond its safety and environmental mishaps. Between 2003 and 2013, BP's trading activities in the crude oil, gasoline, propane, and natural gas markets were investigated by US regulators, resulting in a series of fines being imposed. In its core exploration and production business, BP experienced continuing problems from its large investment in Russia, first from difficult relations with its joint venture partner, TNK, and then from the declining value of its 20% stake in Rosneft following Western sanctions on Russia and the declining value of the ruble.

In the recriminations that followed the Texas City and Gulf of Mexico disasters, attention increasingly focused upon the organizational structure, management systems, and corporate culture that had developed at BP during John Browne's tenure. The management system developed by Browne had produced what the *Financial Times* described as "the most swashbuckling, the most entrepreneurial, the most creative" of the world's biggest oil companies.[1] Was it also the most accident prone?

A Brief History of BP

BP began as the Anglo-Persian Oil Company, which had been founded in 1909 to exploit a huge oilfield that had been discovered in Iran. At the outbreak of the First World War the British government acquired a controlling interest in the company, which it held until the company (by then renamed British Petroleum) was privatized by Margaret Thatcher's government in 1979.

Under a series of chief executives—Peter Walters, Bob Horton, and David Simon—BP went from being a highly centralized, bureaucratic organization to becoming less hierarchical and more financially oriented. However, it was under John Browne that BP's transformation gathered pace. Under Browne's leadership, BP grew rapidly: its acquisitions of Amoco, Atlantic Richfield, and Burmah Castrol not only made BP the world's third biggest petroleum major after Exxon and Shell but also precipitated an industry-wide wave of consolidation. Browne refocused BP's exploration efforts around frontier regions including deep waters (the Gulf of Mexico in particular), Angola, Siberia, and the Arctic. Browne also broke away from industry convention by acknowledging climate change, supporting the Kyoto Protocol, and rebranding BP as "Beyond Petroleum." This strategic transformation was accompanied by radical changes to BP's structure, systems, and culture.

The Atomic Structure

In 1997, the *Harvard Business Review* commented upon the changes occurring at BP:

> Organizationally, BP is much smaller and simpler than it was a decade ago. It now has 53,000 employees–down from 129,000. Before, the company was mired in procedures; now it has processes that foster learning and tie people's jobs to creating value. Before, it had a multitude of baronies; now it has an abundance of teams and informal networks or communities in which people eagerly share knowledge.[2]

At the heart of Browne's transformation of BP were high aspirations. According to Nick Butler, former head of strategy at BP:

> When Browne stepped in as CEO in 1995, we knew we had to create something different. We looked at the ROACE [return on average capital employed]: we were all operating within a limited space. We realized that to break out we had to redefine ourself. It was not about beating Exxon, it was about how to beat the ROACE of Microsoft. We wanted to create [a] company with sufficient scale to take regional knocks with enough reach to survive in almost any circumstances.[3]

Through a series of mergers and acquisitions, Browne created a company with the scale he believed was essential to become a leader in the petroleum industry. But it also created the challenge of how to organize such a huge company—by

2000, BP was the world's seventh biggest company in terms of revenues. Browne's management philosophy embodied three principles:

- BP operates in a decentralized manner, with individual business unit leaders (such as refinery plant managers) given broad latitude for running the business and direct responsibility for delivering performance.
- The corporate organization provides support and assistance to the business units (such as individual refineries) through a variety of functions, networks, and peer groups.
- BP relies upon individual performance contracts to motivate people.[3]

At the time, most of the oil majors had a corporate head office that coordinated and controlled a few major divisions. These were, typically, upstream businesses (exploration and production), downstream businesses (refining and marketing), and petrochemicals. BP had been similar; it had been described as a "collection of fiefdoms."

The structure created by Browne was radically different: the divisions ("sectors") were dismantled and the company was organized around 150 business units each headed by a business unit leader who reported directly to the corporate center. According to the deputy CEO, this was "an extraordinarily flat, dispersed, decentralized process of delivery" that reflected a division of responsibility between the business unit heads who were responsible for operational performance and senior management who were responsible for strategic direction and managing external relations—especially with governments. The 150 business units were organized into 15 "peer groups"—networks of similar businesses that could share knowledge, cooperate on matters of common interest, and challenge one another.

The Performance Management System

A basic principle of BP's management system was decentralized, personalized responsibility:

> Under the Management Framework, authority is delegated, but accountability is not. Delegations of authority flow from the shareholders to the Board of Directors to the Group Chief Executive and down throughout BP. BP's philosophy is to delegate authority to the lowest appropriate point in the organization—a single point of accountability. The single point of accountability is always a person, as opposed to an organization, committee, or other group of people, who manages performance through monitoring and intervention. Those higher in the chain of delegation monitor this performance and report up the line of delegation to meet their accountabilities. This structure reflects BP's philosophy that leadership monitors but does not supervise the business; leadership only supervises the people who report directly to them. BP's Management Framework is evident at every level of the organization. Its concepts of delegation and accountability begin with the shareholders and extend through each level of the organization.[5]

The relationship between top management and the business units was governed by a "performance contract": an agreement between the head of the business unit and the corporate center over the performance that the business would deliver in the year ahead. While the performance targets included strategic and operational goals—including HSE objectives—the primary emphasis was on four financial targets: profit before tax, cash flow, investment, and return on invested capital.

Performance goals for the year were proposed by the business unit head after discussions, first with his/her own management team and, second, with the other business unit heads within the peer group. BP encouraged the business unit heads within each peer group to support and encourage one another. There was a particular responsibility for the top three units in each peer group to assist the performance of the bottom three.

Each business unit then discussed its performance targets with top management. The outcome was a performance contract. Once a performance contract was agreed, the business unit leader was free to pursue them in whatever way he or she found appropriate. The monitoring of performance targets involved a quarterly meeting between top management and the business unit leader. "There is an understanding here ... that this is a performance culture and either you deliver or you don't," explained one senior executive. Failure to achieve performance targets often meant reassignment to another job or termination.

Performance contracts were given to all managers within BP from the CEO down and were a key determinant of a manager's annual bonus.

BP as a Learning Organization

At the same time as driving financial and operational performance, Browne was determined to recreate BP as a "learning organization." According to Browne:

> In order to generate extraordinary value for shareholders, a company has to learn better than its competitors and apply that knowledge throughout its business faster and more widely than they do. Any organization that thinks it does everything the best and that it need not learn from others is incredibly arrogant and foolish.[6]

Turning BP into a learning organization involved redefining the role of top management. The primary role of top management was strategic thinking, which involved a quest for knowledge and a commitment to analysis and sharing ideas. Browne espoused an intellectualism that was foreign to the senior executives of most oil companies:

> This company is founded on a deep belief in intellectual rigor. In my experience, unless you can lay out rational arguments as the foundation of what you do, nothing happens. Rigor implies that you understand the assumptions you have made: assumptions about the state of the world, of what you can do, and how your competitors will interact with it, and how the policy of the world will or will not allow you to do something.[7]

This openness involved BP's executives fostering links outside their own company and outside the petroleum business. Browne was a board member of both Intel and Goldman Sachs.

The same culture of interaction and communication was encouraged among peer groups and supported by a number of intranet-based knowledge management and groupware tools. It also involved increased emphasis on career development within BP through training and mentoring.

Social and Environmental Responsiveness

Browne sought to distance BP from the common perception of oil companies as being powerful, secretive organizations complicit with the corrupt, autocratic practices of many leaders of oil-producing countries. Browne envisaged the "new BP" as being more open and responsive to the interests of its employees and the needs of society:

> To build the reputation, we picked four areas. First, safety: when you invite someone to come and work, you should send them home in the same shape as when they arrived—that is a minimum requirement for respect of a person, and you have to take that terribly seriously. Second, you have to take care of the natural environment. It is important because people do not want companies to make a mess and leave them behind. Third, everyone wants a place in the ideal which is free of all discrimination; it doesn't matter what you stand for in terms of your race, gender, sexual orientation or religious beliefs. All that matters is merit. Fourth, the company has to invest in the community from which the people have come, so as to narrow the gap between life within the company and life outside the company.

The key initiative was Browne's endorsing of the link between greenhouse gases and climate change and his commitment to a path of environmental responsibility for BP. The resulting effort to reposition BP in the minds of consumers, governments, and NGOs involved a host of initiatives, including renaming British Petroleum as simply "BP" and replacing its shield logo with a sunburst. The effectiveness of BP's newfound environmentalism was indicated by references to BP and Exxon as "beauty and the beast"[8] and the *Oil & Gas Journal*'s lauding of the company:

> Among the top 10 [oil and gas companies] there is one striking example of a company driven by a different vision. BP has designated corporate citizenship and being forward-thinking about the environment, human rights and dealing with people and ethics as the new fulcrum of competition between the oil companies.[9]

Adapting the Management Model, 2001–2008

In 2001 and again in 2003, BP's organizational structure underwent significant revisions designed to address excessive decentralization and to improve coordination and control.

Instead of the individual business units reporting directly to top management, the peer groups were replaced by "strategic performance units," which were more formalized organizational units with their own budgets and with responsibility for the business units beneath them.

The strategic performance units were organized within three business segments: exploration and production; refining and marketing; and gas, power, and renewables. Thus, while BP's individual refineries remained as separate business units, they reported to refining, which itself was one of the three strategic performance units that comprised the refining and marketing segment.

In addition to the business structure there was also a regional structure. BP had four broad geographic areas: (1) Europe; (2) the Americas; (3) Africa, the Middle East, Russia, and the Caspian; and (4) Asia, the Indian subcontinent, and Australasia. The head of each region was responsible for ensuring regional consistency of the businesses within that region, managing BP's relations with governments and other external parties, and conducting certain administrative functions relating to tax and compliance with local laws.

Further changes took place when Tony Hayward took over from John Browne in 2007. A consulting report from Bain and Co. declared that BP was the most complicated organization that the consultants had ever encountered. Bain identified more than 10,000 organizational interfaces. Hayward's "forward agenda" emphasized cost cutting and simplification. Regional structures were eliminated, functional structures streamlined, and the number of senior executives was reduced from 650 to 500.

Findings of the Baker Panel

An independent investigation by a panel led by former Secretary of State James Baker into the Texas City refinery explosion offered penetrating insights into the role that BP's culture and management system had played in the events leading up to the disaster. Among the findings of the Panel were the following:

- From board level downwards, "BP has not provided effective process safety leadership and has not adequately established process safety as a core value across all its five US refineries."[10]
- Inappropriate performance metrics. Establishing and monitoring performance targets can reconcile individual decision making with overall coordination—but only if the targets encourage the right decisions. In safety, BP's key performance metric was the number of days lost through injury. While conducive to improvements in personal safety, this metric did not help BP in improving its process safety. According to the Panel: "BP's corporate process safety management system does not effectively translate corporate expectations into measurable criteria for management of process risk or define the appropriate role of qualitative and quantitative risk management criteria."[11]
- Inadequate resources. On this issue of whether BP's emphasis on cost reduction and profit performance caused inadequate resources to be devoted to safety, the Panel was agnostic. However, it did observe that: "the company did not always ensure that adequate resources were effectively allocated to support or sustain a high level of process safety performance. In addition, BP's corporate management mandated numerous initiatives that applied to the US refineries and that, while well-intentioned, have overloaded personnel at BP's US refineries. This 'initiative overload' may have undermined process safety performance."[12]

- Failure of board oversight: "BP's Board of Directors has been monitoring process safety performance of BP's operations based on information that BP's corporate management presented to it. A substantial gulf appears to have existed, however, between the actual performance of BP's process safety management systems and the company's perception of that performance … [T]he Panel believes that BP's Board can and should do more to improve its oversight of process safety at BP's five US refineries."[13]

Similar allegations surfaced following the Deepwater Horizon tragedy. A study by the Center for Catastrophic Risk Management observed that BP lacked a 'functional safety culture'; there were "gross imbalances between the system's provisions for production and those for protection"; a potent driving force was "BP management's desire to "close the competitive gap" and "improve bottom-line performance." In addition to "incentives that provided increases in productivity without commensurate increases in protection" and "inappropriate cost and corner cutting," the study pointed to BP's emphasis on "worker safety" and its failure to address "system safety."[14]

However, these inquiries into the Texas City and Deepwater Horizon disasters focused entirely on BP's performance in relation to safety. A broader issue concerned the appropriateness of BP's organization structure and management systems to overall corporate performance. It was notable that BP's organizational delayering and system of performance management had not been imitated by other oil and gas majors. Exxon Mobil for example remained organized around 10 global businesses, and maintained a management system that was dominated by its emphasis on disciplined processes. Its management style had been described as "no-nonsense," "conservative," "detail-oriented," "engineering-based," and "military." Yet, Exxon Mobil had maintained the best financial performance in the industry and was widely admired for its operational excellence—including its safety record: it had not suffered any major incident since the Exxon Valdez oil spill in 1989.

Notes

1. "BP: The Inside Story," *Financial Times* (July 3, 2010).
2. "Unleashing the Power of Learning: An Interview with British Petroleum's John Browne," *Harvard Business Review* (September–October 1997).

The Transformation of BP, London Business School (March 2002): 2–3.

See *The Report of the BP U.S. Refineries Independent Safety Review Panel* (January 2007).

Ibid.: 27. Note that the "Management Framework" refers to the company's description of its management system, produced in 2003.

The Transformation of BP, London Business School (March 2002): 5.

Ibid.: 7.

8. I. H. Rowlands, "Beauty and the Beast? BP's and Exxon's Positions on Global Climate Change" *Environment and Planning: Government and Policy* 18 (2000): 339–54.
9. "Common Financial Strategies Found among Top-10 Oil and Gas Firms," *Oil & Gas Journal* (April 20, 1998).
10. *The Report of the BP U.S. Refineries Independent Safety Review Panel* (January 2007): xii.
11. Ibid.: xv.
12. Ibid.: iii.
13. Ibid.: xv.
14. Deepwater Horizon Study Group, *Final Report on the Investigation of the Macondo Well Blowout* (Center for Catastrophic Risk Management, March 1, 2011).