Corporate Strategy in changing Energy Market

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About the Author:

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Energy companies have been traditionally large. They follow Classic Strategy with annual forecasting and planning. They make long term plans, which typically are investment planning and decisions to enable them to grow production. This method has worked for many years, but now as the market has become more volatile, this rigid approach brings with it many risks. Also, the market is moving from **supply-driven to consumer-driven** where the consumer has more choices on how to fulfill her energy needs, not just rely on a petrol-driven car or utility-supplied electricity.

In this article, I would suggest **"Examine – Change – Review"** method to move forward in this changing market

Changes in the Industry (Oil & Gas, Power, Renewables)

The energy market has long been a Sellers Market. Oil companies or an electricity company would dictate terms. It has always been taken it or leave it. But now the consumer has a choice. He or she can choose from electric car to replace oil, or he can get solar panels to go off-grid. Within oil industry as well, shale/ tight oil & gas pushed OPEC countries and brought down oil prices. Some companies are pushing to drive out coal from the market by selling cheap solar power.

Apart from what is happening in the market, climate change and global warming are forcing countries to follow Decarbonisation in their countries. COP21 was indeed a game-changer. India too gave decarbonization targets at COP21 to help mitigate global warming.

Apart from the energy sector, this generation is overall more connected and doesn't want to own things. They want experiences, not ownership. The world hence, is moving towards decentralization. There is an ever more interconnected world, and disruptive innovation and technological advancement reach to far-flung areas more quickly. Disruptions are easier than they were 100 years ago. With, interconnected world, economic shock waves travel around the world within days.

Can the Energy sector stay from this change, this volatile nature of the world economy? No, the energy sector has to change with the world

Examine – Change – Review

There are different approaches on how to change your approach to strategy in a volatile environment. ECR is one such approach.

Step 1: Examine

Examine your current practices, how you approach strategy, how responsive your organization is to your strategic initiatives. Lowell Bryan talks about how companies should adopt dynamic management in uncertain times in his article:

“The specifics of how companies should build these muscles will, of course, vary. Well-run organizations—particularly those accustomed to using stage-gate-investment approaches for activities such as oil exploration, venture capital investment, and new-product development—may find that moving toward a more dynamic management style requires a few relatively small, though collectively significant, shifts in their operating practices. Others may find the necessary changes, which include migrating away from rigid, calendar-based approaches to budgeting and planning, more wrenching.” [2]

For budgeting, he says:

“Yet it’s important to recall why we have them: they enable the efficient delegation of authority between managers and subordinates. In return for the freedom to make decisions and allocate resources, the subordinate contracts through the budget to deliver expected results. The managers of a large company make tens of thousands of operating decisions every day, and if all of them required constant deliberations up and down the chain of command and across the organization, it would grind to a halt. Jettisoning budgeting, therefore, is hardly an option—though it may have seemed reasonable at points over the past year since most of the budgets produced in late 2008 for 2009 proved worthless (as did most companies’ earnings guidance to stock analysts). What this underscores is a basic problem with budgets: if developments in the marketplace are sufficiently different from the assumptions used in budgeting, managers can’t make their numbers no matter what they do. At best, by the time these developments have surfaced to the top, most of the lead-time needed to address the emerging issues have been exhausted. At worst, the company faces a crisis after being weakened by the hidden costs of all of the short-term actions (such as maintenance cutbacks for manufacturers or excessive risk-taking for financial institutions) undertaken by managers endeavoring to make their numbers.” [2]

Step 2: Change

Develop new processes after you have examined what is good and bad about your current strategic processes. Try to create a rigorous and on-going management process to formulate strategic initiatives to deal with the volatile environment. Chris Bradley, Lowell Bryan, and Sven Smit suggest one such management process **“moving from ideas to execution requires seven distinct modes of activity”** [1)]. There are other ways as well to strengthen your strategic management process. After developing the process, formally integrate the strategic-management process with your financial-planning processes as well to integrate budgeting and financial control (financial planning processes have to be changed as well to make them more flexible).

One of the processes that I would like to focus on is Scenario Planning that has been pioneered by **Shell**.

Scenario Planning

Like Shell, companies can develop scenarios based on demographic trends and reversal of unsustainable trends, economic action, and reaction and scheduled events outside the planning horizon.

Charles Roxburgh talks about the need for developing scenarios in his article

“Many winning business models are highly specialized and precisely adapted to the current business environment. Therefore no one should ever assume that today’s winners will be in an advantaged position in all possible futures (or even most of them). Therefore, scenarios should be based on creative thinking about how predicted changes in the business environment will alter the competitive landscape. If the environment changes in a scenario but the competitors remain the same, that scenario may not be imaginative enough." [3]

Many variables can easily be predicted, e.g., 'Changes in population size and structure.' Economic variables are hard to predict, as there is a reaction to all economic actions, e.,g. Price changes of oil & gas drive supply and demand reactions in every relevant value chain. These reactions can be found out through careful scenario planning.

Business plans have forecasts or targets that are based on extrapolation of past data, which are more of a wish list than forecasts. Economies, on the other hand, are cyclical. There can be optimistic projections, and there can be pessimist projections. Strategists should always be in touch with the underlying assumptions and data so that they are not lost in the euphoria of projections and investment bubbles. If you are developing scenarios for 25 years, you would be forced to **think beyond cycles and see which trends would hold and which won't**. Also, having scenarios for 25 years or more would help you to look objectively at events that are typically not covered by corporate's long-term plans. E.g. 'adjustable-rate mortgages where you may be required to refinance your projects.'

Scenarios are hard, as Charles Roxburgh concludes in his article

"None of the above is rocket science. Why, then, don't people routinely create robust sets of scenarios, create contingency plans for each of them, watch to see which scenario is emerging, and live by it? Scenarios are, in fact, harder than they look—harder to conceptualize, harder to build, and uncomfortably rich in shortcomings. A good one takes time to build, and so a whole set takes a correspondingly larger investment of time and energy. Scenarios will not provide all of the answers, but they help executives ask better questions and prepare for the unexpected. And that makes them a very valuable tool indeed."[3]

Step 3: Review

Regular discussion about strategy with a top team, board, and periodically revisiting corporate aspirations helps in making any big, directional changes in strategy required by changes in the global forces at work on a company. As the strategic process now regularly brings more insight to the management, they can decide on the changes required or grasp an opportunity before the competitors. One cannot change the direction of a company just by one-time activity; hence, regular discussions are required throughout the year. As Chris Bradley, Lowell Bryan and Sven Smit write.

"Changing the strategy of a large bank, or any large company for that matter is a bit like turning a supertanker. The momentum of the institution is so strong that the ability to change direction quickly is limited. After all, the focus of the senior and top-management teams of most corporations, most of the time, is on near-term operating decisions—particularly on delivering earnings in accordance with the financial plan. As a result, many, if not most, of the decisions that shape the future of organizations are made unconsciously in the flow of running the businesses or through annual planning processes that suffer from trying to cover all businesses and issues simultaneously (or through one-off projects)." [1]

In our turbulent times, companies need to spend time building their strategic capabilities according to the volatility in the market. In the Energy sector, as we have seen, there have been lot of changes. Big Oil & Gas or energy companies cannot keep following the processes they have been following when the market was rigid. They have to build institutional skills and generate strategic ideas to develop themselves further with changing times. To prepare for the future, companies have to change the way they think and make decisions.

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