

Competing in New Environments: A Chevron View of the Global Oil Industry

Remarks by
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As delivered to the
Energy Policy Foundation of Norway's Energy Policy Conference
Sanderstolen, Norway
February 5, 1998

Our hosts have asked me to talk today about competing in new environments. So let me start by defining a new environment as any area of our business where the game is new or where the rules of the game have changed.

By this definition, probably a dozen or more specific areas of our business would qualify as new environments. Some involve management challenges. Others present us with personal challenges. And some confront us with both. Some we must face separately and internally. Others present competitive challenges to our total industry, not just to individual companies.

Competitive leadership

First, I believe we are facing a new leadership environment in the oil industry. It boils down to how companies will go about getting as much performance out of our people as we do from our assets.

As managers, a lot of us are good at business judgment, technical insight and financial analysis. And we're good at giving orders. But that doesn't necessarily mean we're good at leading people and building teams. This game is new mainly because our organizations are flatter and our staffs are smaller, and because the oil industry is becoming more collaborative.

The main point on leadership is simple: When every person's contribution counts more, the manager's role as a leader becomes that much more important. There seems to be a consensus in the industry that being able to motivate a work force is a critical success factor. In short, it's not enough anymore to do a good job driving the hard assets. Now you have to nurture the soft skills as well.

A lot of companies like to say that people are the key — people make the difference. I couldn't begin to count the number of times I've heard that over the years. But now I think we are really starting to believe it.

Speaking for myself, I'm a geologist, and nurturing human beings was not part of my professional education. The same is true for engineers and others in technical disciplines.

But regardless of one's training or natural ability as a leader, none of us can do it alone. So if I had to choose one competitive issue in the new leadership environment that will make a significant difference in the long run, it would be selecting and promoting the right people within your organization.



The diversity advantage

Another part of this new leadership environment is the issue of diversity. The best global companies for years have managed their human resources based on skill, talent, experience and merit — without regard to race or national origin.

The diversity issue can be confusing, because we're supposed to recognize differences and ignore them at the same time. I think the challenge today is to get beyond merely recognizing diversity and to start promoting it. The smartest energy companies won't just work around cultural barriers. They'll make it their business to eliminate them.

One of the ways they'll do this is to look for and define the competitive advantages inherent in putting diverse people into keystone jobs. In the global business environment, this will be one more way to take full advantage of your work force. And each of us in management has an opportunity and, I believe, a responsibility to promote this approach.

New energy markets

We sometimes call these markets nontraditional for oil companies. That's not quite true, and we have Exxon's long-standing electric power venture in Hong Kong as one example.

But in general, when oil companies enter the newly deregulated gas markets and the electric power markets — private or otherwise — they're walking not just on unfamiliar ground but also on unsettled ground. Nevertheless, we all want growth and strong profitability, so we are compelled to participate.

For Chevron, it's the deregulated European gas markets and the North America alliance with NGC Corp. For Enron, it's full speed ahead, worldwide — they've defined the business. And Shell revealed an aggressive strategy recently with its acquisition of 50 percent of InterGen. Here in Scandinavia, there's news of a proposed merger of Neste and IVO, and I understand they are looking at a new pipeline to bring in Russian gas.

All the forecasts suggest that we'll see a lot more of these new energy market investments. And the competitive issue that gets all the attention is how fast each company can grab a share.

We know that gas and power markets will keep growing, partly for environmental reasons. But we also know that energy demand slows down when regional economies stumble. The present situation in Asia serves as a clear reminder of this.

The real competitive advantages for each of our companies reside in our risk/reward analytical skills and our portfolio-balancing skills in choosing where and how we will invest in these new markets. Even the strongest competitors may find that profits can become an endangered species when intense competition mixes with excess capacity.

Managing technology

Let me turn now to the new technology environment.

The industry is more dependent than ever on technology, but it isn't cost-effective for each company to throw money and big technical staffs at inventing and developing everything it needs. The situation requires a

higher devotion to the discipline of "technology sourcing."

Companies should sustain and promote their best proprietary technologies. They should also buy superior tools from others and seek more through alliances and cooperative research and development with universities, governments and partners. The well-managed technology organization today should be asking: What technologies do we need, and what's the best way to get them?

Still, there's a full range of perspectives. One example that comes to mind is gas-to-liquids (GTL) technology. It's our best new hope for monetizing stranded gas reserves. But some companies are leading; others are following.

Shell has already invested more than a billion dollars in its Malaysia plant, and it's proposing another GTL venture with Petronas in Bangladesh.

Meanwhile, Exxon's proposed plant in Qatar would convert a billion cubic feet of gas into 100,000 barrels of liquids per day.

Both Shell and Exxon have developed proprietary gas-to-liquids processes. Other companies can't take that expensive route or don't want to — just yet. Texaco and Arco are betting on their relationship with Syntroleum. And Statoil has chosen to work with Sasol. Still others expect that GTL technology will be accessible at a reasonable price — no matter who invents it.

Managing knowledge

A parallel challenge to managing technology is managing knowledge and, in particular, sharing best practices. For our companies, these disciplines are part of a larger challenge, which is creating a new kind of workplace environment called a "learning organization."

The companies that are good at finding best practices, creating better ways to work and then making improvements faster than their competitors will enjoy an operational edge. They will also adapt more easily to change — and they will be quicker to take advantage of new opportunities.

Building a learning organization is an inexact science, at best. The managers at the top can be constant advocates — this is our main role. But only the employees can make it really happen.

And if you're wondering whether it's worth the struggle, try this exercise:

First, imagine having a work group smart enough to save \$100,000 a day by putting a new idea to work at their facility. And then imagine having a company culture that would put that same idea to work at 10 facilities, all at the same time.

A regulated world?

I'd like to discuss now some new environments which present competitive challenges to our total industry, not just to individual companies.

First, I believe that our industry is facing a world regulatory environment that's fundamentally new. More than ever, it's one world today. So it's not surprising that global climate change has become a universal environmental issue.

The people who are pushing the theory of global warming are, in many cases, the same people who would like the world to stop using oil.

Greenpeace is leading the charge by launching an international campaign to ban new oil and gas exploration. And now it appears that world leaders will try to enforce a complex regulatory program to reduce greenhouse gas emissions. These agendas will present each of the companies in our industry with some unique challenges.

Some host countries will endorse and embrace the global rules. Others will totally reject them.

So everywhere companies work as outside partners, we will have to respect the host-country position and stay focused on the business of profitable energy development. That is our job.

In one sense, this is a competitive issue. And we've seen a full range of public positions taken by different companies. But I think all of us can expect worldwide criticism of the entire fossil fuels industry to continue because of the climate change issue.

So in addition to responding individually to this criticism, we should renew our commitment to another very important asset: our shared, total worldwide reputation as an industry.

We need to show new progress in safety, environmental protection, community relations and cleaner fuels. If we can do that, I believe world leaders concerned about climate change will take a more balanced perspective on regulating our business.

It's important to remember that the global climate change debate is as much about promoting alternative fuels as it is about saving the planet.

Some of us, such as British Petroleum (BP), are investing in these emerging businesses. But some others want to artificially stimulate alternative-fuels industries that aren't ready. They want to use politics and fear to create markets for their products. Our response — as an industry — should be to do more to remind people of the enormous benefits our own products bring to consumers and the world economy. The U.S. chemicals industry has done a particularly good job of this. We can do the same.

Meanwhile, we can remind world leaders that the best scenario is for alternatives to continue to compete against oil and gas in a free marketplace.

In a contest based on performance, price and environmental appeal, all contenders can only improve; the best options will prevail; and customers will be the true winners.

The geopolitical factor

Let me turn now to competing in new geopolitical environments.

South America stands out as a region where privatization and partnerships with outside companies have transformed the oil and gas industry. And 1998 is expected to be a very big year for new investment, particularly in Venezuela. Meanwhile, on the other side of the globe, China seems to stand as a new geopolitical environment all its own.

But the former Soviet Union (FSU) is in a class by itself. Seldom does a region face an agenda of changes so historic, so unique and so extreme.

And seldom have our companies faced such an urgent call to make short-term business decisions about major investments in a high-risk region where only a long-term perspective makes sense. This is a very large and complex region of tremendous potential, where unpleasant surprises are often "business as usual."

It has been six years since the collapse of the FSU, but this is still a new geopolitical environment for our industry. It's a region where the top competitors are required to think as much about creating the future as they do about forecasting it. And anyone who has tried to make investments in the FSU knows by now that linking transportation solutions to new developments is standard operating procedure.

The pipeline deals bind us together even more than the partnerships — so we have common interests to consider on two levels. There is a third level, however, and this is the total regional stability of the industry.

The Caspian region, in particular, faces huge international relations challenges. Fortunately, oil is an interdependent industry. Our ongoing transactions and developments can be as powerful and as important as regional diplomacy.

In the past, Caspian nations were linked under a centrally planned economic structure that's now abandoned. In the future, they will be linked by interaction in a free marketplace for mutual benefit. The oil industry has an opportunity — and an obligation — to help drive the transition to that new order.

We aren't just another industry in the FSU. We are a primary participant in the political rebirth and the economic transformation of one of the most important regions in the world. So while we're looking for ways to compete, we should also look for ways to contribute.

The Caspian and the oil companies that invest in this important region share a common destiny. And everything we can do to cultivate interdependence will pay off in the years ahead in stability and good will.

Russia: positive momentum

I want to make one more observation about the FSU before I move on. And this is that no one should be surprised that the assumptions made several years ago about outside investment in the Russian industry turned out to be merely assumptions.

In retrospect, we've learned that it was not prudent to try to seek big shares of Russia's oil and gas industry before Russia had moved further into its economic transformation.

Frankly, I don't fault the Russians for not being in a hurry to share their national energy treasure with outsiders. I am pleased to see the process of privatization moving forward. The recent alliances formed by Shell and BP with leading Russian oil companies are in some ways exciting and new. In other ways, they're traditional oil ventures, and I think that is a positive reflection on the emerging oil-industry structure in Russia.

The best strategy for meeting the challenges of Russia's energy future is for world-class Russian companies to efficiently manage their assets on behalf of their stockholders. Already, these companies see and understand the value of relationships with other world-class companies. So even though we have been through a period of false starts for investment in the Russian industry, I see a positive investment picture for the long term. And as this develops, competing in the new environment of the Russian oil and gas industry will start to look a lot more like competing elsewhere in the world.

Partnering for performance

This is probably a good point to move on to the last of the new environments I want to talk about, and this is the new partnering environment.

Performance is our primary concern as managers. And today, more than ever, the key is how effectively we choose our partners and perform together in the long term.

Partnership is hardly a new concept for our industry. Indeed, it has been a primary tool for managing risk, still a major reason to share projects. But clearly, we have gone beyond that. We've entered a time when a lot more of us really believe we'll do better together than separately.

James Crump of Price Waterhouse describes what's happening as "an evolution in business relationships." A competitor today, says Crump, is an ally tomorrow. But he also observes that a strategic partner in one environment can be an adversary in another. This might look like a recipe for confusion and conflict. But Crump argues that our industry is more than capable of living with the contradictions while taking advantage of the combinations. And I agree with him.

A good share of the total industry spent the last 10 years in restructuring. We looked internally and made enormous changes to become more efficient. Now we're looking externally. Mobil's chairman Lou Noto said recently that looking for new relationships is something companies do when they accept the fact that there are people in the world who do things better than they do. He's right — and I think that when companies accept that, their business prospects double overnight.

The same can be said about a company's perspective on the entry of national oil companies into the world deal-making environment: Petronas, China National Petroleum, Kuwait Petroleum — the list goes on.

Each national company has a unique personality. And yet, many of them have followed a predictable path to maturity, which now leads them outside their borders and into the world marketplace.

New players, new partners

Today, the traditional majors find themselves facing a host of new, unfamiliar, wealthy and powerful contenders in the global oil game.

Personally, I think this is one of the most exciting developments in the history of the industry, because every new competitor is also a potential new partner. So one of the competitive challenges for all of us today is to see these things clearly and act on them quickly.

There are other reasons for the rise of the new partnering environment. Some reasons are operational. The emergence of the deepwater frontier, for example, compels us to share the high costs and major technical challenges, as well as the host of risks. Other reasons are financial. Some host countries need to bring in investors to help them manage maturing resources or to share costs.

But beyond those, the intense pressure to be competitive in the flat-price environment has forced companies all across the industry to forget the old rules and look for new ways to outperform the other companies.

Hard times and openness to new business concepts have taught us to pursue marriages today that we never considered or imagined yesterday.

Operating alliances have attracted a lot of attention, for good reason. And some of us have formed supplier alliances, locking in cost advantages, technical exchanges and reliability of service. Some of us have formed operating service agreements, finding common ground in long-term fee income when the host countries are

not comfortable with traditional production-sharing agreements.

The trend is clear: In our industry today, top competitors are moving toward more cooperation, so that, in turn, they can be even more competitive.

Stable business conditions

For host-country companies seeking to attract partners, I urge you to stay focused on creating and sustaining stable business conditions in your countries. This is particularly true for your tax structure. Other countries are working hard to offer competitive business conditions, and their reward will be to attract a larger number of outside companies negotiating to win their projects.

For those countries that have not opened to outside investment, I would urge them to think very carefully about what they're missing.

Business conditions in the past 10 years have created an industry filled with smart, nimble, efficient and resilient companies. They all want to grow, and they are eager to work with you. It's a buyer's market, and it's a good time for closed countries to learn more about the rewards of partnerships by trying some.

Finally, for companies seeking access to new projects in various countries, remember that, to a certain extent, all oil companies are alike. Like high-performance automobiles, the harder we compete, the more we look the same to future partners. Remember also that not all oil companies are alike, and they shouldn't try to be. The big challenge in the new partnering environment is "positive differentiation."

Any company that hopes to survive will have to be good at technology management, leadership, risk management, reputation management and the rest. But in reality, no company can be the best at everything — and we probably can't afford to try.

Indeed, the name of the game will be to seek out partners who complement, rather than duplicate, our own capabilities and to attract those partners by seeking to be the absolute best in our own areas of special expertise.

What does your company represent? What are its strongest points of experience and its greatest achievements? Are you the low-cost producer? Are you the leader in liquefied natural gas (LNG) or clean gasoline?

Is your skill in partner relations superior to others? Do you have the operating record to back it up? Can you bring superior environmental management to troubled locations?

Statoil's Rolf Magne Larsen recently noted in *World Oil* magazine that high ethical standards and greater sensitivity to human-rights issues will help determine each company's success in the future. Do those terms describe your company?

Do you offer superior training and exchange of knowledge or superior financial management capabilities to your host-country partners? Do you bring to each partnership a portfolio of skills and business relationships — upstream and downstream and in petrochemicals — all over the world? Are you prepared to share these relationships and future projects with new partners?

Positive differentiation is the basis for competitiveness in the new partnering environment. Being good at selling your highest value as a partner will only become more important over time.

The door is open at Chevron

So let's talk — the door is open at Chevron.

Our industry faces a lot of uncertainty as we head into the 21st century. Anyone who doubts this should look up the current price of Brent compared to that of a year ago, check on the weapons inspection dispute in Iraq, look at the latest LNG demand projections for Korea or get an update on gas market deregulation in Europe.

But one thing is certain: The smartest companies will search the landscape well for the best partners. It's going to make a big difference.

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