

## **A Conversation**

### **Profits with Principles – The Transformation of Royal Dutch/Shell**

*Mark Moody-Stuart, J. Ladd Greeno, and Jonathan B. Shopley*

*With more than 100,000 employees and assets valued at \$80 billion, the Royal Dutch/Shell Group is a global giant in the energy industry, involved in the whole production process of fossil fuels – from initial prospecting and recovery to final sale – as well as other businesses, such as chemicals. Recently, the Group, which was established early in this century, has moved into the renewable energy business. Since the start of 1996, Shell has been effecting a radical transformation of its company structure. The goal of this transformation is twofold: to create a more flexible and cost-effective framework to meet the business challenges of the next century and to pursue a business focus driven by the interests – financial, social, and environmental – of Shell’s customers and others. Arthur D. Little is helping Shell adapt its management framework to enable the company to put its sustainable development goals into practice.*

*This year the Royal Dutch/Shell Group startled business and political communities around the world with the publication of its report „Profits and Principles – Does There Have to Be a Choice?“ This groundbreaking report shattered the image of the Group as a closed, purely commercial entity and was striking evidence that transformation is truly under way.*

*Openly and directly, the report discusses the business principles driving Royal Dutch/Shell. It takes a bold and frank approach to issues and dilemmas facing the Group, such as climate change, renewable resources, and human rights. And it sets out the road map for the Group’s transformation to achieve prosperity through sustainable development. The message in the report is clear: „There does not have to be a choice between profits and principles.“*

*Mark Moody-Stuart is the new Chairman of the Committee of Managing Directors of Royal Dutch/Shell, and one of the chief architects who has been involved in the Group’s transformation from the outset. In a recent interview, he spoke with Ladd Greeno and Jonathan Shopley of Arthur D. Little about the transformation process’s business drivers and the vision and values behind this pioneering effort. Together they discussed how to align people in business units around the world with the Group’s vision of sustainable development, as well as the means Shell is adopting to measure and accelerate progress.*

**Ladd Greeno:** Shell is in the midst of a major transformation. How is sustainable development seen in this change process?

**Mark Moody-Stuart:** They are a part of each other, really. One of the essentials in a process of change is that you have a reason for being and a view of where you are going. Over the last three years, we have started to put our business and the direction of the business into a sustainable framework. That gives an overall logical direction, so that people can see how the development of our business moves through oil and gas into materials, electricity, and now into renewables as well. So the framework is a picture of the present, but it also shapes commercially where we will be going and what is really important in the future.

**LG:** What are the business drivers for Shell’s transformation process?

**MMS:** We are a commercial organization, and so, in the end, commercial judgments drive what we do. We have to be able to make a sustainable profit, as it were. Our shareholders will always expect us to make a reasonable return. I think they also like to know that we have made that return in a way that is not out of line with broadly accepted values and that we contribute to the things that matter to our stakeholders.

**Jonathan Shopley:** Is there a conflict between the bottom line and sustainable development?

**MMS:** The picture is not yet complete in sustainability. However, I am absolutely convinced that if you get this overall picture right, the organization will be healthier and more effective, more motivated and aligned, and the benefits will come through to the financial bottom line.

We had a meeting with major shareholders on nonfinancial issues in January. Many of them are large fund-holders or insurance companies. We talked about developments in different countries, about climate change and our approach to it, about verification and the Shell Report. A lot of them weren’t sure when they came how we were going to talk for three hours about nonfinancial issues, but they were so interested in the discussion that the meeting ran over, and many people stayed for a late lunch to carry on talking.

I think this was an indication that shareholders are beginning to realize that this is a direction in which the world is moving and should move. We can say that we think it’s a good idea, but in the end, if the shareholders don’t think it’s a good idea, you have a problem. We haven’t had that problem.

**LG:** How does sustainable development fit into Shell's vision?

**MMS:** Historically, Shell – and most companies like us – have concentrated very much on the needs of the present generation. For many years Shell has been a major contributor to overall economic development in many countries of the world, by providing fuel for transportation and low-cost energy. We have provided the means to give people real personal freedom of movement; and low-cost energy is also vital to actually developing the capacity of an economy. We have also contributed to the building of human capacity, in the form of technical, organizational, and business skills, which are very important in sustainable development.

We have always been involved in looking at the development of different kinds of fuels. We are part of the evolving fuel chain energy picture that goes from wood and coal to oil – which is where we came in – to gas, electricity, and different forms of electricity generation. Now we are looking at how this chain will continue to evolve in the future to satisfy society's desire to move to sustainability. We are part of that society and evolve with it in this way.

In 1996 we produced something called „The Shell Business Framework,“ in which we talked about sustainable development and about the impact of carbon dioxide, the need for energy efficiency and precautionary measures, and so on. However, our work to put the business framework together dealt with much more than that. At the time, we were facing lots of other challenges in the outside world, so we went right back to the roots of the whole argument.

We started by revising our group business principles, which we had held for more than 20 years. After a lot of internal and external consultation, we made three adjustments. One adjustment was to make a commitment to sustainable development. A second was a commitment to human rights. Third, we modified our statement on politics to say we would not be involved in party or partisan politics, because the original statement was so often misinterpreted.

**LG:** What is the role of values, both corporate values and perhaps your own personal values, in this whole process?

**MMS:** If you run a global organization that is decentralized and very local in many areas, you can't control and direct. The only way of making sure that an individual on the spot at any one time makes what, from a corporate point of view, would be the right decision is to share common values. It's a question of trust, really. I know what other people are doing out there, and those people know, as a matter of trust, what I am going to do. If I have a discussion with someone – a head of state, say – to me it's of critical importance that people all around the Shell world know, on the basis of our values, what sort of things I am going to say and how I will behave, and vice versa.

One of the reasons I have stayed with Shell all these years is that I have never found a conflict between my personal values and those of Shell. People here can always challenge things on the basis of values.

That will be very important for us in this process of change. If we talk about sustainable development, our policies on investment and everything else will have to be congruent with that; otherwise it will fall apart. This is a complex subject, so exactly what being in line with sustainable development means is not always plain. That is something we are working to define now in all the businesses.

**LG:** Within a company as global and decentralized as Shell, how do you get everybody on board with something as vague and ambiguous as sustainable growth?

**MMS:** We have done a great deal of heart-searching over the past few years, partly of course in response to the events in Brent Spar and Nigeria. When an organization is subject to external pressure, you need to go back to reassess your values and what it is you are doing and then make sure that you have agreement on all these issues.

When we changed the business principles, we did it through a process of consultation. We went to people all around the world and said: „If we put this sort of thing in the principles, do you think it's achievable?“ Through this process of consultation, you start the process of internalizing the document. We interviewed 600 Shell people in 55 countries. When people began to think about it, they recognized that there were things we needed to clarify and put right, but also things we can be very proud of. That engendered quite a lot of enthusiasm.

Then we said, OK, if this is really to be company policy, we need to make sure that it is built into the corporate framework as mandatory. But it's no good having something mandatory if you don't have the capacity to deliver it. So we set about getting people in different businesses to talk about the new principles and to understand what those principles actually mean for each business. We also set up a small team to start the process of demonstrating that we are doing what we said we would in our business principles – and out of that came the Shell Report.

When we finally put all the information together in this experimental report, „Profits and Principles,“ it had a big effect internally as well as externally. People have looked at it and said, „Now I can see what we are working toward.“ I’m really glad we’ve done it. We know we have a very long way to go, but we have started on the right path.

**LG:** What are you doing now to move the organization forward?

**MMS:** Not everybody wants to change, of course. Lots of people are quite happy with their bit of the business and where it’s going. But a lot of other people, at all levels in the organization, like to see how their bits fit into the whole organization and how our whole organization fits into society. It is very important to people, I feel, to have this emotional enthusiasm about what the corporation as a whole is doing in society.

Sustainable development is a big piece of that. As part of the consultation process, we asked people, „Why do you work for Shell?“ The international nature of Shell is an attractor for many. Also, people work for Shell because it gives them the ability to achieve something, build something, make something happen. Equally clearly, the attraction is commercial. There is a strong, shared belief across countries that part of Shell’s contribution to society is through generating wealth by doing things that society actually needs and by supplying things our customers need to achieve the things they want, be it transportation or light or economic development.

All these elements tie in quite strongly with sustainable development. When you match the need for this kind of economic usefulness with the need for seeing where we fit into society, you have a framework in which people can see both how they fit and where we are going in the long term.

Plainly, if people who are motivated in this way suddenly felt that the whole thing were going to come to an end when an oil field is depleted or when energy sources change, that would be a kind of betrayal of what they have worked on. In that sense, too, sustainability is fundamental.

**LG:** How is sustainable development helping with the short-term changes at the heart of Shell’s transformation?

**MMS:** I always say that transformation as a concept with a capital T is fairly useless. It only begins to have any real meaning when you talk about: What am I going to do in relation to my particular job? How does my bit of the organization fit into the overall pattern? We’re a long way from everyone in Shell being able to explain that. But that’s where we will have to get to in the end. We are putting together a detailed road map that goes on for several years, and we are well aware that it’s going to be a long run.

**JS:** What measurements are you making to check how well you’re doing on the way?

**MMS:** The measurement of progress is not easy. There are people outside Shell who say: You should be able to measure your performance in this or that area. Where there are indicators and we can apply them, we will apply them. But we may come to the conclusion that some of these things cannot be measured, in which case I hope we will all agree that they will not be measured.

The other question is: Who is going to verify this? Many nongovernmental organizations claim that they are the only independent bodies, and that therefore they should do the verifying. I don’t agree that they are independent. They too have customers whom they have to satisfy. *You do* need to approach verification in a very structured and numerical way, but this is difficult because there aren’t any standards for verification.

However, within Shell we do have three ways to assess the impact of change. First, we expect to see an impact on overall performance. Since we tend to measure overall performance financially, we should see an impact on financial performance in parts of the organization that have really changed and are applying these things effectively. And we are already seeing that impact in some areas of our business.

The second way we assess the impact of change is through managerial „sensing.“ When I visit one of our organizations in some part of the world and spend a day talking to people, at the end of the day I have a very strong feeling about the atmosphere in that organization. How flexible are the employees? How rapidly are they responding to changes? Have we released the creativity within that organization? It’s what I call „kicking the skirting boards.“ If you want to buy a house, you go in there and you prod the walls and kick a bit, and if you get a robust reaction then you feel a lot happier. If your foot goes through and you suddenly find that where you start digging and scratching there doesn’t seem to be anything, and you dig a bit farther and half the wall falls down, then you know that you’re in trouble.

I think that sometimes we underestimate this managerial sensing. To me, it’s very important. Of course it’s totally qualitative and very personal. *You* have to really trust the judgment of the managers who are doing the sensing. Part of the value is in the value of the evaluator, as it were. The last method of assessing the impact of change is to ask people what they think through surveys. We have done that in some parts of Shell. Shell Canada, for example, is very advanced in this. For a number of years they have tracked attitudes there and have included progressively more difficult questions, such as how your supervisor behaves toward you. This approach allows us to see how people’s attitudes and experiences change year-on-year. We can then take steps to respond.

**JS:** How do you measure and reward individuals for their contributions to progress?

**MMS:** We move increasingly toward linking financial rewards and pay to performance generally. We do that, obviously, as much as possible in relation to hard numerical measures, which tend to be financial – related to costs or return on capital or net income or production or whatever. In our system, these measures make up 60 percent of the variable element. We have said the other 40 percent should be as hard as possible, but it includes some more qualitative measures, such as performance on health, safety, and the environment, performance relative to the competition, and performance on managing our external reputation. We're still working on what the ideal mix in that area would be.

**LG:** What kind of reactions have you had across the industry to what you are doing?

**MMS:** When I have presented these ideas personally to people I thought would be interested – which is, of course, a biased sample – the reaction has been almost universally positive. I have also been astonished by some of the letters I've received. Some are very strong statements saying: „We really think this is something important.“

Internally, we have also had very positive reactions. A lot of the responses come back saying: „I'm really proud of what we're trying to do.“ So I think that internally it's quite strongly motivational.

I don't think we have had negative reactions from industry. We did have a burst from a particular group who read the Shell Report on the Internet. They referred back immediately to Nigeria and said that they did not believe the report and they were never going to buy Shell petrol anyway. *You* could see that it was a coordinated response started by an organization, because the wording of the letters was always the same. It is clear we still have a lot of convincing to do in some quarters. I don't believe we are ever going to have a quiet life.

**LG:** What lessons have you learned at this early point in Shell's journey, and what advice would you offer other companies contemplating a similar journey?

**MMS:** It's complex. You have to have enthusiasm and commitment at the top of the organization, and yet you have to be sure that you can deliver something throughout the organization. It's no good just writing it.

If we go back historically in Shell and look at external reporting on health, safety, and the environment, we have always been rather cautious about this and were slow in doing it. We believed the way to go about it was to build it up from the bottom. So our operations in different countries would publish things that related to their respective environments, and we would gradually build these up into an overall company position at the pinnacle. That is a very long, slow process – very sound, but very slow.

When we were setting out on our present transformation, we said we cannot do that, it will take forever. We needed to make the different businesses aware of what we were doing, but what we actually needed was strong commitment at the top. We would never have got going if we had not had a group of people who sat down at intervals and said: „Where are we going? What are the problems?“ Somebody over here may be howling that it is not practicable and someone from the top has to explain to them why we're doing this. Someone else over there says: 'Are we really going to put all this information out? This is dangerous and I don't agree with it.' *You* need the high-level capacity to deal with all of that. And, while you are doing that, you have to be very sure that what you are actually doing is congruent with what goes on in the organization.

**LG:** Given the long journey you've mapped, what's the engine that will maintain, and even accelerate, Shell's advances in sustainable development?

**MMS:** The ultimate driver is survival and sustainable profits. You have to look at the future of the business, what new bits of the business are you going to create; and inevitably some bits of the business will cease.

This isn't, of course, something new. Think back to the 1950s and early 1960s, when we had people tramping around much of Europe in the movement to convert industry from coal to oil. Then in the '60s and '70s we ourselves killed the fuel oil business with gas. Having wiped out our own fuel oil market, we had to do something with the fuel oil. This was stuff that was no good for anything but burning. We added hydrogen to it and put it into diesel and gasoline. Now we have refineries that produce virtually no fuel oil because nobody needs fuel oil, they need transportation fuels, interestingly enough, this movement was not originated by worries about climate change, but it's absolutely congruent with the changes that are needed.

**JS:** How much of Shell's future will involve real innovation, in terms of reaching out for a sustainability goal?

**MMS:** I believe our transformation's biggest contribution to our business will be the way it releases people's creativity and speeds their response to what the customer wants, making our everyday business truly excellent while identifying the new opportunities. And doing all that with a sense of enthusiasm and fun.

There will be things the world needs us to continue doing, more and more effectively, because there are no viable commercial alternatives at the moment. In the meantime, the whole situation will move on to the next phase. Just as we moved from coal to oil and from oil to gas, we now also have a business unit that brings together solar, biomass, and forestry sources of energy.

People often say, „These changes are uniquely driven by climate change.“ I don't think they are. Many of the alternative energies would be developed as a result of technological development, with or without the driver of potential climate change. What that driver will do is make sure that the process of development goes in directions that have the most positive – or the least negative – effect on climate change. So views on climate change influence the overall process, but I am quite sure that the process would happen anyway.

**LG:** The Shell Report is an innovation in itself, in terms of being candid about where you are going and setting forth the issues and challenges involved in the journey. But, of the 20 million people who walk into your outlets every day, how many would you say you've reached with it?

**MMS:** Recently, when we've researched brand preferences, we've found that many people who buy from us say that feeling comfortable with the company from which they buy is important to them. I am not sure whether the message is getting through, but it is clearly important to us that our customers do feel comfortable with what we are doing.

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