The new energy leader: The essential attributes of US energy leaders for the next decade

As the petroleum industry continues to navigate unprecedented price volatility and falls out of favor with investors, the real competition in the next decade will not be for customers, but for leaders: those who are able to develop a new humility building their capabilities to think like activists internally, relate like diplomats externally, and serve as effective advocates for the industry that powers all others.

On October 22, 2020, Zoom zoomed past ExxonMobil in total market value. This was not widely noted at the time outside the petroleum industry—but for the sector's leaders it became an unsettling market metaphor. Coming toward the end of a year in which uncertainty, volatility, and hardship had already become commonplace, that moment followed an even more catastrophic one, in April 2020, when West Texas Intermediate (WTI) traded below $0 per barrel. Coupled with longer-term underperformance and pressure from activist investors as well as the quickening pace of the energy transition, it seemed as if everything in the energy industry was turning upside down. Most industry leaders were unprepared for this new reality. How they lead in the next decade could very well make or break the industry.

Energy, specifically petroleum-based energy, fueled the rise of modern industry, modernized agriculture, and powers the digital age—and literally powers almost every other industry in the world. Though renewable sources are taking some market share (supported by the petroleum energy supply chain), most experts acknowledge that the vast majority of the increasing demand for power cannot be generated or supplied by renewable sources in the next—or even the following—decade. According to the International Energy Agency, fossil fuels make up 81% of global energy demand today, dropping to only 78% in the next 20 years,[1] while overall worldwide energy demand is expected to grow by as much as a 50% by 2050.[2] Furthermore, energy poverty remains a global crisis, especially in sub-Saharan Africa and parts of Latin America, China, and India; roughly 3.3 billion people still live with little or no electricity.[3] All this means that the energy business will remain fossil-fuel based for decades to come. David J. C. MacKay, a physicist at the University of Cambridge, summarized the situation clearly: "I love renewables, but I am also pro-arithmetic."[4]

1 "US total energy exports exceed imports in 2019 for the first time in 67 years," US Energy Information Agency, April 20, 2020, eia.gov.
2 *International Energy Outlook 2020*, US Energy Information Agency, October 14, 2020, eia.gov.
3 Robert Bryce, *A Question of Power*, New York: Hachette Book Group, 2020, p. 74.
4 David MacKay, "A reality check on renewables," filmed March 2012 in Warwick, United Kingdom, TED video, ted.com.

The petroleum industry is the protector of billions of lives on the planet, providing electricity for clean water, heating, sanitation, cooking, refrigeration, communication, and illumination, and, most notable recently, supplying the polypropylene-based materials used for N95 masks, hundreds of life-saving petroleum-based plastics used in the production of vials, screening and personal protective equipment and gear, and machines in hospitals around the world. Indeed, COVID-19 vaccines would not be possible without America's plentiful supply of oil and natural gas. And it is petroleum-based power, not intermittent solar or wind energy, that cools COVID-19 vaccines to the necessary –70 degrees Celsius. Put another way, ExxonMobil would survive, perhaps even thrive, without Zoom and its sophisticated communication platform; but neither Zoom, nor any other major technology company, could exist or survive without the reliable, cheap, and plentiful energy and materials (power, plastics, lubricants, solvents) that ExxonMobil and its peers produce.

Petroleum company leaders faced the events of 2020 having managed a paradox for the prior decade or so: on one hand, many companies had soaring success during the American shale renaissance, which increased US energy independence (or in global markets, increasing interdependence), generating global geopolitical benefits and providing even more plentiful, reliable, and cheap energy. On the other hand, the industry delivered significant shareholder value destruction: the US shale industry peaked without ever making money—production boomed, yet profits shrank.

Over the past decade, the United States nearly doubled its global market share, from 8.9% to 17%, but the sector delivered an average return on capital employed from 2010 to 2020 of 4%—well below the industry weighted average cost of capital.[5] The decline was reflected in the S&P 500 Index, on which oil and gas companies represent less than 3% of the total number of companies, down from 10% a decade ago. Furthermore, in January 2021, the S&P warned 13 oil majors that they were at risk of downgrades because of growing competition from renewables.[6] That many exploration and production CEOs were earning well over their target compensation while debt piled up and valued declined was not lost on investors whose faith in sector leadership continued to deteriorate.

The shale sector got religion about its business model in 2020, with companies embracing the concept of capital discipline and the need for free-cash-flow generation versus growth. But if the discipline fails to stick when prices recover, the industry will regress to its old "spend, baby, spend" habits, generating another cycle of share value destruction and broken trust. If so, the industry will increasingly fall further out of favor.

To thrive going forward, energy leaders will need to maintain the discipline of their newer mindset that is focused on reducing costs, finding operational efficiencies, leveraging data and artificial intelligence, and allocating capital smartly while also minimizing and mitigating their carbon footprint and making new investments in the energy transition already underway.

5 *Preparing the E&P Sector for the Energy Transition: A New Business Model*, Kimmeridge, February 27, 2020, p. 3, kimmeridge.com.

6 Ben Butler, "Rating agency S&P warns 13 oil and gas companies they risk downgrades as renewables pick up steam," *The Guardian*, January 26, 2021, theguardian.com.

To thrive going forward, energy leaders will need to maintain the discipline of their newer mindset that is focused on reducing costs, finding operational efficiencies, leveraging data and artificial intelligence, and allocating capital smartly while also minimizing and mitigating their carbon footprint and making new investments in the energy transition already underway. Industry leaders know this: those we surveyed in early 2021 most often cited capital discipline or energy transition as the single most important issue facing the industry over the next decade.[7] Making it happen will be the hard part.

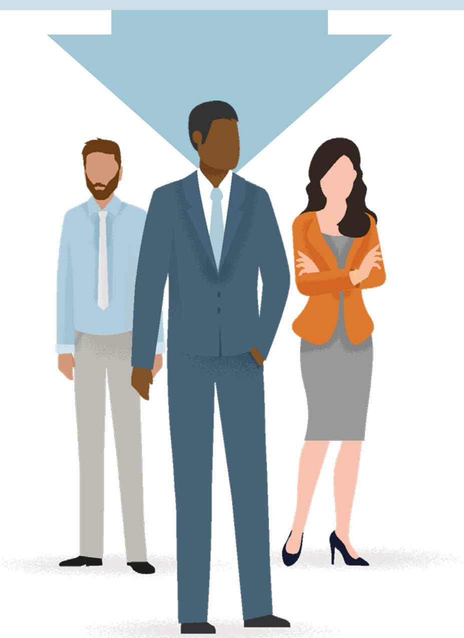
To rise to the challenge, the energy industry must invest in a different frontier basin closer to home: the discovery, exploration, and production of a new breed of leadership. Our research and decades of experience working with the industry[8] suggest that successful leaders will need to:

THINK
like an activist

RELATE
like a diplomat

SERVE
as an advocate

DEVELOP
a new humility



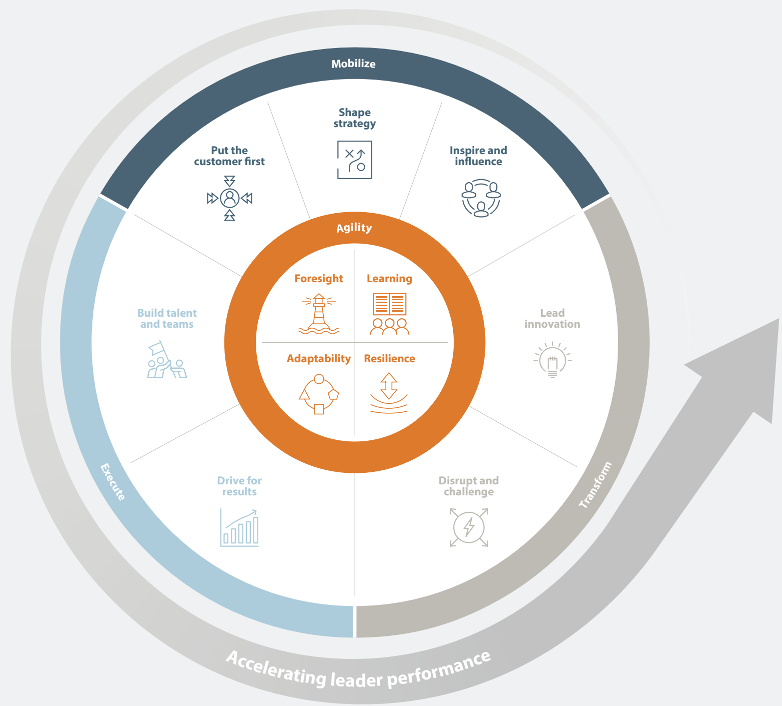
7 Analysis of an online survey of 86 industry executives, directors, and investors conducted by Heidrick & Struggles in January 2021—92% chose either capital discipline or energy transition as the most important issue facing their industry.

8 This research has also been shaped by the more than 750 conversations and interviews Heidrick & Struggles conducted with industry leaders over the past year.

The essential attributes of the new energy leader

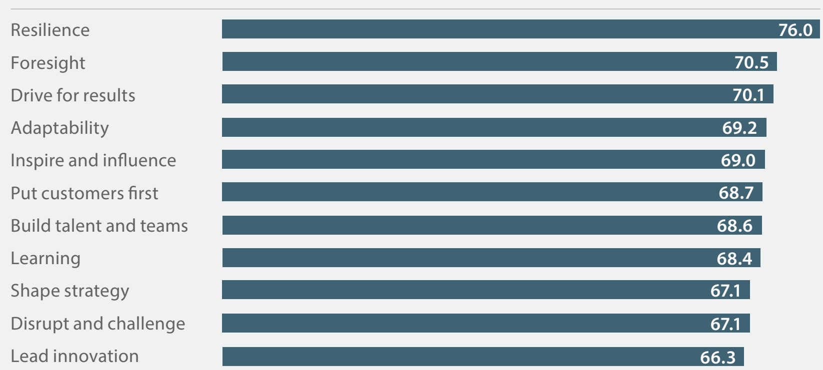
To succeed, energy leaders must change the way they are educated, developed, and mentored; the way they are assessed and evaluated; and the way they are incentivized and remunerated. The data tells us that the industry needs a new breed of leadership. Heidrick & Struggles research has identified a group of 23 companies we called "superaccelerators." These companies consistently outperformed their competitors in terms of revenue growth. We were able to determine that these companies did so well because of their ability to mobilize, execute, and transform with agility, drawing on the factors shown in the graphic.[1]

The drive factors for accelerating organizational performance



Our analysis and research conducted over the past year clearly points to a shift in the attributes and behaviors required for leaders in the energy industry for the next decade.[2] Currently, for example, energy leaders tend to score highest, according to colleagues (in 360-degree reviews), in resilience, foresight, and driving for results. This makes sense: they know how to persevere through cycles and proficiently explore, produce, develop, and transport abundant supplies of crude oil, natural gas, and natural gas liquids.

Energy leaders: Drive factors (%)



Source: Heidrick & Struggles analysis of 183 energy leaders based on more than 1,000 surveys completed by their colleagues.

1 For more on the META framework and its applications, see Alice Breeden, Becky Hogan, and TA Mitchell, "Bringing your organization up to speed," Heidrick & Struggles, September 12, 2019, heidrick.com.

Think like an activist

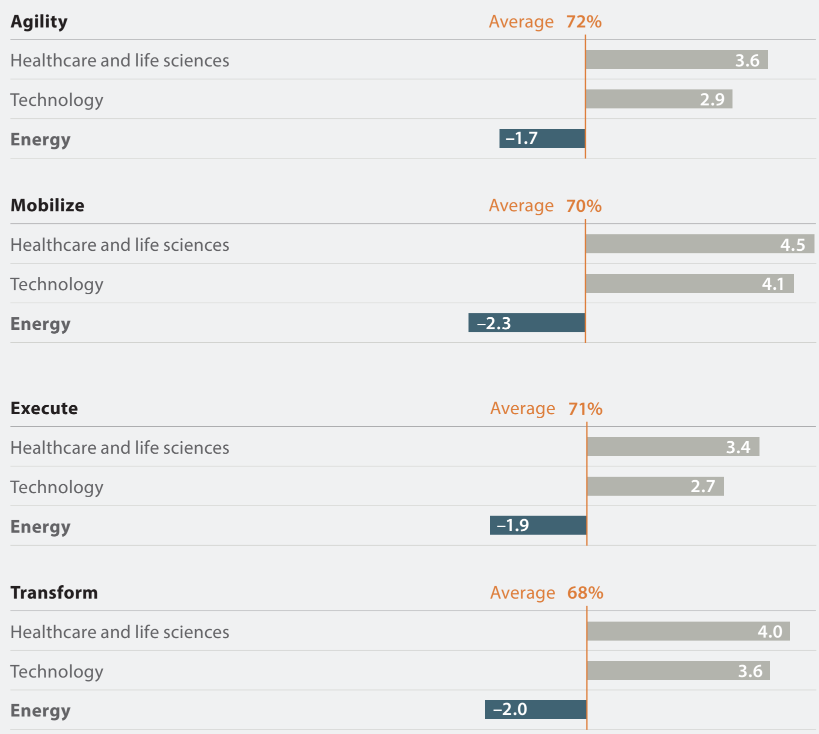
A number of upstream investors have noted that many exploration and production stocks often trade below the value of their proved developed producing reserves, and, therefore, the market no longer believes in the reinvestment economics of unconventional oil and gas, nor do investors trust the executives or board members who oversee capital allocation. As a result, despite historically attractive valuations, there does not appear to be any incentive for generalist investors to come back to the sector, and dedicated capital is shrinking due to the truncated investment timeframe of most public-equity investors.[9]

The cost and capital-efficiency discipline energy leaders have begun to embrace—essentially, an owner's mindset—is therefore essential to rebuilding trust and investment. The approach is one often brought by shareholder activists who, in recent years, have expressed concerns about underperformance and weak governance in the sector and sought to influence the makeup of boards and management teams. Though it is viewed suspiciously—perhaps because activists have had, at times, an obsession with short-term financial gain—shareholder activism performed in the right way can serve as an effective monitoring tool for financial performance, governance, and decision making in areas such as M&A and capital allocation, balance-sheet liquidity, and complex people decisions.

What if, for example, executive leaders embraced an "activist" mentality and brought it in-house? Or if directors were less deferential to the CEO and demanded greater performance and accountability? When calling for more robust governance, Warren Buffett (certainly no activist himself) once said that CEOs and boards "don't look for Dobermans . . . they look for Cocker Spaniels and then they make sure their tails are wagging." The necessary shift in focus on what creates actual economic value requires, among other things, a culture of accountability and healthy internal dissent at the CEO and board level, with a built-in, rigorous system of checks and balances. In addition, adopting an activist attitude internally can also create the ancillary, yet not insignificant, effect of mitigating the risk of an activist campaign.

On the other hand, energy leaders' lowest scores (as perceived by their colleagues) are in innovation-related areas such as disrupt and challenge. Furthermore, energy leaders tend to score lower across the board than their peers in other sectors (selected data shown).

Energy leaders compared with leaders in other industries
(% difference from the mean)



Source: Heidrick & Struggles analysis of 183 energy leaders based on more than 1,000 surveys completed by their colleagues, compared with analysis of some 2,800 leaders in other industries based on more than 20,000 surveys.

As they seek to transform their industry, themselves, and their leadership pipelines, new energy leaders will need to be exceptional and collaborative in innovating and leveraging technology. They will need to bolster their leadership skills in practically every area, becoming even more resilient and agile while also prioritizing learning, innovation, and inspiration.

2 Heidrick & Struggles analysis of 183 industry leaders, assessed by more than 1,000 colleagues using Heidrick & Struggles' leadership assessment methodology.

9 *Preparing the E&P Sector for the Energy Transition: A New Business Model*, Kimmeridge, February 27, 2020, p. 10, kimmeridge.com.

Relate like a diplomat

Former US Ambassador Richard Haass, the current president of the Council on Foreign Relations, was prescient when, in 2009, he spoke of the CEO as a diplomat.[10] In energy, in particular, over the past decade, the average day of a CEO or local region or asset leader has become increasingly complex and volatile, particularly for exploration and production and service companies trying to earn or retain the right of a social license to operate. Global energy companies have always had to navigate international complexity, adherence to foreign corrupt practices acts, and foreign government partnerships and concessions agreements. Looking ahead, nearly all—97%—of the executives we surveyed think that the regulatory pendulum will likely swing farther in the direction of greater government intervention. This will mean that businesses will need to work in even closer partnership with governments on a series of issues that include climate change, trade, investment, health, corporate security, and cybersecurity.

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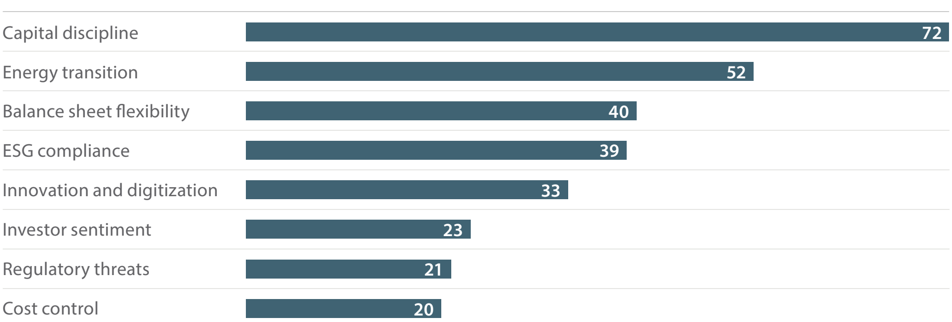
In addition, the urgent rise in environment, social, and governance (ESG) accountability—particularly in the wake of the COVID-19 pandemic and global calls for racial and social justice—and a more active investor base are together requiring business executives and government officials to manage an increasingly overlapping landscape of interest groups, stakeholders, and regulatory agencies. Indeed, our survey shows that 47% of industry leaders think ESG compliance is one of the top three issues facing the industry in the next decade, and among all issues it's the fourth most important.

The top three issues facing the industry in the next decade (%)



Source: Heidrick & Struggles analysis of a survey of 86 industry leaders conducted online in January 2021.

10 "The CEO as diplomat: An Interview with Richard Haass," McKinsey & Company, October 1, 2009, mckinsey.com.

A recent Edelman survey of 600 institutional investors representing over $20 trillion in assets in the United States underscores the financial risks and opportunities across all three elements of ESG: 87% of investors said that their firm monitors specific ESG key performance indicators to inform investment decisions on an ongoing basis, and 88% said that companies that prioritize ESG initiatives represent better opportunities for long-term returns. In addition, investors increasingly want executive pay tied to ESG.[11]

All this, as Ambassador Haass suggested more than a decade ago, will require diplomacy skills. The strongest diplomats will be able to take their ESG performance from a routine "check the box" exercise or basic table stakes to the creation of a competitive advantage with best-in-class performance on the mandates expected by regulators, proxy advisory firms, and investors. Closely following Sustainability Accounting Standards Boards (SASB) practices, among other ESG rating firms, is a start. Understanding the BloombergNEF, which assesses the energy transition risk of petroleum companies, will also help. In addition, diplomacy can foster best-in-class ESG performance across the board.

Environment

Leaders should consider more aggressive initiatives to achieve effective environmental stewardship such as inviting experts with external perspectives to boardrooms and executive offices to inform and advise them. Also, a rigorous examination of environmental targets and disclosures in areas such as upstream emissions, methane, and flaring intensity and attaching real, not discretionary, compensation targets to specific plans will build both real progress and trust.

Social

The S&P Global Ratings consider oil and gas companies to have extremely high exposure to social factors in all ESG categories. This means leaders should make an intensive effort to further heighten their companies' sensitivity in areas such as safety, health, and community partnerships. Though sector leaders have traditionally been defensive, the new energy leader should articulate the social benefits of the industry in a balanced, informed, and compelling manner.

Furthermore, energy companies are behind their peers in other industries in terms of diversity and inclusion, with most employees coming from the largely male-dominated technical fields of engineering and geology. Setting and tracking progress toward more aggressive diversity goals and building consensus for doing so, as well as creating the inclusive culture that is crucial to companies' seeing the business benefits of diversity, will take new diplomacy skills.[12]

Governance

Boards should address board tenure and committee structure issues,[13] and, instead of deferring to the CEO, as has often been the case in energy companies, they should respectfully yet forcefully press for real ESG results that are transparent and actionable. Indeed, the aforementioned Edelman survey shows that 99% of investors expect the board to engage on at least one ESG topic.

In addition, rather than resisting reforms in executive compensation, the new energy leader will need to lead a renegotiation of his or her renumeration with the shareholder interests foremost in mind. Investors and boards should work collectively to create long-term compensation structures that disclose and reward cash-on-cash returns and long-term value creation. This creates alignment with long-term owners (not speculators) and enhances transparency at a time when trust is in short supply. Adding an element of linking compensation to hitting ESG targets, 69% of respondents to the Edelman survey said, will further build trust.

While companies have made progress on executive compensation reforms and diversity and inclusion initiatives, substantial work remains. Indeed, two-thirds of executives we surveyed rated the industry's progress on D&I as "below expectations" or "poor." Transformational success will depend on mastering the art of diplomacy.

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11 *2020 Edelman Trust Barometer Special Report: Institutional Investors*, Edelman, November 17, 2020, edelman.com.

12 For more on how executives think diversity and inclusion support business performance, see Krishnan Rajagopalan and Lyndon A. Taylor, *Meeting the Inclusion Imperative: How Leaders Can Link Diversity, Inclusion, and Accelerated Performance*, Heidrick & Struggles, April 30, 2020, heidrick.com; in addition, see more on Heidrick & Struggles' Director Institute, an innovative program to increase diversity on US corporate boards.

13 For more on why boards should address their basic structures, see Alice Breeden, Theodore L. Dysart, and David Hui, "Building the foundation for better board refreshment," Heidrick & Struggles, January 7, 2021, heidrick.com.

Serve as an advocate

One of the greatest threats our survey respondents and CEOs we've talked with identified is talent risk. This is a crucial, but far from the only, reason leaders must become advocates for their enterprises.

If leaders cannot be talent magnets, they risk losing real talent share. Energy companies face fierce competition for technology talent specifically but also serve in an industry that is increasingly becoming unpopular with many potential recruits. Attracting diverse candidates is often even harder. Most company engagement surveys show that employees, especially millennials, tend to remain in a company (or an industry) where they find purpose and meaning, and flee businesses considered harmful to their communities or the environment. Recruitment and retention problems in an industry that is losing the PR battle and is identified by some investors, policymakers, and much of the general public as a pariah will only become more acute.

More than half of the executives we surveyed said that serving as an advocate both internally for their business and externally for the industry is one of the three most important attributes of leadership over the next decade, and 86% said that the industry has been too weak and defensive in its advocacy. By almost every measure, life has improved dramatically for humans generally over the decades because of increasing fossil fuel use (in areas such as life expectancy, standard of living, reduction of extreme poverty, a drop in climate-related deaths per capita, and the decrease in CO_2 emissions in the United States as a result of the transition from coal-fired to gas-fired power generation).[14] There are some indications that sector leaders are finding the courage to speak up.

Adam Anderson, the CEO of Innovex Downhole Solutions, Inc., is an example of a persuasive advocate. He placed an order with a leading US clothing manufacturer for 400 jackets as Christmas gifts for his employees. But the order was immediately rejected. Claiming consistency with its policy against co-branding with companies that sell alcohol, tobacco, and pornography, the company said it could not co-brand with an oil and gas company either. The fact that these jackets are made with Nylon, a petroleum-based product, was not lost on Anderson or other industry leaders.

As with diplomacy, becoming better at inspiring and influencing others will help leaders become stronger advocates.

Anderson wrote a letter to the manufacturer's CEO arguing that "low-cost, reliable energy is critical to enable humans to flourish," and trumpeted the progress the industry has made in reducing harmful emissions.[15] Touching a nerve, the letter went viral, especially among industry leaders who have grown weary of apologizing for the products they provide, and Anderson chose another jacket manufacturer for his employee gifts.

Such advocacy will rely on a willingness to disrupt and challenge. It also takes courage, which our leadership model considers part of learning: another area in which the data shows energy leaders can improve. Finally, as with diplomacy, becoming better at inspiring and influencing others will help leaders become stronger advocates.

Develop a new humility

When Albert Einstein said that the greatest "measure of intelligence is the ability to change," he was likely considering both cognitive and emotional intelligence. His point about change rings particularly true as it relates to leaders whose success or failure now almost entirely falls or rises on the depth of their emotional intelligence (EQ).

The ability to change and heighten EQ is a key lever of all the attributes mentioned in this article. For decades, the energy industry hired and developed smart, dynamic, sometimes charismatic leaders and granted them huge incentives based on volume, not returns. Those incentives and perks, in turn, often created what some might call a "sense of entitlement." For example, consolidation has been necessary to reduce costs in the industry for more than a decade, but our survey shows that 43% of executives cite "social issues" as one of the biggest limitations to successful M&A. This suggests that at least some boards (and their CEOs) are consumed with their own professional and financial security rather than their companies' and stakeholders' best interests.

The organizational cultures many energy executives create do not encourage the kind of humility in which diversity of thought and dissent is not only allowed but embraced.

Another failure we have seen is some executives' inability to act with agility in response to a failed strategic plan, such as overbuilding based on hyped geological potential or rosy financial projections. Moreover, the organizational cultures many energy executives create around themselves do not encourage the kind of humility in which diversity of thought and dissent is not only allowed by the CEO and the senior team but embraced as a way of challenging assumptions and sparking innovation. This is likely one reason that so many leaders in the industry find it hard to be constructive disruptors.

14 Alex Epstein, *The Moral Case for Fossil Fuels*, New York: Penguin, 2014, pp. 258, 277, 325, and 334.

15 Len Vermillion, "Why Innovex's CEO spoke up about North Face's stance on oil and gas," Hart Energy, December 14, 2020, hartenergy.com.

In addition, there have been periods in the industry when leaders have followed others' strategies without taking the time to assess whether their organizations have the capabilities to execute them. Some refer to this corporate peer pressure as the "lemming effect," when companies follow each other to their demises by submersion. During the Enron era, for example, CEOs of many companies ventured into ancillary noncore businesses, with well-known consequences. In recent years, leaders showed interest in complex financial tools to quarantine risk or raise additional capital to spend outside of cash flow, which in the end only created more indebtedness. As leaders seek to change how they lead in a decidedly secular, noncyclical downturn, they will have to resist the temptation to follow their peers, remain disciplined, and be agile when strategic plans go awry—all by building a humbler mindset. It begins by placing the interests of others—their shareholders and their industry itself—ahead of their own.

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A renewed need for leadership development

We know that the world will only need more energy, not less. We also know that the petroleum industry will provide the vast majority of that energy for the foreseeable future. Returning the energy sector to prosperity depends not only upon price recovery and resurgent investment capital but also upon a new kind of human capital that inspires and invests in the production of a new leadership model.

Returning the energy sector to prosperity depends not only upon price recovery and resurgent investment capital but also upon a new kind of human capital that inspires and invests in the production of a new leadership model.

The road to transforming industry leadership begins with a recommitment to the development of leaders as well as thinking about leadership differently. Theories on leadership vary, but perhaps none have been more discussed in energy in the past decade than Jim Collins' book *Good to Great: Why Some Companies Make the Leap…and Others Don't*, in which Collins writes that "level 5" leaders tend to be proverbial "hedgehogs," doing one thing well.[16] Collins' work underscores the attributes we see as necessary: discipline, diplomacy, advocacy, and humility. However, when William Thorndike published *The Outsiders: Eight Unconventional CEOs and Their Radically Rational Blueprint for Success,* which was also widely noted in the industry, he focused on a kind of leadership that is both transformational and urgent, especially relevant in the petroleum industry today.

Like Collins, Thorndike defined exceptional executive performance as "returns for the shareholders over the long term."[17] And he also emphasized some common characteristics of effective leaders—namely, humility, frugality, and tenacity. Thorndike's book amplified the importance of having a laser-sharp focus on per-share value as opposed to earnings or sales growth, exceptional talent for allocating capital, and a belief that cash flow, not reported earnings, determines a company's long-term value. Thorndike found that his successful executives were more like foxes ("knowing many things") and thus were more versatile.

Successful energy leaders for the next decade will need to be more adaptable than ever before. This means keeping their heads down like hedgehogs, executing on generating cash flow and savvy capital allocation and building on their strengths in driving results and resilience. Yet they will also need to be like foxes, able to be many things—diplomats and advocates, disrupting and challenging, inspiring and influencing—and able to anticipate, learn, and react to the dangers looming outside.

Countless CEOs and directors have told us they are concerned about whether they and their teams are sufficiently prepared to meet the challenge of the next decade. To prepare for the energy transition and ESG requirements, anticipate the next black swan event, and seize opportunities for growth, they must invest heavily in a new leadership transition. This begins with leaders who are able to develop a new humility building their capabilities to think like activists internally, relate like diplomats externally, and serve as effective advocates for the industry that powers all others.

The fiercest competition in business has never been for customers but for the best leaders, those who can anticipate, meet any crisis, and build companies and industries that last.

16 James Collins, *Good to Great: Why Some Companies Make the Leap…and Others Don't*, New York: HarperCollins, 2001.

17 William N. Thorndike Jr., *The Outsiders: Eight Unconventional CEOs and Their Radically Rational Blueprint for Success*, Boston: Harvard Business Review Press, 2012.

Oil & Gas Practice

Heidrick & Struggles' team of industry leaders in oil and gas serve as a trusted advisors to boards and executive teams globally. We maintain close relationships with companies and sponsors and are actively engaged as thought leaders in the industry while proactively developing next-generation senior talent. As the oil and gas sector navigates disruption and looks to the future of the New Energy Leader, Heidrick & Struggles is well positioned to serve energy clients to solve some of their most critical leadership needs, including advocating for a new paradigm in industry leadership.

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