

A White Paper on Innovation Culture

Management practices, idea generation and realization in innovative companies

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**BP's newest new culture addresses safety issues.
More change to come – no doubt.**

**Will the new culture build on Tony Hayward's
innovative initiatives?**

Updated October, 2010

*Originally prepared in May 2010 shortly after the Macondo well drilling disaster [entitled **BP's Hidden but Rapidly Changing Culture**] this White Paper is updated with the events of the most recent months. The C.E.O. Tony Hayward is gone and Bob Dudley has taken over. Recent announcements by BP indicate that a new culture is in place, or at least under development, but so was a new culture a priority for Tony Hayward. Will the newest corporate culture impact BP's risk profile and therefore impact innovation? What do the new announcements reveal about the old culture? Can you change a company's culture so easily?*

Executive Overview

The departure of Tony Hayward signals yet another shift in the culture of this 80,000-person global corporation. Tony Howard had made the point that the company's culture needed to be changed from the time of Lord Browne. BP, under the new C.E.O. Bob Dudley, now make the point that the company will be changed yet again, this time in response to the Macondo drilling disaster and the need to restore trust amongst stakeholders.

BP Chairman Carl-Henric Svanberg¹ reinforces the change by adding; 'it (BP) will be a different company going forward, requiring fresh leadership supported by robust governance and a very engaged board. The implications seem clear; leadership needed changing, governance was ineffective, and the board's head was elsewhere! Did shareholders know all this at the time? Who would have guessed that the situation was in such a sorry state?

White Paper

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¹ BP Press release; July 27, 2010

Hayward took over in 2007 and Dudley is now in place. Two major cultural shifts have or are taking place in a short period of time. These significant shifts in culture take place on top of the cultural discontinuities arising from BP's acquisition program under Browne and the need to create a corporation working as one company. Hayward's initiatives and accomplishments need to be noted since, in terms of instituting positive programs to improve management, he was heading in the right direction. His actions, once he was on top, reflected an in-depth knowledge of the company gained through his field experience and technical background.

With the failure of its off-shore drilling rig and its tarnished reputation for offshore drilling, world-wide attention has been drawn to BP. BP, you would think, wants to be known as innovative; this being one of its four core values. BP's inappropriate response to this latest disaster, however, raises some questions about its preparedness; its research and its ideas.

In the case of the drilling well disaster, BP wants to be able to say that it has brought the most modern up-to-date technology to bear on the problem; i.e. to clear up the current mess and, more importantly, lay a foundation of trust amongst stakeholders so that its deep-water drilling plans can continue apace. However, its strategic objectives², based on what BP regards as the best portfolio of assets in the industry, placed, under Hayward, the most emphasis on improving financial performance through introducing 'continuous improvement' and making cost reductions while maintaining, at the same time, that safety and reliability were the #1 priority. It is hard to understand just what the real priorities were and how the employees, more particularly, leadership, internalized Hayward's strategic priorities.

Culture change, after all, takes time, and comes about as a result of an ongoing set of actions, mainly by the leadership, which contribute to a new sense – the culture – of any organization. One of the lessons learned from these two transitions is that it takes more than talk to shift the culture of an organization.

Had the drilling disaster not taken place, it is fair to speculate that no changes would have taken place quickly. Had the new Safety and Operational Risk unit (currently being put in place) been in place, the stop button might have been pressed and the disaster avoided. Toyota, decades ago, instituted their own quality control when they gave the assembly-line worker the right to stop production if there were problems. Such a move went a long way to convey to employees and stakeholders that Toyota was serious about quality. Is this recent organizational step by BP intended to send a signal to restore trust? Is it sufficient?

BP mini-profile

Sales and operating revenue:
2009: 239 billion and 16.6 billion in profit. 2008: 361 billion and 21.7 billion in profit.
Employees at the end 2009; about 80,000.

Background to cultural change at BP – Under Hayward

Hayward was in the process of structuring a new culture into BP and had an approximate two-year period to initiate and bring about the proposed changes. There were many significant references to the new, and by inference, to the old BP culture, and how the situation changed since 2007. The challenges faced by Hayward, even leaving aside the issue of safety, were enormous.

- Schumpeter³ comments are that on the occasion Tony Hayward took over in 2007 he set about changing the 'sprawling bureaucracy' set up by his predecessor Lord Browne, and getting 'back to basics'. Schumpeter points out that BP's strategy 'depends on its ability to keep pushing the

² BP 2010 Strategic Presentation, March 2nd, 2010, London.

³ The Economist, May 8th, 2010, Schumpeter, 'In the black stuff'.

frontiers of oil exploration: drilling the world's deepest wells and probing the corners of the Arctic for deposits'.

- Tony Hayward, in his March 12th, 2010, Strategic Presentation references the 'cultural changes' which have occurred over the 'past three years'. The over arching theme of the 'Strategic Presentation'⁴ is that BP's portfolio is solid but that financial performance 'needs catching up'. Corporate emphasis is now on cost reduction and 'continuous improvement'. Quantitative targets for reducing costs to circa 2003/2005 levels were specifically identified.
- Upper management has been 'refreshed'⁵; a carefully chosen word for major restructuring.
- Massive numbers of employee shifts have taken place. 20,000⁶ employees have left over the past 2 years (either including, or not, a reduction of corporate headcount of 7500 during 2009) and there were 14,000 hires over the same 2-year period.
- The introduction of a comprehensive Operating Management System, intended to bring some standardization to all parts of the company, is underway and currently covers 80% of operations. Inferentially, this indicates that prior to 2007 considerable autonomy existed and could not continue to be tolerated by top management.
- According to Schumpeter, acquisitions made under Lord Browne, particularly the acquisition of Amoco in 1998, were not integrated into BP, important since there was, under his tenure, a nine-fold increase in capitalization.
- The current approach (under Hayward) was to tie rewards much more closely to performance. This suggests that this was not so much the case under Lord Browne and that different criteria for setting rewards and bonus amounts were in use.
- Hayward makes special mention of the need to create opportunities for technical personnel, i.e. opening up career paths for technically/scientifically oriented personnel. The inference is that these same personnel were not treated as well as others, for example those who were a part of general management, marketing or financial functions, under the old culture. It is unclear, but there was to be a significant change in the career and reward area impacting technical personnel.
- The establishment of 'academies' and the new leadership centre in Houston was a major initiative and reflected the need to train personnel and put the corporate stamp on all 'leaders' as the company moves ahead. This aspect of leaderships was, by inference, not given such a high priority under the previous management.
- The approach to development is to be changed through the establishment of a centralized decision-making group. This is a further indication of the desire of BP top management to regularize this key aspect of the management of the company's far-flung operations.
- According to Schumpeter's article, Tony Hayward is quoted as saying that previous management under Lord Browne, was "too directive and doesn't listen sufficiently well". Hayward set out 'to replace flash and fluff with nuts and bolts' and to 'focus like a laser on safe and reliable

⁴ March 12th, 2010, '2010 Strategy Presentation'.

⁵ BP 2010 Strategic Presentation, March 2nd, London.

⁶ BP 2010 Strategy Presentation, March 2nd, 2010, Tony Hayward's comments.

operations'. Lord Browne concentrated too much on 'soft furnishings and too little on the foundations'.

In sum, the culture in BP was undergoing a dramatic and swift change under Hayward. Of the 25 Factors⁷ which we use to calibrate a company's culture for innovation, the changes at BP impact at least 14 of these Factors.

The inference is reasonably clear and that is that the then current management want to step-change the company from its earlier organization, management, operations, practices and that these dramatic changes would change the culture of the company hopefully in the right direction. The old system was not working, at least in not the eyes of the new 'refreshed' management, and dramatic changes to policy and management practices were required and quickly. Hayward's legacy set the course for change and was, unfortunately, cut short by the Macondo 'affair'.

Cultural Change at BP – under Dudley's Watch

What is different – under the new C.E.O? One is sure that more changes are on the horizon, but in the intervening period some changes have been announced.

According to BP, 'safety will now be the sole criterion for rewarding employee performance in its operating business for the fourth quarter'⁸. Evidently a review is underway to come up with a plan beyond the fourth quarter!

Dudley has promised to change the culture of BP but continues to deny that its executives put the achievement of profit and efficiency targets ahead of the safety of BP staff and its contractors. He also states: 'There are lessons for us relating to the way we operate, the way we organise our company and the way we manage risk'. Future announcements will, hopefully, lead to a more coherent picture of the changes afoot.

A new unit, the Safety and Operational Risk function will have its own staff embedded in the operations units and they will have the authority to intervene in all aspects of BP's technical activities⁹. The new unit will report directly to Dudley.

BP plans to change the way it manages its third party contractors.

Hayward emphasised	Dudley now emphasises
<ul style="list-style-type: none"> • a fine asset base but financially underperforming • quantitative targets for reducing costs were established • safety was identified as the number one priority but cost reduction and continuous improvement were also a priority to increase financial performance. (We now know that BP did not have a good track record of safety, even before the Macondo drilling disaster.) • a new company-wide Operating Management System – in the process of being implemented • leadership training – the Houston centre – was put in place • opening up opportunities for technical personnel 	<ul style="list-style-type: none"> • a fine asset base • safety as the number one priority • a Safety and Operational Risk function reporting directly to the C.E.O. • modifications to the performance reward system

⁷ For a definition of the 25 Factors, see: <http://www.corporateinnovationonline.com>

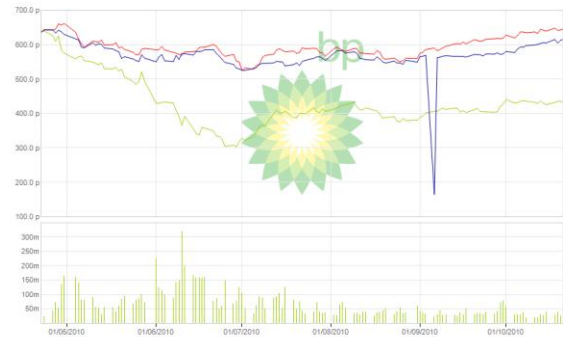
⁸ Wall Street Journal. October, 2010.

⁹ BP press release. September 29th, 2010.

Dudley states: “These announcements do not mean that everything in BP is going to change. We have great strengths that are important to maintain. We have a high quality portfolio of assets. We have a sound financial footing on which to build. We have good technology. We have very strong local relationships. We have started the journey with our strong Operating Management System. Most importantly, we have great people. “All those factors give me immense confidence that we can achieve a fast-paced evolution into a company that is better placed and better organised to manage the complex range of risks in our industry.”

BP chairman Carl-Henric Svanberg states: "The tragedy of the Macondo well explosion and subsequent environmental damage has been a watershed incident. BP remains a strong business with fine assets, excellent people and a vital role to play in meeting the world's energy needs. But it will be a different company going forward, requiring fresh leadership supported by robust governance and a very engaged board.

These and the other changes which are proposed to the organization are designed to restore stakeholder trust in BP. Shares have not performed well compared to industry competitors.



Culture Shifting

What is the nature of the culture change? Is the change consistent with moving to becoming an innovative company; one that can be trusted to bring about innovative solutions to new complex problems such as deep-water drilling and its safety and reliability? Dudley has put in place an organizational unit which can minimize risk, but is unlikely to countenance innovation at the edge since this inherently means an assumption of greater risk.

Changing a company’s culture is akin to trying to turn an ocean liner around in a tight circle. It is extremely difficult to do over the short term. Culture develops over a long period and most often arises from the beliefs and attitudes of one or more of the company’s founders and later influenced by successive generations of leaders at the C.E.O. and/or Chairman level.

Cultural changes are most often successfully brought about by a newly-appointed C.E.O. who, because he/she grew up in the company and knows its operations intimately can, if motivated, bring about cultural change. Witness A.G. Lafley’s dramatic change to the culture of P&G and that this was built on a 30-year career with the company. Given their knowledge of the company, they know where to start and know what aspects of the change in culture to emphasize. Tony Hayward joined BP in 1982 and began his career dealing with rig issues as a rig geologist. Successive appointments led to his returning to head office in London in 1997 and his appointment as Group Executive of BP plc in May, 2007. Hayward obviously knew the culture and had the company experience to bring about change.

Company stability, i.e. consistent but not dramatic growth creates the opportunity to alter a culture. On the other hand, too rapid growth, particularly by acquisition, makes the putting in place of a new culture even more difficult. In the case of BP, perhaps it was a problem of trying to do too much in too short a time frame and complicated by having the reward system focussed on improving financial performance at all costs. Financial performance is easier to measure than safety or risk assumption, which are more easily ‘fudged’.

Sourcing Ideas

Shortly after the drill-rig crises began, a BP executive was on television asking – more like pleading – for anyone who had bright ideas on how best to stop to the flow of oil. All ideas would be welcomed. The first most significant idea, which, one presumes came from BP itself, was to drop a large containment dome over the source and direct the oil upwards in a controlled fashion to a ship on the surface. This did not work in the first instance but with refinements the solution was finally found. Even Tony Hayward explained that the ‘dome’ might not be successful as they had never tried it before. Confidence in the innovativeness of BP, and with BP the whole of the deep-water drilling approach by the industry, has been severely damaged. Not one other oil company (according to our knowledge) came forward with a good idea for solving this problem. Has the industry spent enough of its resources researching the implications of its operations?

The innovative ideas deployed so far in reaction to the disaster have, by most accounts, been around for years: ‘a low-tech affair’¹⁰. Chemical dispersants, containment booms, burning oil are technologies which have been around for decades. The same technology was used for the Exxon Valdez spill in 1989. The idea of dropping a ‘containment dome’ over the gushing well and then piping oil to the surface, while a failure for now, is the only response to the failed well-head. Other ideas – Rube Goldberg devices – are in the works but whether they will be successful is very much an open question. One might have thought that BP (or Transocean) as the operator with the most experience working at depth¹¹, would have thought through several plans to recover from a blow out – like the containment dome – and tested the device as part of an ongoing research and development program. It seems only logical that if a company is to work at such depths it should be advancing its research on the implications of working at depth.

Maybe it’s the approach to idea generation and realization

- tolerance for mavericks (F#3)
- tolerance for failure (F#5)
- tolerance for variances from a defined or undefined corporation norm(F#8)
- availability of reward mechanisms for innovators/innovations (F#14)
- a sense that resources are available should attractive ideas/projects be identified (F#19)
- R&D spending levels as compared to the competition (F#23)

BP set up a web site and hot line to encourage and collect suggestions for capping the flow or cleaning up the oil¹². While not wishing to minimize this idea-gathering’ effort, surely more should have been done in advance. Responding to, and testing, a range of possible failure scenarios should now be a priority for BP.

The diagram opposite sets out some of the characteristics of innovative companies¹³ which impact idea generation and realization. It is hoped that the current shift in culture recognizes the importance of most of these Factors.

¹⁰ MacLean’s, May 24th, 2010, In Deep Trouble, Jonathan Gatehouse.

¹¹ BP makes the point (in the Presentation) that it is the pre-eminent player in the deep-water drilling business. It has drilled more wells than any other player in the industry and drilled the deepest well (35,000 feet).

¹² Maclean’s, May 24th, 2010, In Deep Trouble, Jonathan Gatehouse.

¹³ For more information on the Factors, visit; <http://www.corporateinnovationonline.com>

Leadership

The culture for innovation is most influenced by senior management. The illustration opposite sets out 4 characteristics of leadership style or practice which constrains innovation. How do these characteristics relate to BP?

The appointment of Mr. Svanberg as Chairman may make an important contribution to a changed culture at BP. His experience could provide that additional leadership so necessary to innovation. Ericsson, Sony Ericsson Mobile Communications AB as well as Asea Brown Boveri are companies which emphasize innovation and have gone through significant changes in fast-moving industries.

Has the culture shift at BP changed the company's ability to innovate? Not once does the Strategic Presentation refer to innovation nor to back up plans for managing disasters. Innovation – the word – is used only in connection with its line of lubricants. BP management does not *explicitly* look for innovation, except to note it as one of their value system's four pillars.

One might worry somewhat about the continuing emphasis on cost reduction and continuous improvement and whether long-term goals are too far down the list of priorities.

Organization and Management of Day-to-day Affairs

The diagram opposite illustrates some of the key characteristics of how innovative companies organize and manage their day-to-day affairs. BP, through the establishment of its academies and leadership training, is placing a great deal of emphasis on its people and their interactions.

BP is in the process of putting in place a management system which will put in place a common operating management system across operations¹⁴. The uniform system is no doubt required because of the acquisitions made during Lord Browne's time and which, at the time, were not properly integrated into BP¹⁵. To a great extent, the new system must

Perhaps it's leadership

- **management (and Board level people) do not explicitly look for innovation (F#2). The subject is not high on the agenda for Board meetings, management meetings, conferences, etc.**
- **the emphasis by senior management is on achieving short-term profit at the expense and priority of long-term goals (F#1)**
- **planning; business/strategic/planning/budgeting all emphasize cost cutting or rationing of resources rather than finding opportunities (F#4)**
- **little tolerance for risk in the planning process (F#9)**

Maybe it's how the company organizes and manages day-to-day affairs

- **the emphasis which management places on people – human resources and interaction (F#6)**
- **degree of formal communication in the company (F#10)**
- **use of independent (groups with authority to make changes) work groups to accomplish projects and special tasks (F#11)**
- **the degree to which decisions are made with input from several sources in the company – or is decision making unilateral and driven from the top (F#12) – too much or too little staff involvement in decision making (F#20)**
- **the formality of the decision process (F#13) and the approach to organization; centralized decision making or decentralization (F#18)**
- **is the organization action oriented or lost in planning processes (F#15)**

¹⁴ BP 2010 Strategic Presentation, March 2nd, London.

¹⁵ The Economist, May 8th, 2010, Schumpeter, 'In the black stuff'.

embody a new culture and while one does not have a lot of information on the new system, it is clear that change is underway. Often, however, centralization and formality inhibit innovativeness.

It is difficult to judge whether the new organizational arrangements and management practices are all a positive influence on the innovative culture at BP. One presumes that the prior arrangement was so bad that introducing more centralization and a formal approach to development is absolutely necessary even though this is counter to the practices of many innovative companies.

While innovative companies emphasize decentralization, minimal hierarchy, and informal processes, there is a time and place for all approaches. What one does is directly related to an assessment of a company's current situation since each company is different and at a different stage of its evolution. Change is inevitable, constantly evolving, and responding to current priorities. Known changes today are not likely to be the changes required in the future.

Conclusions

BP, under its newest management, is embarking on a significant make-over of its culture. The rapidity of the change, the urgency of restoring trust amongst stakeholders, the 'refreshing' of management and new practices along with the challenges represented by 'new frontiers' of deep-water drilling will challenge the company over the short and medium term.

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October 23, 2010