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Why We Hate the Oil Companies

by John Hofmeister

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WHY WE HATE THE OIL COMPANIES

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As Shell's then top U.S. executive traveled the country, he discovered how corporate leaders create their own reputation for arrogance – and lose their chance to deliver the right message.

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On a brilliant blue sky Saturday morning in August 2006, I found myself in Erie, Pa. At that time (I have since retired), I was the president of the Shell Oil Company — the U.S.-based operating company of Royal Dutch/Shell, and itself one of the largest oil companies in the world. I was conducting an outreach tour.

We had started the tour after Hurricanes Katrina and Rita hit the Gulf Coast in the late summer of 2005, just months after I became company president. Oil prices had been climbing for the past three years, and the serious supply disruptions caused by the storms sent them skyrocketing. I started receiving hate mail, including a drawing showing me hanging in effigy; not exactly what I expected when I took the job. Moreover, most lawmakers were ignoring the critical issues in energy: the need to guarantee affordable supply from as many sources as possible, to take climate change impact (and other emissions problems) seriously, and to safeguard energy security.

I had something to say about this — and I still do. Total energy use in the United States has tripled in the six decades since 1950. Consumption has also shifted from manufacturing to residential and commercial use; much of this growth can be traced directly to the increased use of computers and associated servers, printers, and other devices. With the massive populations of the world's emerging economies, the spiral of energy demand is accelerating. But both governments and the energy industry are dismally unprepared for a future of rapidly rising energy demand and insufficient sources

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Previous pages, top to bottom: **Oil company executives, with Hofmeister at left, testifying before the U.S. Congress, Nov. 9, 2005; gasoline retail station in Florida; scene from the 1989 Exxon Valdez oil spill in Alaska.**

of supply. And this is especially serious given the very real need for lower environmental impact — not just from carbon emissions but from all energy-related emissions — and the time it will take to shift to more renewable energy. The countries that don't address these issues now, even if they seem to be all right in the short run, will face electricity shortages, constraints on their manufacturing and computing industries, excess air pollution, and ultimately a permanently damaged quality of life.

We understood this at Shell, but we weren't being heard, and we realized that one of the main reasons for that was that we weren't listening to anyone else. Thus, from mid-2006 to early 2008 I crisscrossed the United States, visiting 50 cities, together with about five managers per city — some 250 Shell people in all. We met with business leaders, community leaders, government representatives, the general public, and our own wholesalers and retailers. We listened in town hall–style meetings and spoke in a range of venues. I interacted with tens of thousands of Americans; I was probably out in front of the public more than any of my peers, the chief executives of other U.S. oil companies. All of this took up roughly 6 percent of my time, which is not all that much. But it was a lot more than I had imagined when I first took the job.

Friendly and Unfriendly Encounters

My weekend itinerary during those months often included stopping by local Shell stations, unannounced, to chat with store managers and customers. And my first store visit in Erie — a family-oriented city whose local economy was in transition from industrial enterprise to entrepreneurial services and information management — could not have gone better. The manager was not present, but the cashier, a young woman with less than a year of experience, greeted me with a hello and smile. She was cleaning an already shining checkout counter, and her broom and dustpan were right behind her. The store was bright and cheery, with plenty of Shell promotional materials highlighting our popular NASCAR sponsorship. The shelves were stocked neatly, the freezers full, the beverage refrigerators well arrayed. You could smell the morning coffee, and that's where I went first.

Over a fresh cup of black coffee we talked about her time at the Shell station. She said her regular customers weren't too happy about the rising gas prices, but no one had so far blamed her. She asked who I was. I explained that I worked for Shell out of Houston, and liked to drop into local Shell stations to get a sense of how things were going. I didn't play the president card; that's a good way to close down an otherwise open conversation. She said she didn't know much about Shell, since her station was owned by a small independent distribution company (known as a "jobber" in the industry). But she thought the tanker delivery people were always nice and prompt, regardless of the weather or time of day.

Strolling outside, I found a few customers filling up. They too seemed friendly and open. Interestingly, no one asked me who I was. One person told me he stopped here because of his Shell MasterCard and the discount he got. Another person said he and his family lived a few blocks away; he liked the people who worked at the station and confirmed that it was always clean, unlike some other stations around town.

Then I was off to the next station, a Shell store near the interstate. What a disaster! There was so much gravel and dirt covering the forecourt concrete that it must not have been cleaned in many months. The store

manager was inside behind the counter, surrounded by trash, piles of old newspapers, and store records, as a radio played loud music. The shelves of merchandise were haphazard; the coffee counter filthy, the coffeepots empty. Aisles were blocked by stacked merchandise waiting to be shelved. A departing customer said to his buddy, "Forget the restroom, it don't flush; you don't need to see how bad it is. Let's get out of here."

As I approached the manager, he turned his back and went into the office, leaving me standing at the register. When he came back I asked how business was. He said, "None of your business, that's how." If nothing else, I'm persistent. "No, seriously," I said, "how's it going what with the prices and all?" He shook his head at me and asked if I was buying anything.

I could have just left and reported the condition of the station to the regional manager. But I decided to play the president card — literally — and handed it to him, explaining why I was there. He looked from my business card to me in silence, then suddenly erupted.

"Do you know you are putting me and my family in the poorhouse? Who do you think you are? I saw Shell's profit report two weeks ago. You disgust me. You make billions, and I squeeze nickels to keep up with my bills."

I asked if he was a jobber or if he leased his store. He said he leased it and that his jobber and the wholesaler who supplied him were bad people. I asked about volumes. He said they were down because of the high prices, "so you can make more profits." I asked if he had been visited lately by anyone from Shell. He said I was the first visitor from Shell he'd met. He said the store had been presented to him as a moneymaking proposition by his jobber and that he had signed a lease about 18 months earlier.

Despite the unpleasant circumstances, I decided not to give up yet. I talked candidly about the pressure of global supply and demand on prices, the failed energy policies in the United States, the country's dependence on expensive imports, our prohibitions on domestic production, and the challenges for retailers. These were all the themes I was talking about in the outreach tour. I also brought up Shell's standards for swept forecourts, tidy stores, and clean restrooms, and the critical importance of the store owner as Shell's face to the customer. We went head to head for a while. He wasn't buying it; I was still selling it. We didn't part friends, but we did talk in respectful tones. He said he was surprised that I took this much time to talk with him.

When the person wearing your logo sees your company as the problem, you know you are in trouble. All large companies — not just oil companies — need to think carefully about the way they are perceived by customers, suppliers, retailers, and other stakeholders. Corporate behaviors of all kinds are being scrutinized much more closely today than they were in the past, and the public face that a company presents has never been more crucial to its long-term fortunes. Perhaps the most important lesson that I learned during my years at Shell — and especially during my listening tour — is that companies need to take their own messages seriously, so that others will as well. Are the messages that are sent out what we really believe? Or are we merely saying things that we hope will give us a temporary advantage?

Overlooking the Customer

Every day, tens of millions of people around the world stop at a retail gasoline station. For many, it is the most negative experience of the day, unless they have to have a tooth pulled. A retail customer has to stop, get out of the car, figure out the pump, pay in advance (like a suspected criminal) or enter a zip code to confirm ownership of a credit card, pump the gas (trying not to acquire the smell of benzene on his or her hands), maybe clean the windows with the dingy water available, and decide whether to chance the restrooms (probably locked with a key attached to a giant tag, a double sign of distrust).

For this delightful experience, consumers pay a price that they don't understand or feel is justified, to a huge company of which they have at best a faint knowledge. Need mechanical help or directions? Good luck. For seven years, in a Gallup poll on the favorability of 24 different industry and government sectors, the oil and gas industry has been rated 24th. (In the 2009 poll, the runners-up for most disliked were real estate and the federal government.) When the major oil companies run their retail businesses in such a consumer-unfriendly manner, why are they surprised to have a bad reputation?

Even the product is unappealing. From the time the substance is extracted from the ground — a dirty, backbreaking process — to the time it enters a vehicle's tank, oil companies go to extreme lengths to make sure their product is not seen, smelled, or touched, much less tasted. "Loss of containment" of crude oil or refined gasoline is not only an unpleasant experience for those around it, but it is also dangerous. The products are flammable, and some elements within them are known carcinogens.

There are other products we use every day that we wouldn't want to be exposed to in their raw form. Computer chips and circuit boards are made using a toxic mix of chemicals (hence they are disposed of as hazardous waste). But companies like Apple build a loyal following of customers who are passionate about their products. The basic difference: Apple sees itself as a consumer products company and works hard to build relationships with customers. In contrast, although their brand signs may be on every street corner, oil companies see themselves as commodity producers.

Retailing fuels is basically a secondary exercise from the oil company's point of view, a way to get rid of the product it has spent so much time and money producing. Although the gross margin on a clothing store or similar retail store is typically 35 to 45 percent, gross margins on gas stations — even with convenience stores — have been as low as 12 to 13 percent in the last few years. This makes the retail side the least valuable part of the business, more often a nuisance than a value creator.

At the same time, oil companies that own a retail network have historically faced innumerable antitrust charges. After hurricanes or other supply disruptions, I could always count on attack letters from the attorneys general of the states that were affected, who accused the company of conspiring to raise prices or withhold supplies. Retail outlets have also been a source of fines and permit violations. There's nothing like local officials going after the deep pockets of a big oil company over a single gas station violation of a local ordinance.

That's why ownership of the retail end of the business has shifted from oil companies to local business owners, who purchase supply and branding rights. For their part, top-level oil executives spend virtually no time on the retail end of the business. In eight years of executive meetings in my global role at Shell headquarters in The Hague, I can recall very few discussions about the retail business, unless they had to do with selling off stations. In some major oil companies, you have to dig four or five layers down from the top to find someone dedicated to retail stations. Indeed, in the middle of the controversy over rising oil prices in late 2005, one oil company executive is rumored to have told Dennis Hastert, then Speaker of the House of Representatives, that if the American people didn't want his gasoline that was fine with him. There were plenty of others around the world who did. (Of course, this remark was not made in a public hearing.) And oil companies wonder why they are hated.

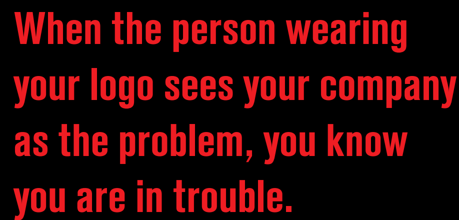
The Perception of Time

When oil executives speak publicly, they focus on what they believe is the best thing they can do to benefit consumers: finding more oil and gas supplies for the future. The oil that will be in gas pumps and cars and planes and ships for the next eight to 10 years has already been secured. By the time a tanker's load of gasoline is delivered to the retail station, the oil executive has moved on to thinking about the gasoline that will be delivered 10 to 25 years in the future, and that is still to be discovered or tapped. The clock never stops ticking on the need to identify and access future supplies, or reserves. It is a compelling, ongoing preoccupation for many oil executives.

To develop access opportunities, each oil company must build and sustain relationships with governments, other companies, and mineral rights owners. It must also invest in talented people, advanced geology and drilling and production technology, logistics management and refining equipment, and safety and environmental management. Time is the most critical resource. What risks and opportunities will present themselves in what time frame? Shell is famous in the industry for its 100-year forecasts and even more so for its complex scenario planning. Both approaches are time-based analyses that attempt to describe the future of resource supply and depletion while anticipating global, regional, or local events — in society, culture, politics, and the economy — that may or may not impact supplies.

This difference in perspective further distances the oil executive from the consumer. Imagine the dumbfounded oil executive who is jerked back to today's market reality by public opinion issues. The executive is further perplexed when public officials inevitably side with consumers. I heard it many times over the years: "How could these elected officials be so dumb, so detached, so distant, and so unrelenting in their opposition to what it takes to meet future demand for gasoline? Don't they know everyone needs fuel?"

One area where oil executives are focused firmly on the present is profit. They expend particular effort on cost management. The temptations to spend, to address issues with more money, are ever-present. And all budget planning has to take into account the volatility of oil prices. Huge capital expenditures, investments in growth and new facilities, staffing levels, positioning plays, and day-to-day operations must carry on despite unpredictable and extreme fluctuations in the oil price.



It may seem from the outside as if higher oil prices are a win-win for oil companies, but those higher prices also drive up competition and costs for new oil leases, drilling equipment, and oil-field services. When prices later fall, especially as dramatically as they did in 2008, recouping those costs becomes difficult.

Yet financial performance is measured quarter by quarter, and although the raw profit numbers for oil companies are huge, earnings — measured as net income as a percentage of sales — are actually fairly modest, in the range of 6 to 8 percent. Even at the peak of crude oil prices in mid-2008, energy company margins were just 6.8 percent. In mid-2009, they fell to 5 percent. These numbers are fairly typical for manufacturing companies and well below the earnings of pharmaceutical, tobacco, and beverage companies.

The disconnect between oil industry top management and consumers comes to a head when things go wrong: when prices rise or supplies are interrupted. Political leaders looking out for their constituents immediately tie top executives to the plight of the consumer. They want desperately to demonstrate that they are doing something, anything, to be on top of the price increase or fuel shortage. Whether that means dragging the executives into public hearings for verbal thrashing or lambasting them in absentia, such behavior feeds consumer disdain and confirms the overall disconnect.

Why Things Will Get Worse

Are we stuck with this paradigm forever, unlovable and unavoidable? Is there nothing that can be done to patch up the relationships between oil companies and consumers, or oil companies and politicians? From where I sit now, and based on my years in the chair where I sat then, I see little hope that things will change for the better, absent some major intervention. Instead, as a realist, I think they will get worse over time. I see two areas where the industry has failed and is unlikely to change course: poor politics and poor public relations.

The industry is stuck in its own political purgatory; it has been shortsighted and one-sided. Rather than engaging and informing government officials across the board, oil company executives tend to seek out their friends in the political arena, complaining about officials who don't understand them. They essentially compound their problems, especially if their friends are in the political minority, which happens regularly over long cycles. In the U.S., since investigative reporter Ida Tarbell took on Standard Oil in 1904, the industry has lived with a victim mentality, especially when the Democratic Party is in power. Members of the oil and gas industry are perceived as friends to Republicans, not Democrats. Opponents of the industry delight in confronting and publicly humiliating oil and gas executives; this is seen as fair payback for being otherwise ignored by the industry. *Feeding frenzy* is not too strong a phrase for describing the predicament. *Bunker mentality* describes many oil company responses to public outcries. Personally, I believed in walking down the center of the aisle politically as Shell's president. It was, however, a lonely walk relative to the rest of the industry.

Today's green initiative is seen by some outsiders as the industry's comeuppance. Politicians have seized on the opportunity to displace a century of investment in the hydrocarbon (oil, gas, and coal) infrastructure with a rush to invest in whatever magical, especially green, formulas can rewrite the future of energy and make new fortunes for their adherents. They see themselves as sav-

Oil splat photograph © Jamie Farrant

If the oil companies have the answers to the energy crisis — and in many cases they do — who will believe them?

iors of the economy and the environment without regard to the fact that they would effectively be disregarding about 75 percent of the nation's energy supplies. Subtract nuclear power, and it totals 93 percent. As a new breed of populist politicians promote new technologies, industry reminders that we will be dependent on fossil fuels for the next 50 or more years, even if true, sound like automakers' empty protests from the 1950s that seat belts were an unwarranted expense.

Even those in the industry who are making serious efforts to diversify the future fuels mix gain little credit for their efforts as long as they continue to drill for more oil and gas, lobby for access to new hydrocarbon resources, and build more infrastructure — all necessary to enable affordable energy during the transition to a new energy age but denied credence by new-energy-age aspirants because of a basic distrust of the industry.

The oil industry's poor political skills have been neatly complemented by even more abysmal public relations. Much of its poor image is self-inflicted; the industry has allowed itself to appear to not care about customers and political stakeholders, an unforgivable transgression in a consumer society and political democracy. Transparency and open communications have never been a strong suit for the oil companies. Yes, they comply with public reporting requirements. But from the earliest days of the industry through the boom periods of the middle of the 20th century, to the secret deliberations of the Organization of the Petroleum Exporting Countries, to the price volatility of recent years, oil companies have generally resisted the candor and forthcoming style of communications that other industries call best practice.

When the oil industry makes operational mistakes, they can be spectacular: refinery explosions, well blowouts, shipwrecks, and oil spills. Equally spectacular is the industry's poor handling of such incidents, to the point that they live on as case studies of what *not* to do in a crisis.

A Commitment to Transparency

Over the decades, the industry has done many good things but then failed to capitalize on them. It has carried the United States to victory in two world wars by supplying its allies with ample supplies of U.S. oil. To this day, oil supplies are a part of our national defense strategy. The industry supplied the fuels that helped power the nation's industrialization through the 20th century; it enabled the freest people in the world to enjoy virtually unlimited and (usually) affordable personal mobility.

Oil companies have also provided hundreds of millions of dollars in philanthropic support to organizations and communities. One example I know firsthand: After Hurricane Katrina, Shell provided tens of millions of dollars in financial support for rescue, education, and rebuilding, including underwriting the cultural classic of the community, Jazz Fest. The company also provided significant in-kind contributions of fuel and other supplies to first responders. Shell's monetary and manpower support, which continue to this day, have been a mainstay of the rebuilding of New Orleans.

Best practice doesn't just mean taking credit for the positive steps the industry has taken. It also requires public exposure by top executives — putting a human face on a complex organization and demonstrating consumer empathy and engagement that is obvious and intentional. A commitment to transparency, which was

behind the outreach tour I undertook at Shell, was not an easy initial sell to the Royal Dutch/Shell board, although its members quickly saw how it paid off in reputation improvement. It ended up encouraging similar Shell initiatives in other areas of the world. Until individual companies move their public relations model from providing the smallest amount of information necessary to providing the greatest amount of information possible, the oil industry will continue to rank last in public opinion, and to be the recipient of harsh public policies and sustained criticism as a result.

I've focused on the oil industry, which is the arena I know best, but the dichotomy of customer dependence and customer avoidance is just as pronounced in the electric utility industry. And the role of state public utility commissions and similar intermediaries adds a unique barrier between utility companies and customers. Like gasoline buyers, electricity consumers want to spend as little time as possible thinking about electricity supply or reliability or price, unless bad things happen and they are forced to confront their electricity reality. Whether it is an outage or an unexplained spike in billing, it is almost always a negative experience. As a consequence, the electricity company is unlovable and unavoidable, just like the oil company.

Thus the electric utility's insights, like those of the oil company, often go unheard. I recall a conversation in 1994 with a Southern California Edison executive at a social function in Hollywood. He told me that he was retiring from the company so that he would not be part of — and therefore not bear responsibility for — the pending upheaval and ultimate catastrophe that deregulation would mean to customers in the years ahead.

He said, in essence, that California consumers did not know how good they had it in their regulated markets and that it was a shame that they would have to experience deregulation to find out. He predicted that deregulation would lead initially to lower prices for consumers but ultimately would take the market to unprecedented high wholesale prices and then lead to shortages of power.

Turns out he was pretty much right on all counts. The ill-conceived legislation of the late 1990s in California set up a deregulated electric power market by capping wholesale prices to "protect" retail prices. This led to shortages in the state's internal supply system that made it necessary to bring in hugely expensive uncapped supplies from outside the system. The resulting energy shortages and price hikes not only inconvenienced people, but also led to a number of tragic deaths (for example, among those caught in rolling blackouts). Like the Standard Oil abuses in the oil industry 90 years earlier, the experience tarnished the power industry and has poisoned the well of deregulation for a long time to come.

When oil and utility companies are seen as the problem, it is easy to avoid looking at some of the deeper social and political issues that need to be addressed. If the oil companies have the answers to the energy crisis — and in many cases they do — who will believe them? Would you accept a fox's plan for a chicken coop? Ignorance leads in one direction: bad public policy that ultimately hurts all energy consumers. If oil company leaders want to act against this ignorance, the place to start is within their own companies: toward transparency, better collaboration with outsiders, and more attention to understanding their customers. +

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