

McKinsey
& Company

The State of Energy Organizations 2024



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Energy organizations in transition

Organizations in the energy sector are evolving in response to the energy quadrilemma. With critical choices and challenges on the horizon, making proactive moves now could determine future success.

This article is a collaborative effort by Robert Belanger, Ignacio Fantaguzzi, Christopher Handscomb, Jesper Ludolph, and Phil Quadri, representing views from McKinsey's Global Energy & Materials and People & Organizational Performance Practices.

The coming decade will be a defining moment for the global energy system. Institutional and public interest is at an all-time high, driven by the ever-increasing need for affordable, reliable, secure, and competitive energy. Companies must navigate the task of maintaining a strong, high-return “traditional” core, while building businesses in the fast-moving, high-growth space of renewables, low-carbon solutions, power, and retail. This challenge demands bold action and innovative solutions, as we work toward a sustainable energy future that benefits our planet and our economies.

For the world, solving this energy quadrilemma will require significant investment, technological advancements, and a favorable operating environment. However, at the heart of this journey are energy organizations and their leaders. Being fast, agile, and efficient will be essential as competition for talent intensifies, integration of mergers and acquisitions becomes crucial for value creation, and generative AI (gen AI) changes the workplace as we know it.

In this report, we build on our flagship cross-industry State of Organizations research and take a closer look at the State of Energy Organizations.¹ We identify and explore four key themes for energy companies in the coming year: operating models, leadership, talent, and mergers and acquisitions, with reflective questions for organizations to consider as they navigate through 2024 and beyond.

Choices to define the next decade

Over the past 18 months we have seen several energy companies announce strategic adjustments that reemphasize the importance of their traditional core businesses. This reflects the growing importance of energy reliability and security, as well as slower than expected cash flows from new energy businesses. Against this backdrop, companies are recognizing that now is the time to

maximize value creation in the traditional business, grow cash flows, and take advantage of the high returns. However, as this momentum grows, an old question has resurfaced: business unit- or function-first for the traditional core business?

What primary axis should be used for the traditional core?

The choice between business unit (BU)—whether asset, regional, or value chain—or function-centric as the primary organizational axis has been a hot topic for several decades, with many companies switching between these models over time.

The choice of model essentially reflects a fundamental belief about how a company creates distinctive value: on the one hand, a functional model enables you to optimize across portfolios, and drive global scale, standardization, and functional excellence. On the other, anchoring ownership in the BU incentivizes local optimization, aiming to capture value in each and every facility, with the potential to move more quickly and unlock significant growth.

Over the past year, we have seen an increasing number of companies begin to revisit this choice and we expect this to be a growing theme through 2024. To contribute to this debate, we reviewed over 20 years of McKinsey proprietary performance datasets to draw insights linking asset performance with operating model choices. We found, on average, that BU or asset-centric models have the edge in terms of operational performance, but that they can compromise on consistency and produce a wider range of outcomes on both operating cost and production efficiency.

Irrespective of the choice made, companies can also go back to basics by focusing on some fundamental step changes across their operating model: radical simplification, value-backed technology deployment,

¹ *The state of organizations 2023: Ten shifts transforming organizations*, McKinsey, April 26, 2023.

delivery through agile teaming, and other efforts to close the productivity gap.

Additionally, we are observing a trend of companies going even deeper into their operating model—reimagining both technical and nontechnical support models. Naturally, gen AI and digital will play a leading role, however, many companies are rethinking their geographic footprint, tapping into large engineering talent markets, and revisiting their operating models for technology development and deployment to ride the next technology S-curve.

Key questions to consider

- Do you have the right tension between a BU- and function-centric organization to deliver your ambitions?
- What are the big unlocks in 2024 that would drive performance?
- How could changes to your geographic footprint or technology operating model enable stronger performance?

Should new energy businesses be integrated in or independent from the core?

Most energy players have ambitions to grow new energy businesses alongside enjoying continued success in their existing core. These twin objectives require winning simultaneously in very different markets, with different drivers of success and, therefore, different operating model needs. As a result, we see energy companies around the world grappling with profound questions over how to set up their organization to win in both worlds.

First, the bad news. The data shows that most corporate new business builds are not a great success. Just 16 percent of all new business builds in Fortune 100 companies since 2000 have turned out to be

blockbuster successes; the remainder were partial successes at best.²

Overcoming these odds will not be easy and the fundamental question is how to harness the advantages of being an incumbent while providing the freedom to deliver with the agility of a start-up.

The answer is not the same for all; however, purposeful decisions are needed sooner rather than later to deliver on the growth promised to investors.

Key questions to consider

- At the strategic level (including capital allocation) how autonomous should your new energy business be?
- What are the right key success factors that will enable your new energy business to grow?
- What are the right architecture, corporate functions, technical support, midstream gas or trading decisions that will set your new energy business up for success?

What are the talent and leadership needs for a new era?

The focus over recent years has been to secure specialist engineering, digital, and commercial talent to develop new businesses and capabilities. This challenge remains alive, and competition for talent continues to be fierce.

However, a new challenge of equal proportion is bubbling under the surface: the need to retain and refresh the skill base to sustain the existing core business. This challenge will grow in prominence against a backdrop of significant retirements, with 400,000 oil and gas employees in the United States approaching retirement, and the increasingly negative perception of the traditional energy sector among younger workers in some parts of the world.³

² Matt Banholzer, Markus Berger-de León, Subu Narayanan, and Mark Patel, "How industrial incumbents can create new businesses," McKinsey, November 13, 2019.

³ "Labor force statistics from the current population survey," U.S. Bureau of Labor Statistics, 2022.

The good news for employers in the new energy space is that knowledge, expertise, and competencies gained in more traditional energy businesses are relatively easily transferred. However, this transferability further compounds the challenges in retaining and attracting talent to the historic core.

To enhance their attractiveness to the talent market, many firms are reevaluating their employee value proposition (EVP), focusing on creating broader, or faster career opportunities, reshaping the corporate culture, and changing the perceptions of senior leaders. At the same time, many firms are broadening their accessible talent market, taking advantage of the global talent pool to strengthen their bench. Whichever way this challenge is addressed, it seems that early and purposeful moves in 2024 may position firms ahead of their peers for the next decade.

Beyond the talent squeeze, leaders hold a unique position in the journey ahead. The leaders of today are shaped by their traditional business and corporate histories; however, what lies ahead will be different in terms of challenges and opportunities—and only accelerated through the emergence of new technologies like gen AI. These will place different demands on leaders and require an evolved leadership model.

Our survey of over 140 senior leaders indicates the change needed as leaders move from a “traditional leadership” style prioritizing elements such as planning, directing, and controlling to an “emerging leadership” approach that values a visionary style where leaders act as an architect, catalyst, and coach. Achieving this goes far beyond defining desired leadership behaviors and running development programs, but into the DNA of corporations—requiring a culture and operating system that reinforces and

rewards the desired behaviors rather than hindering or—worst of all—punishing them.

Key questions to consider

- Do you have sufficient strategic talent plans for the next five years, and do they take advantage of the global talent market?
- Does your EVP fit the modern expectations of employees?
- Do you and your leaders understand the transformation ahead and are you ready for it?

How do you create value from M&A in an era of consolidation?

Operators are already taking advantage of the high cash flows generated in the latest market cycle, with many pulling the traditional levers of capital management, shoring up their balance sheets, and returning cash to shareholders.

However, we are already seeing the next wave of M&A activity globally, with a high likelihood of acceleration in 2024.⁴ Oil and gas is moving with this trend, with recent megadeals such as ExxonMobil–Pioneer Natural Resources, Chevron–Hess, and Occidental Petroleum–CrownRock LP, with new energies following closely behind with a more programmatic approach.⁵

Executing the deal is one thing, and for many, acquisitions are seen internally as “bread and butter,” however, more than 50 percent of deals in the exploration and production sector don’t create value for shareholders.⁶ As we begin the next wave of M&As, it is clear that it must be different—the creation of value will underpin success, with organizational unlocks at the center.

⁴ Robert Belanger, Jeremy Brown, and Tom Grace, “Success in the M&A rebound: Riding the coming wave of upstream deals,” McKinsey, February 24, 2023.

⁵ “ExxonMobil announces merger with Pioneer Natural Resources in an all-stock transaction,” ExxonMobil, October 11, 2023; “Chevron announces agreement to acquire Hess,” Chevron, October 23, 2023; “Occidental to acquire CrownRock, strengthening its U.S. onshore portfolio with premier Permian Basin assets,” Oxy, December 11, 2023.

⁶ McKinsey analysis.

There are three characteristics we observe to create value in both the short- and long-term. First, integration—capturing value far beyond general and administrative expense synergies is critical. The best use the moment of transaction to catalyze a step change in performance across all levers and create an inherent “deal and integration machine” to deliver value creating integrations over and over again. Second, enabling long-term growth by selecting the right end-state operating model, striking the right balance between dependent and independent. Third, focusing on managing culture from the very start of the M&A process is important to delivering long-term success.

Key questions to consider

- Do you have the inherent capability to build the “deal and integration machine” required?
- How can new opportunities be catalyzed at the point of integration to realize step changes in performance?
- How will you make the right decision when selecting the end-state operating model?

What role can gen AI perform for energy organizations?

Gen AI has the potential to revolutionize the energy industry by enabling more efficient operations, better decision making, and improved resource management. Potential applications include data analysis and interpretation, predictive maintenance, and virtual monitoring and simulation—among many more yet to be imagined.

Gen AI can analyze large volumes of data from sources such as seismic surveys, well logs, and production logs to identify patterns, anomalies, and correlations that

can help optimize production, reservoir modeling, and allow for higher quality decision making. It can analyze sensor data and historical maintenance records to predict equipment failures and recommend proactive maintenance actions to improve operational efficiency, reduce downtime, and improve safety.

The technological side of the equation is complex but may not be the biggest challenge. There will be a huge impact on people: the capabilities and skills they need and how their day-to-day jobs might change. The introduction of gen AI could lead to the evolution of existing job roles and the emergence of new ones. It opens up amazing opportunities as well as challenges. To make the most of both, it will be critical to stay ahead of the trend and plan for how this may impact your people model and require investments in reskilling and upskilling parts of the workforce.

Key questions to consider

- What proportion of jobs will be significantly exposed to automation due to gen AI in the next decade?
- What impact does gen AI have on the capabilities needed in your workforce in the coming decade?
- Do you have a plan in place to close the capability gap and capture the gen AI revolution?

Faced with change—and opportunity—on several fronts, energy organizations have critical choices to make to shape their future in a low-carbon world. Thinking strategically now about operating models, leadership, talent, and M&A could position energy organizations to evolve ahead of these major trends. Those who don’t plan now risk being left behind.

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New energy businesses: The independence versus integration dilemma

Energy majors set ambitious targets for new energy businesses (renewables, CCUS, hydrogen). They need an operating model combining the strengths of an incumbent with the agility needed to succeed.

This article is a collaborative effort by Esmee Bergman, Ignacio Fantaguzzi, Christopher Handscomb, Jesper Ludolph, and Phil Quadri representing views from McKinsey's Global Energy & Materials and People & Organizational Performance Practices.

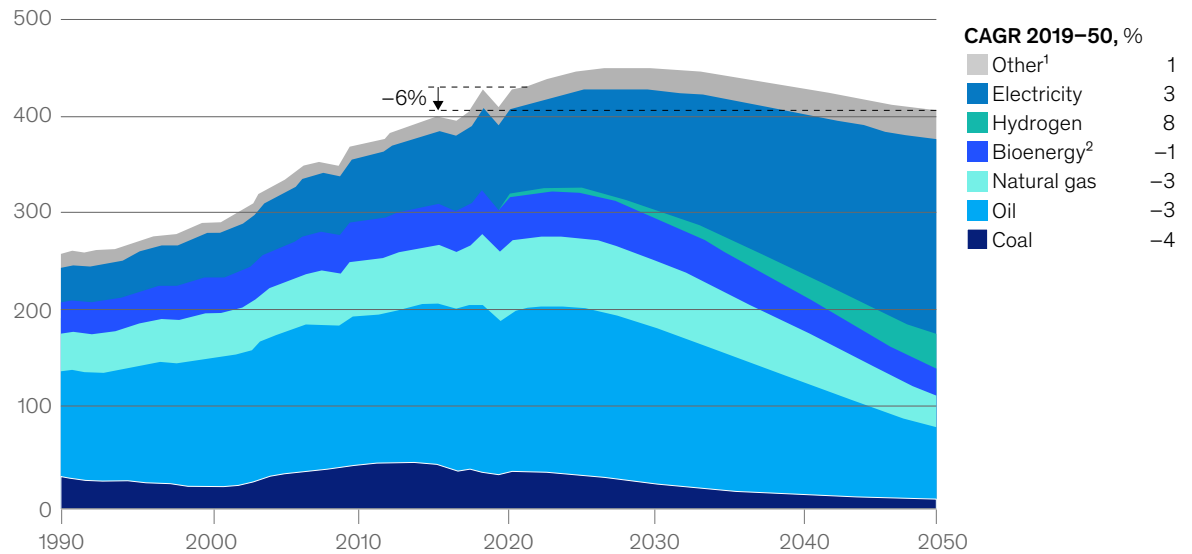
There is enormous value at stake in the energy transition as the world continues to move toward cleaner energy. Electrification and renewables, in particular, show accelerated growth, with electric power and hydrogen expected to represent 32 percent of the global energy mix by 2035 and 50

percent by 2050 (Exhibit 1). It's hardly surprising that energy incumbents are entering this new energy space. The potential 2030 market opportunity in new energy businesses is estimated at \$3 trillion, with top energy majors expected to make an average investment of \$35 billion between 2022 and 2030.⁷

Exhibit 1

The share of electricity in energy composition will continue to grow.

Final energy consumption by fuel, Achieved Commitments scenario, million TJ



¹Includes heat, geothermal, and solar thermal.
²Includes synthetic fuels, biofuels, and other biomass.
 Source: *Global Energy Perspective 2023*, McKinsey, October 18, 2023

⁷ McKinsey analysis.

As many energy majors embark on their own new energy business ventures, an important question on their minds is whether they can strike the right balance between dependence and independence, harnessing the advantages of being an incumbent while enabling the agility of a start-up.

With new energy businesses in their early days, there are no definitive answers to this question of independence or integration; different types of new businesses are seeing initial success with different operating models. However, there are key choices and considerations that can help incumbents avoid the most common pitfalls of business building. This article explores the different operating models chosen for new energy ventures by companies with an established incumbent business (for example, oil and gas and utilities).

Why the right choice matters

Leaders can underestimate the difficulty of starting a new venture within the boundaries of existing processes, systems, culture, and behaviors. New businesses often fail to scale. Only 16 percent of

executives in Fortune 100 companies report that their corporate business builds have achieved blockbuster success after four years.⁸ The remainder were partially successful at best.

Disruption was once considered the domain of start-ups. Today, however, incumbents are actively using this strategy themselves to disrupt the industry. Incumbents are rightly asking how to strike the right balance between dependence and independence when it comes to their new energy business.

The pressure to make the right choice is enormous, given its impact on operational performance.

Clear prioritization and end-to-end accountability for business units and teams can drive an uplift of more than 30 percent in operational performance. Ensuring purpose and the ability to operate autonomously to get things done can increase employee engagement by 30 percentage points. And creating teams of doers and removing red tape can turn plans into action five to ten times faster than if the incorrect operating model has been chosen.⁹

As many energy majors embark on their own new energy business ventures, an important question on their minds is whether they can strike the right balance between dependence and independence, harnessing the advantages of being an incumbent while enabling the agility of a start-up.

⁸ Matt Banholzer, Markus Berger-de León, Subu Narayanan, and Mark Patel, "How industrial incumbents can create new businesses," McKinsey, November 13, 2019.

⁹ Wouter Aghina, Christopher Handscomb, Olli Salo, and Shail Thaker, "The impact of agility: How to shape your organization to compete," McKinsey, May 25, 2021.

Weighing the options

Corporate structures for new energy businesses range from full business separation to full integration within the core business, each with its own benefits and risks.

Full separation

In a separation model, the new business can be set up as a separate entity (such as a subsidiary). As a subsidiary, the new business has its own legal and financial structure, leadership team, processes, and people model. In many cases, it is largely funded by

the parent company but often attracts additional external funding and partners (see sidebar “Case study: Eni creates an independent renewables business—Plenitude” for an example of this approach).

An alternative approach is to form a partnership with an existing renewables venture. The incumbent often provides the brand, access to customers, capital, and seconds specific key capabilities into the venture while the renewables venture provides the lean governance, processes, and culture required to grow at pace (see sidebar “BP partnered up with a renewables venture” for the story of how BP formed a joint venture to accelerate their solar business).

Case study: Eni creates an independent renewables business—Plenitude

In 2023, Eni, a leading energy company, decided to fully carve out their renewables business in order to diversify their portfolio and accelerate their growth. As part of this process, they combined their existing renewables generation business with their retail, energy management, finance, and environmental, social, and governance operations.¹ In doing so, a financially self-

sufficient company was created with an entirely independent operating model from the parent company, with some exceptions on risk management, compliance, and selected audit processes. The board of the new venture was made up of independent board members as well as several members selected from the parent company.

Creating the fully independent organization, Plenitude, allowed them to integrate the renewables value chain (from generation to consumers), better position this part of the business to attract green financing, and achieve a higher valuation for the combined entities.

¹ *Eni retail and renewables capital markets day*, Eni, November 22, 2021.

BP partnered up with a renewables venture

An example of a partnership approach is LightsourceBP. In 2017, BP initiated a collaboration with Lightsource Renewable Energy, investing \$200 million for a 43 percent stake.¹ Two years later, this collaboration became LightsourceBP, a 50:50 joint venture. For BP, it offered a way to establish a start-up-minded renewables business with solar expertise. Conversely, Lightsource Renewable Energy gained credibility, capital, and process standardization through the BP association, leading to rapid growth in the pipeline from

five markets and 1.5 gigawatts (GW) to 19 markets and 55 GW in the pipeline in just five years.²

LightsourceBP is being fully integrated into BP's Gas and Low Carbon unit, after BP announced it was acquiring its outstanding 50 percent stake, aiming to share the capabilities, experience, and learnings from their other technologies (for example, onshore wind).³

What can we learn from this? Opting for this level of independence for the new venture

offers autonomy and decision making free from the processes in the parent company which are often designed for a different type of business. External talent can infuse an entrepreneurial mindset and drive rapid expansion. However, such independence potentially sacrifices benefits like access to the parent company's customer base, stakeholder network, distribution channels, and assets. It also necessitates establishing its new processes, systems, and support functions.

¹ "The deal on the Lightsource deal," BP, March 15, 2018.

² "Better together: Five years of Lightsource bp," BP, December 14, 2022.

³ "BP agrees to take full ownership of Lightsource bp," BP, November 30, 2023.

Integration into the existing structure

Many incumbents choose to set up a new energy business within their existing structure, with varying degrees of independence. The level of independence may vary over time, driven by the maturity of the business, the type of technology, and perceived synergies with the core business (see sidebar "EDP

Renewables goes through a journey with varying levels of integration over time" to read the story of how EDP evolved the level of integration of their renewables business over time). This is a choice we also see in Equinor and others where the business is kept closer to the core when incubated and, over time, given more independence as it matures.

EDP Renewables goes through a journey with varying levels of integration over time

EDP Renewables (EDPR), one of the largest renewables players in the world, has been through a journey in terms of its level of independence.

EDPR's origin story is closely tied to EDP's strategic decision to expand into the renewable energy sector. In 2006, EDP created a dedicated division focused on renewable energy, which laid the foundation for what would become EDPR. This division

was tasked with developing, building, and operating renewable energy projects, with a particular emphasis on wind power.

Over the years, EDPR experienced significant growth and in 2008, EDPR completed its initial public offering (IPO), becoming a publicly traded company.¹ This move allowed it to access additional capital for its renewable energy projects and signaled its commitment to further growth

and expansion. Over time EDP and EDPR's story has remained closely intertwined. This is a story about creating a renewables unit flexible enough to grow in an environment closer to a start-up than the conventional business with the ability to raise external capital needed to do so. EDP always retained more than 70 percent ownership of their EDPR listed subsidiary and they continue to be core to EDP with a shared CEO and CFO.²

¹ Alex Bugge, "EDP raises \$2.4 bln in renewables unit IPO," Reuters, June 2, 2008; EDP Renováveis announces launch of its IPO at a price range of €7.40 to €8.90 per share," EDP, May 15, 2008.

² *Capital markets day*, EDP, 2023.

A more integrated new energy business, especially in the early phases, allows incumbents to provide their new ventures with advantages not available to an independent venture. These include customer access, brand recognition, negotiation leverage, stakeholder relations, existing base of suppliers, talent, intellectual property, distribution capabilities, as well as easier access to capital.

There is still a spectrum in terms of the level of integration across five relevant dimensions: steering model, who sets targets, capital allocation process, talent approach, and operational processes (Exhibit 2).

The first factor to consider is the steering model of the new business. In addition, incumbents need to decide what level of control the core business will have over the new energy business, and which part of the business sets the strategy and targets for the new venture. Capital allocation needs to be considered as does the talent approach. Where will the new energy venture source its talent and capabilities—from within the core business or from outside the core? And, lastly, what are the operational processes that the new venture will use, and specifically, which parts of the business are involved in project delivery?

Exhibit 2

Five key choices drive the level of integration of new energy businesses.

Key choices	Integration levels			Example businesses		
	More independent		More integrated	1	2	3
1 Steering model What level of control does the core business have over the new energy business?	New energy business has full control only constrained by high level directional frame	New energy business sets its own direction but must follow similar core processes and leverage central teams where applicable	New energy business is highly reliant on the core business	● Utility	● Oil major 1	● Oil major 2
2 Strategy and targets Which part of the business sets strategy and targets for the new energy business?	New energy business independently develops strategy and targets within directional frame	New energy business is accountable for the strategy and targets but needs to leverage the strategy team from the core business	New energy business is heavily involved but strategy and targets for the new business are developed in the central strategy unit			
3 Capital allocation How does the new energy business access the required capital?	New energy business gets an envelope and can fully decide within that	New energy business gets an envelope and needs approval from core business to release funding for projects	New energy business competes for capital for projects with core business			
4 Talent approach Where do the green businesses source talent and capabilities from?	New employees are hired on potentially different contracts and can build a new culture	Combine new hires and hires from the core business and follow people processes directionally	Combine new hires into the new energy venture, lean on central HR team to execute and follow exact same processes and compensation strategy			
5 Operational processes Which parts of the business are involved in project delivery?	New energy business delivers projects independently, with own tech and projects teams	New energy business leads on project delivery, leveraging help from central projects and tech organizations	Central projects and tech organizations are accountable to deliver new energy projects, with limited involvement from new energy teams' past development			

Organizations make different choices on each of these five dimensions when setting up their new energy business. However, for capital allocation, we do see a trend that the large majority chooses to allocate an envelope to the new business with stage gates to release funding. For their talent approach, many of the oil and gas majors start out using a very integrated HR process but over time move to more independence for the new businesses.

Integrating a new business into the core traditional business of an incumbent does not come without risks. It is important to make sure entrenched ways of working, relatively cumbersome processes (compared to those of a start-up), cultural norms, and mindsets do not hamper the success of the new venture. Incumbents must be mindful of the risks and purposefully mitigate those.

Based on our experience, eight imperatives are starting to emerge that leaders could consider when starting a new business that is integrated within the existing business:

- 1. Avoid short-term earnings pressure.** Start-ups often prioritize market share and scale over short-term profits. If a parent company pressures its new businesses to meet return thresholds similar to the parent company's, they are more likely to make decisions that limit long-term prospects.
- 2. Provide rapid access to capital.** Access to capital is fundamental for scaling. The operating model could facilitate securing the necessary funding for projects, whether through internal resources, external investments, or partnerships. Financial flexibility is key to seizing growth opportunities when they arise.
- 3. Allow customization of core processes and project design.** Streamlining operational processes is essential for cost-effectiveness and scalability in a low-margin industry (especially compared to major capital projects in oil and

gas). Lean and efficient processes help manage project delivery, reduce overheads, and allocate resources effectively. In addition, designing projects with scalability in mind is essential. The new business could be set up to replicate successful project models in different markets, minimizing the need for reinventing the wheel.

- 4. Create shortcuts for decision-making processes and avoid red tape.** A parent company's bureaucracy can limit the ability to make quick decisions. The new business could be allowed to make swift decisions without being bogged down by bureaucratic processes. A streamlined decision-making framework accelerates the response to market opportunities and challenges.
- 5. Freedom in talent acquisition and retention.** Attracting and retaining top talent is crucial. The setup could enable the new energy business to recruit skilled professionals who are passionate about the renewable energy sector. Offering competitive compensation, growth opportunities, and a compelling employee value proposition (EVP) is vital to building a talented workforce.
- 6. Allow for partnerships and ecosystem integration.** Building strategic partnerships within the new energy ecosystem can accelerate growth. Collaborating with other industry players, research institutions, and start-ups can provide access to complementary capabilities, technologies, and markets.
- 7. Autonomy when setting up enabling services and platforms.** Our research shows that successful business builders grant their new businesses considerable autonomy in core IT, marketing, data and analytics, and HR while making sure the new business stays aligned with the overall strategy of the company.¹⁰

¹⁰ 2021 Global report: The state of new-business building, McKinsey, December 6, 2021.

8. Entrepreneurial culture, aligned with the values of parent company. Ensure that the new business's culture, while different, aligns with the mission and values of the parent company. A cohesive cultural framework fosters collaboration, knowledge sharing, and a sense of purpose.

By carefully considering these critical factors incumbents can position themselves for rapid growth and success in a competitive and evolving industry.

The first steps for incumbents

Choosing an operating model for a new energy business isn't a matter of right or wrong—it's about being clear on the choices and consequences. Striking the balance between dependence and independence to harness both the strengths of incumbency and the agility of start-ups is a complex challenge. The next steps for established energy majors involve carefully weighing the options, understanding the spectrum of integration, and mitigating potential risks.

To navigate this transformative journey successfully, leaders can consider various factors, including how much the new venture would benefit from customer access, brand recognition, negotiation leverage, stakeholder relations, existing base of suppliers, talent, intellectual property, distribution capabilities, as well as easier access to capital. They can also ask whether any of these benefits

can be provided while balancing the need to create a lean, fast-growing organization with a different metabolic rate than the traditional business.

Once the corporate structure and level of independence versus integration have been chosen and the business has started, the next questions arise. How do you accelerate growth and scaling in terms of project pipeline, required workforce, and capability building?

In terms of growing rapidly, new businesses can look at acquisitions as one potential avenue for accelerating growth. An acquisition not only provides access to physical assets and partnerships, it also offers access to a new talent pool when executed well. For example, new businesses were 25 percent more likely to significantly exceed expectations when they made two acquisitions early in the scaling process compared to businesses that made no acquisitions or that made three or more.¹¹ The new venture may need an "acquisition playbook" to ensure successful integration and retention of talent and constant screening of acquisition targets.

For talent strategy, the new business could focus on improving its EVP scores to attract and retain talent. Leaders could consider their EVP right from the start by designing an action plan that gives them a talent advantage.

¹¹ 2021 Global report: *The state of new-business building*, McKinsey, December 6, 2021.

On the leadership front, leaders need to operate with substantially greater speed and entrepreneurialism when entering the new energy sector. They may need to develop innovative ways of collaborating, both within their organizations and in the emerging energy ecosystems. A major challenge is attracting and retaining talent in an environment where traditional energy companies are under intense negative public pressure. These leadership challenges will be more keenly felt in the more integrated operating model, where leaders have to be the bridge between the old and new worlds.

New energy businesses have the potential to thrive, and many incumbents are eager to enter this high-growth space. The operating model that energy players choose can directly impact the success of their new business, and incumbents need to decide what strategy would best suit their business needs. This decision is only the beginning, but it can pave the way for future success.

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Five features of operational excellence in oil and gas organizations

New McKinsey analysis shows that while asset-centric models on average produce better results, function-centric models tend to perform more consistently.

By Robert Belanger, Christopher Handscomb, and Aisha Lemsom.

Operating models are emerging as a crucial performance differentiator as upstream oil and gas operators seek to improve the resiliency of their businesses amid energy transition uncertainty.

To understand which types of operating models are delivering the highest near-term value from efficient operations, we evaluated the performance of different operating models across oil and gas organizations using our Energy Solutions operations benchmarking database. Analyzing the production and operation cost performance of more than 45 upstream business units—which operate more than 180 distinct assets—highlighted the trade-offs between the two approaches to managing assets: asset-centric and function-centric models.

In an asset-centric model, the asset teams are the “center of gravity.” All operational decisions are made by the asset or business unit leadership, and they are also accountable for profit and loss (P&L) results. Asset-centric models tend to embed technical and functional support within an asset team or business unit.

In contrast, a function-centric model is where functional teams are responsible for the outcomes in their respective domains. Decisions within a function’s remit require the approval of the functional team, and in some instances, P&L accountability may be shared between functional and asset or business unit leadership. In this model, functions are often centralized into global teams that support the company’s entire asset base.

The results of this analysis indicate that while asset-centric models tend to achieve better operational

outcomes—measured as higher production efficiency and lower operating costs—they also experience a wide range of outcomes. The function-centric model tends to produce more consistent results, however, with lower operational performance.

Asset-centric models tend to outperform on outcomes

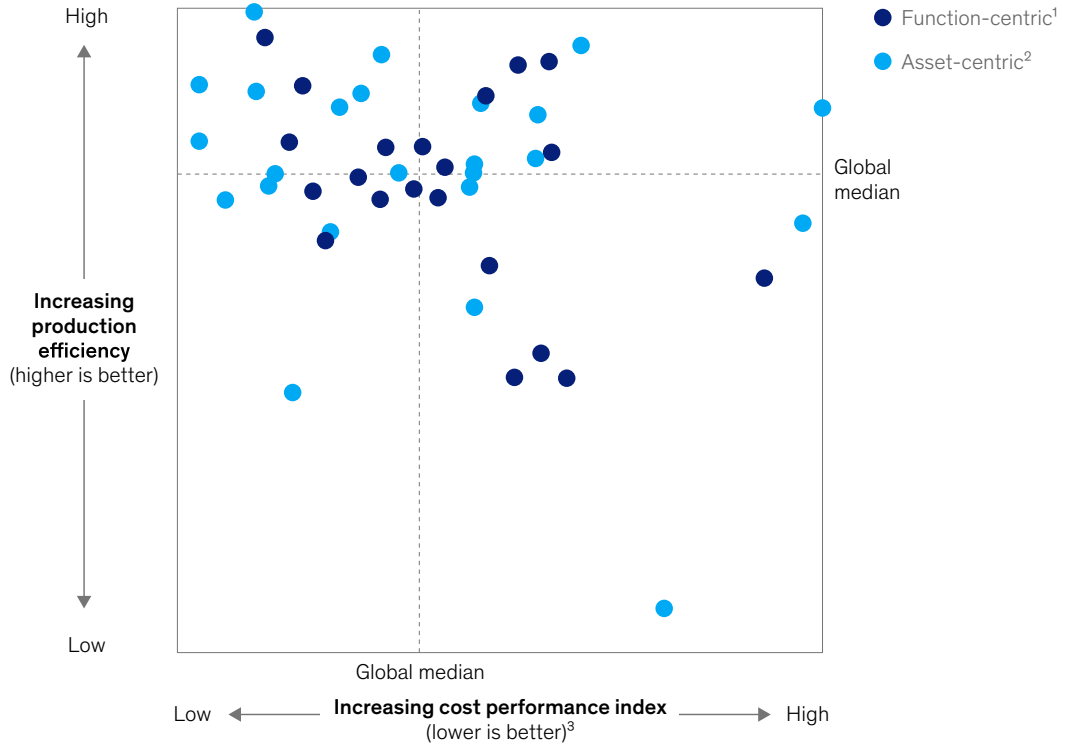
On average, asset-centric models have the edge in terms of operational performance. Operating costs are generally 6 percent lower when normalized for asset scale and complexity and show two percentage points higher production efficiency than their function-centric counterparts (Exhibit 3). This translates into tens of millions of dollars in cost savings and thousands of barrels a day of additional production. This outperformance means that the average function-centric business unit was on par with the third-quartile asset-centric business unit in terms of production efficiency.

However, there is a trade-off between higher average performance and greater variability. Asset-centric models have a wider range of outcomes on both operating cost and production efficiency than function-centric models. This occurs in both directions—the best outcomes for asset-centric models are better than the best outcomes that can be achieved when using function-centric models, but the opposite is also true. The worst outcomes when using an asset-centric model are far worse than the potentially bad outcomes of a function-centric model.

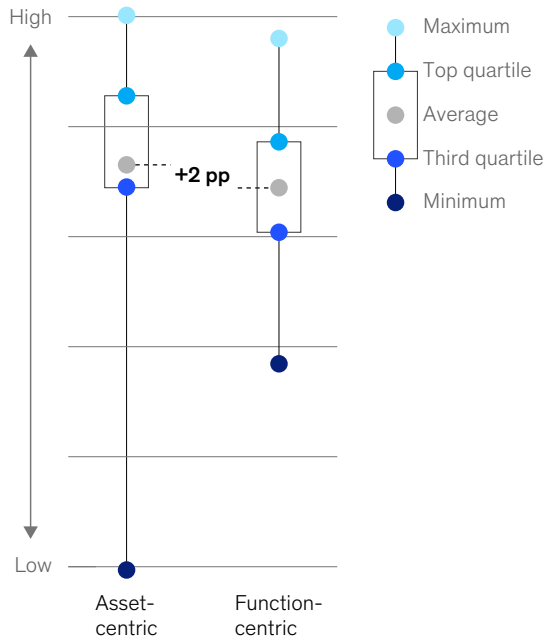
Exhibit 3

Asset-centric operators tend to average better cost and production efficiency but experience a wider range of outcomes.

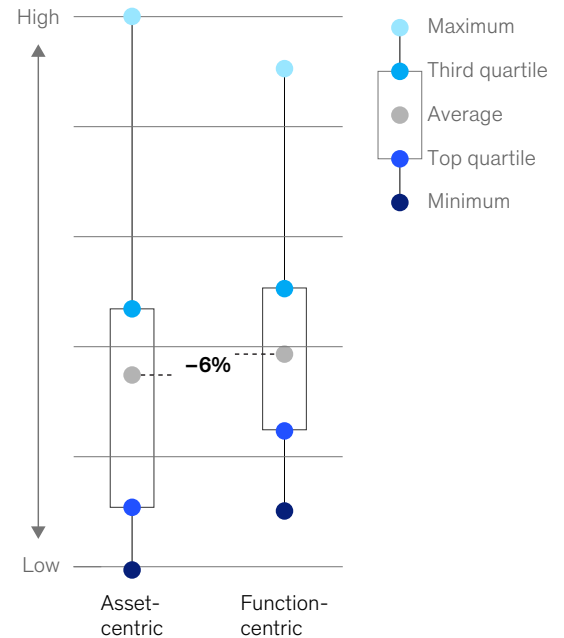
Cost versus production efficiency by business unit



Production efficiency, % (higher is better)



Cost performance index³ (lower is better)



¹Function-centric model is where P&L ownership is diffused across different functions (operations, maintenance, wells, etc) and decision making includes asset and BU leadership and functional team leaders.
²Asset-centric model is where P&L ownership is primarily held within asset or BU leadership and operational decisions are owned by asset or BU leaders.
³Cost performance index is a measure of operating cost performance normalized for asset complexity scale and indexed to global average normalized cost performance.

Enabling operational excellence: Five success factors

Based on our extensive work with operators, our experience indicates that asset-centric operating models can far outperform function-centric models because they streamline and boost performance through five crucial characteristics:

Simplicity. High-performance assets tend to have operating models underpinned by simplified processes and minimal reporting lines.

Control. Functional and technical support is carefully controlled, with integrated teams embedded in the asset creating an empowered frontline.

Expertise. Staffing is tailored to each asset's needs, with the required expertise embedded into the asset team and expressly dedicated to that team. Asset team leadership tends to have extensive experience within a particular asset or region (often more than 20 years) while function-centric leadership often rotates in and out of postings every few years.

Efficiency. Workforces are streamlined with limited layers between asset leadership and the frontline. They tend to have an optimally sized workforce, with high levels of visibility into the corporate function's costs, which helps drive efficiency.

Accountability. High asset performance is incentivized for the whole team, KPIs cascade down to the frontline, and performance is reviewed regularly to ensure transparency. Asset-centric leadership bears a high degree of ownership for performance outcomes because there is no tangential functional leadership to deflect blame; they are ultimately responsible for the results of their specific units.

Function-centric models hold their own advantages

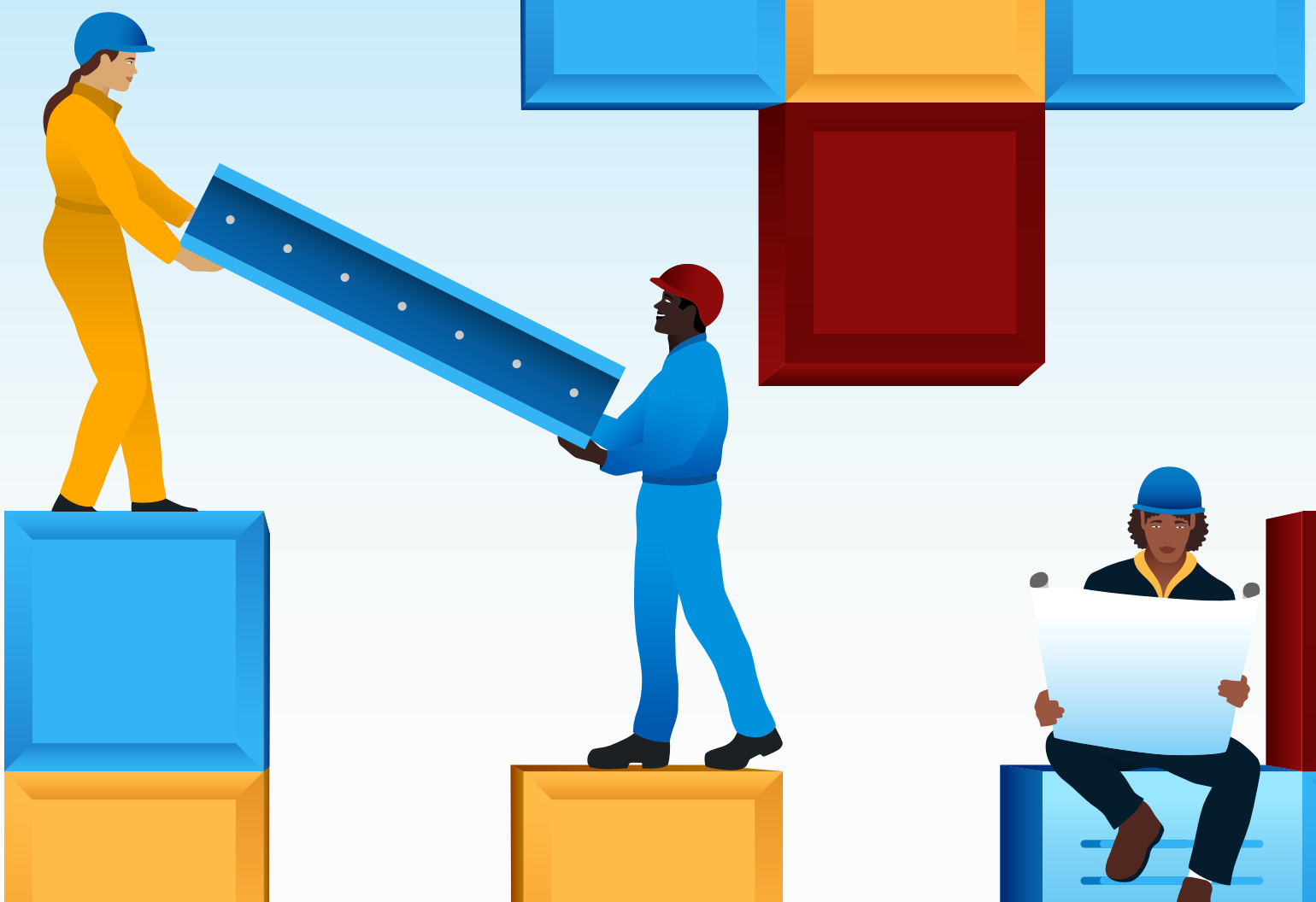
However, function-centric models are not doomed to poor performance. In fact, they might have some distinct advantages that can support broader strategic goals. Function-centric operators typically have a deep talent pool of expertise they can pull from to take on extreme technical challenges, like establishing infrastructure in a new region, supporting large capacity expansion projects, or integrating different asset types in a merger or acquisition, as it can be optimized across assets and countries. An example of where this model would be very beneficial for these types of challenges is during major project procurement and rig sequencing. Because they tend to achieve more consistent results, this can be reassuring to investors and provide stability after market shocks.

With some targeted changes, function-centric models could get the best of both worlds by adopting the winning principles exhibited by asset-centric operators. For example, function-centric operators can adopt transparency in functions to help drive efficiency, challenging costs and support levels to ensure the right level of technical and functional support per dollar spent. Functional operators can further streamline their operations by optimizing organizational reporting layers and emphasizing more time in the seat for asset and business unit managers.

Evaluating the effectiveness of your operating model is a critical and often overlooked lever that operators can pull on to drive performance and cost efficiency. Identifying and implementing the right model can significantly improve performance, and our study indicates that asset-centricity may be the way forward for many oil and gas organizations.

Robert Belanger is an associate partner in McKinsey's Houston office; **Christopher Handscomb** is a partner in the London office; and **Aïsha Lemsom** is an associate partner in the Amsterdam office.

The authors wish to thank Tyler Goldsmith for his contributions to this article.



The productivity prize in oil and gas: Lessons from top performers

Workforce productivity varies significantly across upstream oil and gas companies. Understanding the productivity gap—and the three levers to close it—could boost company performance and resilience.

By Robert Belanger and Christopher Handscomb

In their efforts to improve margins, many upstream oil and gas players are turning their attention to workforce productivity. This focus on productivity may prove especially important given industry headwinds: a looming retirement wave, the sometimes negative perception of the traditional energy sector among younger generations, significant talent outflow from the industry, and increasing competition for talent and capital from new energy industries—all of which are likely to make it harder for oil and gas producers to maintain and improve their productivity.

A recent study of workforce productivity in the upstream oil and gas industry, using McKinsey's Energy Solutions Organization Benchmark, found a substantial productivity gap across operators.¹² Analysis of over 50 business units from more than 30 oil and gas companies from the global dataset found that the most productive companies were 150 percent more productive than the average operator. This productivity gap is driven by all functions across the typical organization. Analysis of these top performers indicates there is significant room for improvement for much of the sector, representing a major "productivity prize."

Analyzing the productivity gap

The productivity gaps we observed between upstream oil and gas companies are substantial—a top quartile peer can deliver 150 percent of the output of the average organization with the same-sized workforce. Remarkably, this increase in productivity does not come at a cost in terms of operational performance—top quartile peers on average have similar levels of production efficiency and safety performance, delivering these outcomes with lower operating cost.¹³

Top quartile organizations are delivering 2.5 times the drilling activity, managing more complex reservoirs, operating twice the number of assets, and spending 20 percent less on maintenance costs. Top performers can also deliver the same output as an average peer with 40 percent fewer full-time equivalent (FTE) employees (Exhibit 4).

A top quartile peer can deliver 150 percent of the output of the average organization with the same-sized workforce.

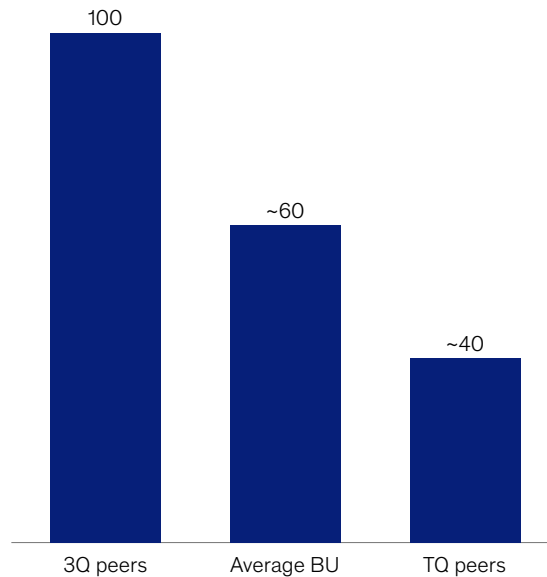
¹² McKinsey Energy Solutions Organization Benchmark, July, 2023.

¹³ McKinsey analysis.

Exhibit 4

The most productive operators can achieve the same outcomes as peers with a fraction of the organizational resources.

Organization size, normalized for operator activity, %



Source: McKinsey Energy Solutions O&G Organization Benchmark

Measuring productivity in a targeted way

One of the most important ways to assess organizational performance is to measure productivity and the potential to improve it. At its core, and simplest means of expression, productivity is the output for a given input.

Traditionally, workforce or labor productivity has been measured by labor input such as working

hours and financial output, including revenue.¹⁴ However, these measures typically mask many of the underlying reasons for high or low productivity, and do not consider the nuances of each individual organization or provide specific insights into which levers have the greatest productivity potential.

Measuring staffing intensity offers an alternative approach that assesses workforce size per unit of activity, or the number of FTE employees and contractors (input) per unit of activity (output)—an inverse of productivity. An advantage of this approach

¹⁴ "Productivity measures: Business sector and major subsectors," U.S. Bureau of Labor Statistics, September 23, 2020.

over traditional productivity measures is that it provides a way to normalize for different activities conducted by different functions. The activity set for Finance and Accounting, for example, looks very different from the activity set for the Subsurface or Wells functions, and traditional methods of productivity measurement make it hard to compare across functions. It also provides a way to adjust for structural differences between companies for things like scale, portfolio composition, asset complexity, and growth plans. Different “activity drivers” are used to normalize each function’s size to provide a like-for-like comparison against peers. For example, reservoir complexity can be used as an activity driver for the Subsurface function, while an index of drilling activity could be used for the Wells function. This removes any differences in performance due to factors outside of productivity and ways of working, which helps managers understand their organization’s true productivity opportunities.

How operators improve their productivity

There are many levers that organizations can pull on to drive productivity. These fall into the three main categories of people, processes, and structure.

People levers include improving the culture to create a more collaborative work environment, reconsidering the size of the workforce, enhancing talent through skills building (for example, multitasking offshore personnel), and acquiring talent from outside the company. McKinsey research shows that the best performers are 800 percent more productive than the average employee in highly

complex roles, highlighting the potential that can be unlocked by focusing on people levers.¹⁵ However, people levers are often enabled or magnified by improvements to process and structure.

Process levers can be used to streamline workflows, improve the efficiency of decision making, or enhance technology systems to support more efficient processes (for example, deploying advanced analytics systems in maintenance processes to improve equipment reliability).

Finally, structure levers include reconfiguring the “boxes and lines” of how the company is organized to better align to sources of value creation. For example, our research shows that an asset-centric axis of organization can yield better operational performance than a function-centric orientation (see article, “Five features of operational excellence in oil and gas organizations”). This includes rethinking the location footprint to provide better access to assets and talent or altering roles and responsibilities to align the highest performers with the biggest sources of value.

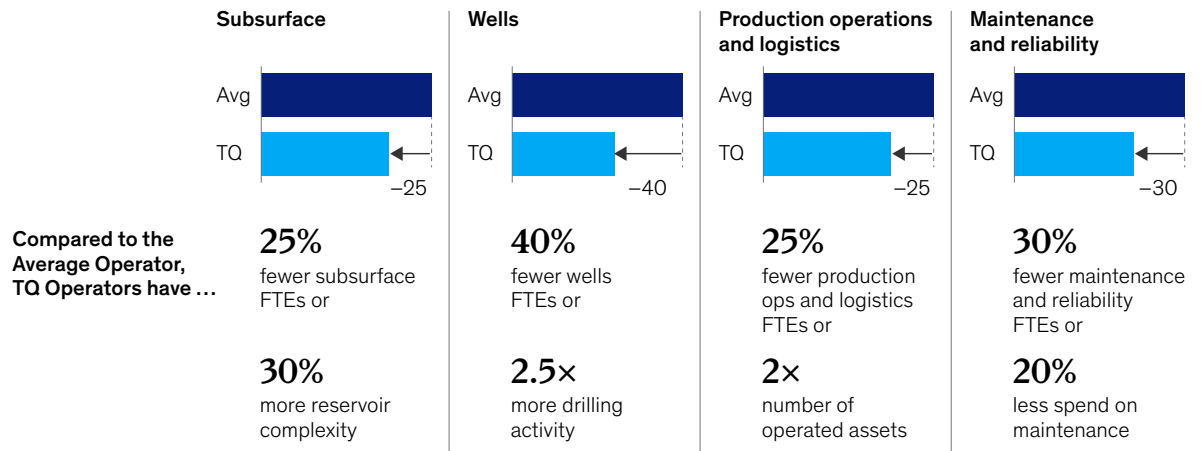
McKinsey’s oil and gas workforce productivity study found that the productivity prize applies across all functions, both technical and nontechnical, meaning there is no one functional culprit for low productivity (Exhibit 5). Rather, leading producers tend to apply multiple levers across multiple functions to drive holistic productivity improvements. Sometimes, a specific functional transformation is needed (such as a financial system digital transformation) in order to enable additional operating model changes to drive productivity improvements.

¹⁵ Scott Keller, “Attracting and retaining the right talent,” McKinsey, November 24, 2017.

Exhibit 5

All functions have substantial productivity improvement potential.

Normalized staffing intensity by selected function¹



¹Non-exhaustive. Normalized staffing intensity measures the number of Full Time Equivalents (FTEs for both employees and contractors) per unit of activity driver, which varies by function (for subsurface, reservoir complexity; for wells, drilling activity; for production operations and logistics, operated asset scale and complexity; for maintenance and reliability, maintenance activity spend). Source: McKinsey Energy Solutions O&G Organization Benchmark

The upstream oil and gas productivity gap—and on the flipside, the potential productivity prize—presents a significant opportunity for upstream oil and gas companies to improve their resiliency as

they face pressure to provide affordable, reliable, secure, and cleaner energy. A holistic approach that encompasses people, processes, and structure could help under-pressure oil and gas producers achieve the productivity levels of their top-performing peers.

Robert Belanger is an associate partner in McKinsey's Houston office and **Christopher Handscomb** is a partner in the London office.

The authors wish to thank Corryn Bourgeois for her contributions to this article.



Talent squeeze: Planning for the energy sector's talent transition

Amid increased demand, an aging workforce, and decreased recruitment levels, the energy sector's talent pool is under pressure. Five strategies can help executives fill their talent pipeline.

By Ignacio Fantaguzzi, Christopher Handscomb, Iyad Sheikh, and Aly Torres

As the energy transition gathers pace, there is an increasing need for energy talent. The global demand for oil and gas is projected to remain roughly stable, while indicators point to substantial growth in supply from new energy sources by 2035.¹⁶ The energy industry is therefore facing two significant and interacting areas of talent demand: securing talent to build and run fast-growing new energy businesses and maintaining core talent for traditional oil and gas production.

While demand for energy talent is growing, the energy sector is expecting to lose a substantial portion of its existing workforce; in the United States alone, as many as 400,000 employees in the sector are approaching retirement, expected to retire in the next 10 years.¹⁷ Given the oil and gas industry's negative perception among younger workers, traditional energy businesses may find themselves at the short end of an upcoming talent squeeze.

Transferable competencies can help meet talent demand

Demand for talent from new energy businesses is likely to increase rapidly over the coming decade.¹⁸ The good news for renewable energy employers is that knowledge, expertise, and competencies

gained in oil and gas are relatively easy to transfer to green energy businesses including carbon capture and storage (CCS), hydrogen, and wind.

CCS has the greatest transferability of both knowledge and experience, which is unsurprising given that many oil and gas companies have been capturing and storing carbon for some time. Hydrogen has fairly high transferability for most knowledge areas, though challenges remain regarding experience, especially in business development, commercial roles, and supply chain partnering. Offshore wind has the lowest relative transferability of these three, though it still offers ample opportunity for upstream employees to move into the new energy space.¹⁹

McKinsey's Organization Data Platform analyzed publicly available data from LinkedIn to explore the talent circumstances of new energy businesses globally. They found that employees in the hydrogen space hold similar degree subjects to the degrees of those in traditional exploration and production (E&P) (Exhibit 6). This overlap underscores the high level of knowledge transferability between roles and indicates that there may be growing competition for talent between traditional and new energy businesses.

The good news for renewable energy employers is that knowledge, expertise, and competencies gained in oil and gas are relatively easy to transfer to green energy businesses.

¹⁶ *Global Energy Perspective 2023*, McKinsey, October 18, 2023.

¹⁷ Current Population Survey, United States Bureau of Labor Statistics, 2022.

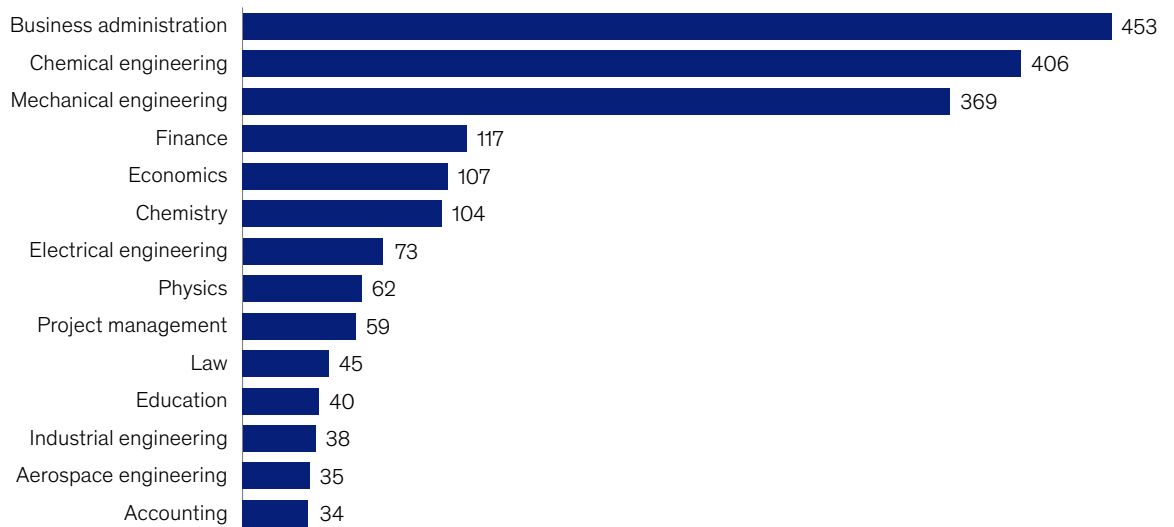
¹⁸ *Global Energy Perspective 2023*, McKinsey, October 18, 2023; Statistical review of world energy, Energy Institute, 2023.

¹⁹ McKinsey analysis.

Exhibit 6

There is high overlap in degree subject between traditional upstream and hydrogen talent.

Top 15 degree subjects for hydrogen talent, August 2023,¹ number



¹n = 4,926.
Source: LinkedIn; McKinsey Org Data Platform

McKinsey also looked at the tenure of those in hydrogen-related roles and found that nearly four-fifths of employees have worked in the space for less than five years and only 10 percent of the total talent pool have more than ten years of hydrogen-related

experience.²⁰ This means that hydrogen businesses could struggle to find experienced people to fill positions and will need to establish programs to rapidly build expertise.

²⁰ Organization Data Platform, McKinsey, September, 2023; LinkedIn; McKinsey Org Data Platform.

Traditional upstream businesses continue to need talent

Meanwhile, demand for talent from traditional oil and gas companies is not going away. Globally, McKinsey expects to see broadly consistent demand for workers through to at least 2035.²¹ Meeting this demand could be challenging amid growing competition

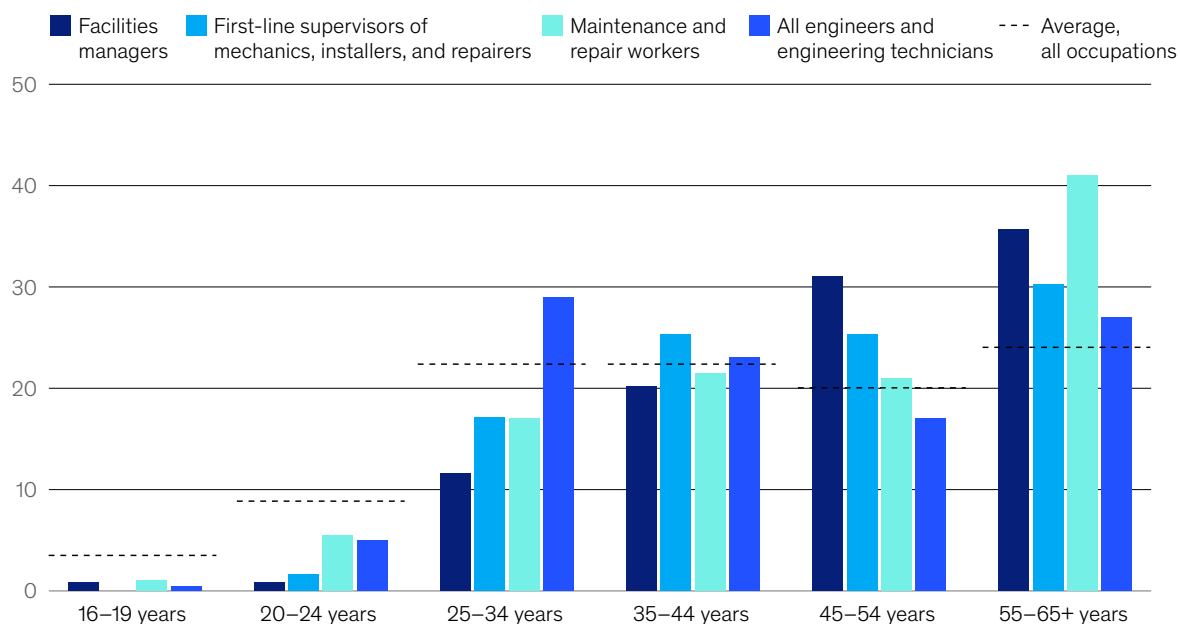
from new energy businesses, and workforce demographics that point to a looming talent crunch.

In the United States, over a quarter of employees are at or near retirement age, many of whom are frontline workers (Exhibit 7). In the United Kingdom, demographics are similar, with 43 percent of offshore workers currently over the age of 45.²²

Exhibit 7

The oil and gas workforce is aging, with particular challenges among the frontline.

Percent of employees in each occupation, %



Source: US Bureau Labor Statistics from Current Population Survey (CPS) 2022

²¹ McKinsey analysis.

²² *Workforce insight*, Offshore Energies United Kingdom, 2022.

While this does not exactly represent a retirement cliff, it does emphasize the importance of maintaining a healthy recruitment pipeline into traditional oil and gas businesses over the coming decade. Energy companies will also need to reckon with—and develop plans to address—the impending loss of a valuable source of technical skills, industry knowledge, and institutional expertise. Thinking creatively about how to manage this aspect of the talent transition now could spur innovation, alternative work approaches, and an entry of fresh talent into the sector.²³

Competition for employees is also heating up. Since 2016, out of all the employees who left their roles in energy and materials companies, 42 percent moved to a different industry.²⁴ This underlines the very competitive nature of attracting and retaining talent within the sector.

Companies that lack a clear talent strategy could face a talent shortage in the years to come. As one upstream executive put it, “The average age of our rig workers is 58 years old. We expect them to retire in ten years, but the life of our asset is 20 years. We currently don’t have a fact-based view on how big the problem is or how we are addressing it in the future.”

Hiring talent to backfill critical roles and fill new roles presents a unique set of obstacles in the energy sector. Experienced workers are retiring,

mid-tenure employees have new opportunities in adjacent industries, and data indicates that fewer new employees are entering this workforce. The percentage of employees with less than two years of tenure dropped from 16 percent in 2012 to less than 4 percent in 2022.

An improved value proposition could attract fresh talent

Another challenge is that the oil and gas sector may not be perceived as attractive by potential employees. Research shows that a compelling employee value proposition (EVP) is strongly correlated with lower attrition rates and that this is an important and influential notion for younger generations (see article Employee retention trends and challenges in the oil and gas industry).

To understand the impact of EVP in the traditional upstream sector, McKinsey examined employee satisfaction across industries on a range of dimensions. While oil and gas still scores above average for compensation, it is towards the bottom of the pack for career opportunities, corporate culture, and perceptions of senior management. In short, oil and gas companies tend to score lower on their EVP relative to other industries (Exhibit 8).

Since 2016, out of all the employees who left their roles in energy and materials companies, 42 percent moved to a different industry.

²³ “Renewable-energy development in a net-zero world,” McKinsey, October 28, 2022.

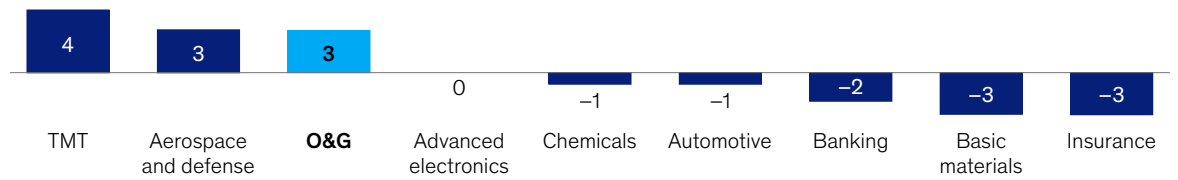
²⁴ “Great Attrition, Great Attraction 2.0 Global Survey,” McKinsey, 2023.

Exhibit 8

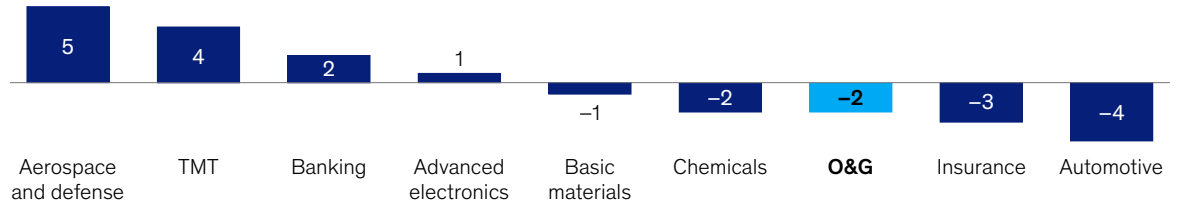
Oil and gas lags many peer industries in several key dimensions of their value proposition to employees.

Rating¹ relative to peer-industry average,² %

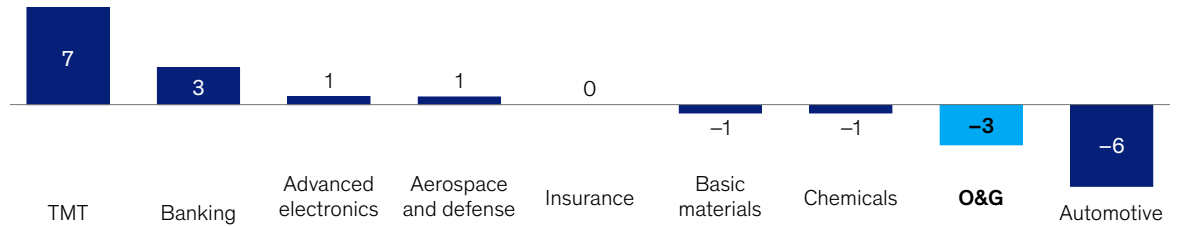
Compensation



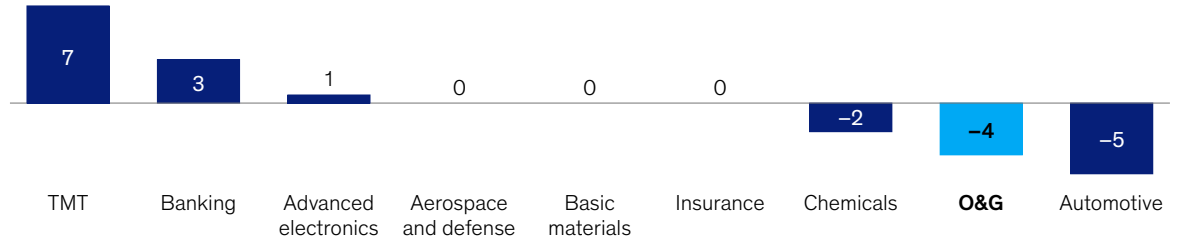
Career opportunities



Culture



Senior management



¹Based on Glassdoor ratings from employee reviews in the US from 2018 to 2023. Reviews are gathered for the top 100 largest companies (by head count) per industry; total sample consists of 475,000 reviews across nine peer industries.

²Denotes the percentage difference in ratings for companies within a specific industry and the average sentiment across the peer industries.

However, employees perceive oil and gas companies differently across regions, and EVP scores differ significantly (see sidebar, “Employee value proposition”). Oil and gas employee satisfaction is generally lower in developed markets, whereas jobs in oil and gas are still seen as one of the most desirable placements for top talent in many parts of the world. These regional differences may play an increasingly important role in talent decisions for global operators in the years ahead.

When rating their employers in terms of work–life balance, European employees reported the highest

satisfaction (3.8 on a scale of one to five). On the other end, employees from Northern Africa, North America, the Middle East, and the Pacific Islands rated their work–life balance lowest, at 3.5, respectively. On average, Central Asian and Russian employees ranked their employers highest in terms of culture (4.1), career opportunities (3.8), and senior management (3.7), while North American employees expressed lower ratings across all categories except compensation, where Caribbean and Latin American employers ranked highest at 3.9.²⁵

Employee value proposition

An EVP defines the unique promise made to employees regarding experiences and benefits that they can expect to receive from a company. Effective value propositions typically encompass four components: the company’s purpose, values, and culture; its leadership, which includes the employee relationship with managers; the employee’s role (including developmental opportunities); as well as their rewards, including intangible benefits, such as the ability to be home every night at a consistent hour.

Charting a course through the talent transition

Executives in traditional oil and gas businesses may need to think about driving talent transformation to underpin long-term success.²⁶ To do this, senior leaders could focus on the following five areas and address the associated underlying questions:

1. Building strategic talent plans. A successful talent strategy most often hinges on facts rather than intuition when it comes to understanding future talent needs and is anchored in the company’s strategic and business goals. Talent plans can be built up from project-level talent needs to inform an integrated skill-based talent view. Executives could consider: which roles are likely to be impacted by retirement in the next six months,

²⁵ McKinsey analysis.

²⁶ “Agile transformation in heavy industries: An interview with SOCAR Türkiye,” McKinsey, March 21, 2023.

one year, three years, and five years? What are the critical capabilities needed? What are the underlying drivers of attrition? Where are the existing hidden pockets of talent with required skill sets? Do we want to take an incremental approach to manage our talent transition, or do we need to drastically correct course?

For example, one leading aerospace and defence company derisked a \$100 million program by focusing on trades talent and attrition and responded with a clear talent strategy, EVP, and improved use of advanced analytics. It was able to reach an equilibrium between talent demand and supply to meet its strategic plans.

2. Renewing efforts to transform the employee value proposition. Driven by data, the best efforts aim to achieve specific outcomes. An example of this is retaining more senior talent in the industry by changing the work environment. Another is delaying retirement or creating flexible career paths to allow graduate hires to work across traditional oil and gas companies and new energy businesses within the same company. Executives can ask: what do our employees really value? What are the risks? How are we measuring success? How will we act faster, more nimbly, or under different resource constraints?

A leading energy company established a talent “war room” to bring together resources from across the organization (including programs, human resources, data science, analytics, and IT) to create a faster, more agile, and more streamlined talent management and EVP

evolution process. It was able to address short- and medium-term talent challenges head on.

3. Modernizing ways of working to meet rising employee expectations and increase productivity. There has been continued uptake of agile teaming and increasing sophistication when devising flexible working policies. Leaders could ask themselves how to make priorities clear from top to bottom in the organization? Where could we release value between functional silos through agile teams? What workplace and hybrid working policies best balance employee satisfaction and productivity? For example, several energy companies are organizing for agility at scale to improve results, speed, and employee experience.²⁷

4. Taking advantage of global talent markets by revisiting technical hub strategies. This is relevant for both traditional and new businesses. Companies are thinking hard about which activities need to be done “close to the assets” and which could be undertaken in other regions to access the world’s largest engineering talent pools. Questions include: how do we evolve our global mobility programs? What type of talent is critical to have close to the work—for example, frontline talent—and what can be sourced elsewhere—for example, talent from the same regions? How can we adopt a more global perspective for difficult-to-fill technical roles? And how do we leverage talent from other countries with renowned engineering or technical programs and educational institutions?

²⁷ McKinsey analysis.

Several oil and gas companies are reshaping their technical functions, such as engineering, to build and grow hubs in other regions. Such moves provide access to large, high-quality technical talent pools and create stronger central support models.

5. Exploring tech such as generative AI to improve productivity and augment capabilities.

Recently, many companies have developed proof of concepts for generative AI (gen AI) that can allow employees to spend time doing higher-value tasks. Companies could ask themselves: how could gen AI tools help

with knowledge and experience transfer between generations? What opportunities exist to use digital tools to accelerate training for technical and operational hires?

This is an unprecedented time for the energy industry as it transitions into the net-zero world. Like many other industries, the talent that oil and gas companies can attract, develop, and retain will shape the companies of tomorrow. The key question isn't so much "How do I get enough talent to deliver on my plans?" but rather, "How can we confidently use this transition to our advantage?"

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The authors wish to thank Giulio Carbone, Evgeniia Levich, Hege Nordahl, Cecily Urnes, and Sirui Wang for their contributions to this article.



Employee retention trends and challenges in the oil and gas industry

Oil and gas companies are struggling to retain top talent. Focusing on EVP can improve retention but levers to boost EVP differ widely across the industry.

By Robert Belanger, Giulio Carbone, and Ignacio Fantaguzzi

In our conversations with oil and gas executives, discussions around talent are converging on a theme: companies are finding it increasingly difficult to attract and retain employees, especially since skill requirements are changing dramatically in the decarbonization era.²⁸ Building a distinctive employee value proposition (EVP)—which is a set of benefits that an employee gets for what they give, including aspects like compensation and benefits, career opportunities, work–life balance, company culture, and management—could prove pivotal to attracting and retaining the best talent as compensation for workers heats up.

Analyzing more than 70 major organizations across different parts of the oil and gas value chain, we found a direct correlation between a company's EVP score and tenure rates: when a higher EVP score is observed, employees generally remain at the company

for longer. While our research suggests that retention dynamics vary strongly across industry subsectors, leadership style, more than compensation, is generally key to driving a distinctive EVP.

EVP scores vary widely across the industry

With the support of the McKinsey People Analytics experts, who collected publicly available information from LinkedIn and Glassdoor, we analyzed the EVP ratings of more than 70 organizations and their corresponding attrition rates and found a clear link between low EVP scores and higher levels of attrition. We broke down the findings to understand how these trends are playing out across the different types of major oil and gas companies (Exhibit 9).

Leadership style, more than compensation, is generally key to driving a distinctive EVP.

²⁸ For more information on these trends, see: "Renewable-energy development in a net-zero world: Overcoming talent gaps," McKinsey, November 4, 2022.

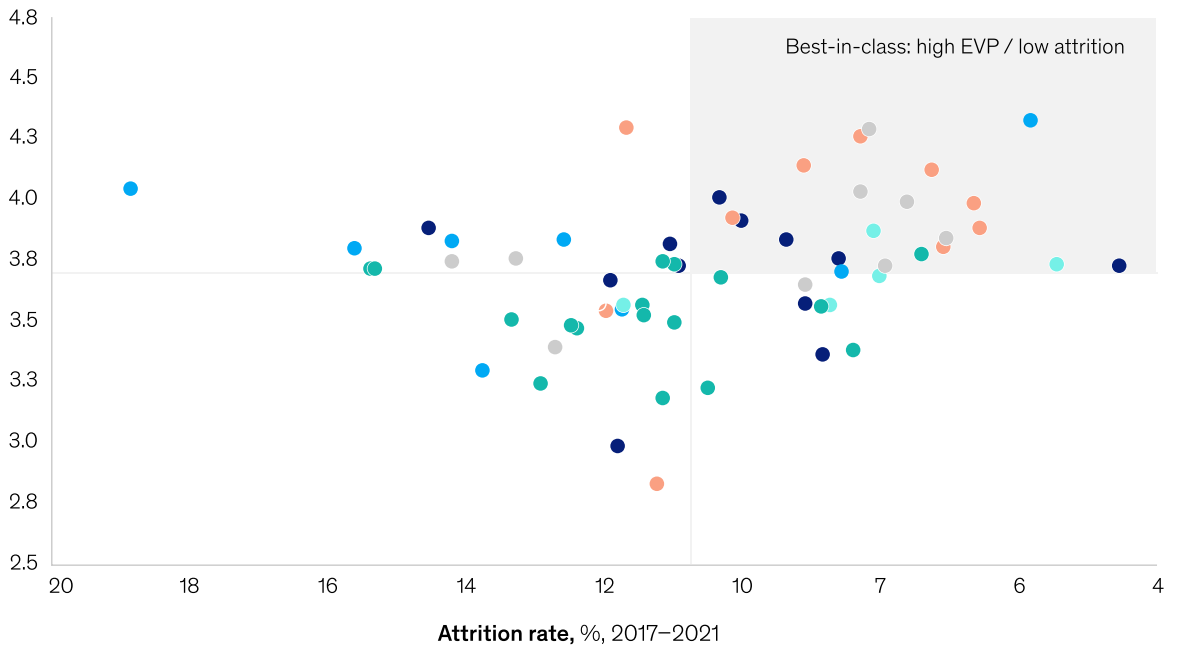
Exhibit 9

Outside-in data of key oil and gas players suggests a link between EVP and attrition.

Industry subgroups:

● Majors ● NOCs ● Upstream ● Midstream ● Services and equipment ● Downstream

Employee Value Proposition (EVP) score, 2016–2023



Source: LinkedIn and publicly available reviews from data sources including Glassdoor reviews over 2016–2021. LinkedIn sample size, latest year: Downstream: 50112; EPCM: 80844; Major: 365795; Midstream: 26740; NOC: 133590; Services and Equipment: 342595; Upstream: 37081. Glassdoor sample size: Downstream: 5,351; Major: 30,200; Midstream: 3,035; NOC: 7,201; Services and Equipment: 27,801; Upstream: 2,982

The data shows that EVP and retention dynamics are specific to the different subindustry segments, and therefore require different “calls to action.”

Majors—large global oil and gas companies operating in different parts of the value chain—are closely aligned in a “midrange” position with a limited degree of differentiation in terms of EVP and attrition rate. Most big corporations have an EVP score of between 3.3 and 4.1 (out of a 5-point scale) and corresponding attrition rates of 9 to 11 percent. Majors could

create a more distinctive EVP to better differentiate themselves from peers and attract the best talent in the sector.

National oil companies (NOCs) have the strongest position across oil and gas, both in terms of EVP and low attrition, as they are often the leading employers in their country’s energy sector and face less national competition for talent. It is important for NOCs to build a well-rounded EVP, leveraging distinctive compensation, benefits, and broader organizational

health to attract unique capabilities and young talent, not only within national boundaries but also from abroad.

Upstream companies are seeing the highest levels of attrition in the industry, despite their EVP scores tending to be in line with the sector average. This might be related to the high demand for specific technical skills, which are difficult to develop internally and are instead acquired through the job market via competitive offers or outsourced. Other factors may include workers leaving the traditional oil and gas industry for new energy companies, or market volatility as the energy transition accelerates.

Since the high attrition rate is partially structural in this subindustry, upstream companies could focus on reliable and fast recruitment processes to ensure continued insourcing of required talent.

Midstream companies are closely aligned with low attrition overall and an average EVP. Like majors, midstream companies could create a more distinctive EVP to differentiate themselves as an employer of choice.

Downstream companies are closely aligned with a low attrition rate overall and above-average EVP.

There are, however, a few outliers that are challenged by high attrition. The outliers in the downstream subsector may need to quickly align themselves with the standards set by their market peers.

Services and equipment companies tend to have below-average EVPs and high levels of attrition. Talent in services and equipment companies is generally in demand outside of the oil and gas industry, and companies may need to act quickly on their EVP to address high attrition rates. As a first step, service and equipment organizations can investigate the root causes of their high attrition and develop context-specific strategies for better talent retention.

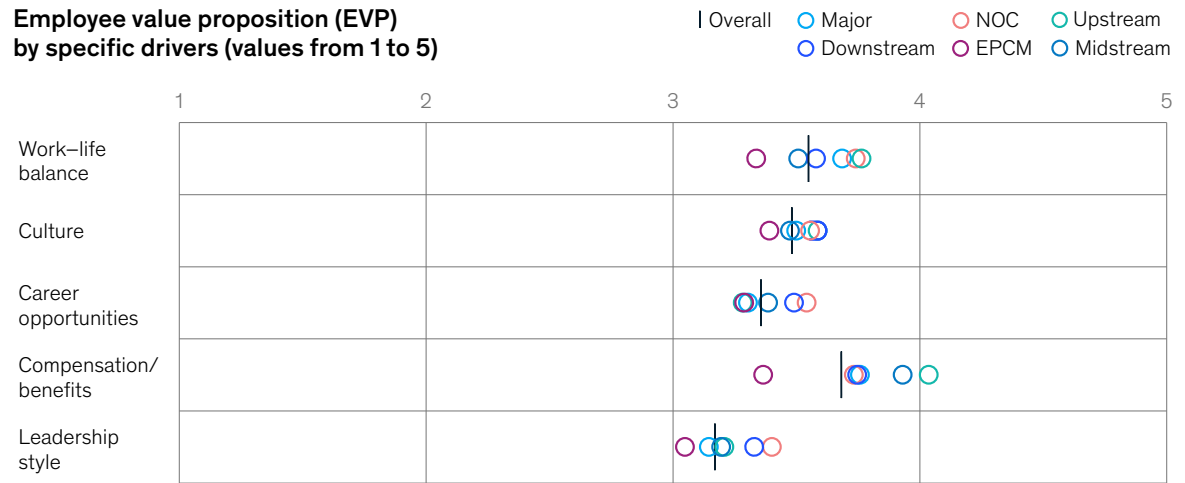
Leadership style is key to driving EVP

We also analyzed the different drivers of EVP across five categories: work–life balance, culture, career opportunities, compensation and benefits, and leadership style (Exhibit 10). While differences are not high, on average, we found that companies in oil and gas across subsectors score the lowest in leadership style and the highest in compensation and benefits.

Exhibit 10

The major gap for employee value proposition is not compensation but management.

Employee value proposition (EVP) by specific drivers (values from 1 to 5)



Note: Employee value proposition (EVP) is measured as the average rating (from 1 to 5) of user reviews on Glassdoor for a company. Source: Based on publicly available reviews from data sources including Glassdoor reviews over 2016–2022, April, 2023; Sample size: Downstream: 5,351; Major: 30,200; Midstream: 3,035; NOC: 7,201; Services and Equipment: 27,801; Upstream: 2,982

These findings have practical implications for how oil and gas companies across different parts of the value chain can strengthen their EVP. Regarding leadership style, it is important for the CEO and other leaders to be recognizable and charismatic role models, not only within the company but also toward the external stakeholders. We have observed that a new leadership style is emerging in the industry around five shifts that change how leaders—and companies' EVPs—are perceived.²⁹

- *Setting focus and direction: from executive to visionary.* When defining the direction of their company, it is important for executives to not only

ensure that profits are predictably delivered to shareholders but also that they take a visionary stance—engaging employees with a compelling purpose to deliver impact and value to all external stakeholders and society.

- *Designing how value is created: from planner to architect.* Rather than taking a traditional, planner-oriented view focused on capturing a greater share of the existing value from their competitors, leaders can adopt an architect mindset by working with customers and other external stakeholders to reimagine and disrupt industry norms to generate new value.

²⁹ Anton Derkach, Ignacio Fantaguzzi, Neil Pearse, and Micah Smith, "Powering up new leadership for a changing energy environment," McKinsey, February 3, 2023.

- *Organizing how people work together: from director to catalyst.* Traditionally, leaders took a director’s approach to developing defined organizational structures, with clear roles, responsibilities, and authorities. A catalyst approach, by contrast, allows leaders to encourage transparency, collaboration, and inclusiveness across the organization and externally, guiding empowered teams and cross-unit networks with external stakeholders.
- *Getting work done: from controller to coach.* Leaders can combine the traditional, controller leadership style with the coach style. In this way, they will operate through detailed analysis and precise planning to deliver outcomes and minimize variances, while also focusing on a more innovative coaching view, operating through short cycles of rapid decision making and experimentation while learning to respond to new challenges and opportunities in the external environment.
- *Showing up as a leader: from expectation-setter to authentic leader.* Blending the traditional expectation-setter approach of setting clear professional expectations for subordinates with the emerging style of “authentic leader” can encourage openness, personal well-being, creativity, and autonomy.

By embracing emerging leadership qualities, industry leaders could tailor a unique and powerful leadership style to improve their EVP, attract the right talent, and reduce attrition.

A step-by-step approach to strengthening EVP: A case study

The European subsidiary of an oil and gas giant found itself facing a shortage of the right talent to address its strategic goals of decarbonization and digitalization. While the company was highly regarded by tenured oil and gas professionals, it was falling short in attracting the new engineering and digital talents required, especially women.

The CEO understood the gravity of the challenge and closely partnered with the chief human resources offices (CHRO) and the rest of the leadership team to attract and retain the right talent through a phased approach:

Aspire. The leadership team worked together to translate the business strategy into a compelling vision for the future, centered on decarbonization and digitalization, to ignite purpose and passion in current employees and future candidates.

Assess. A rigorous approach was followed to listen to the “voice of employees” through employee surveys (such as our Organizational Health Index), interviews, and focus groups. This was complemented with an external diagnostic (using publicly available data from LinkedIn and Glassdoor) to identify the current EVP perception and key opportunities for improvement. The results highlighted that employees were looking for more emphasis on inclusion and diversity, flexible working hours to cater to family needs, and a compelling purpose focused on decarbonization.

Architect. Leveraging the insights from the diagnostics, the CHRO, with guidance from other leaders, shaped a cultural and organizational action plan to address the identified areas for improvement. The company created a compelling EVP with career paths for the specific talent pools required, a new diversity and inclusion strategy, and gender quota objectives, and collaborated with leading universities in Europe to improve their employer brand among students.

Act. The defined plan was actioned collaboratively at all levels of the organization. The company mobilized employees to identify change ambassadors to drive change in the different units and geographies. For this activity, data-driven insights from social network analyses helped the company identify key actors to catalyze change within the organization. At the same time, top executives embraced the new leadership style in line with the five shifts, shaping a different culture and ways of working.

After almost two years since the launch of the project, the company achieved a leading position for EVP—within the top-quartile of industry peers—and a CEO rating of over 80 percent. The company is now considered a best-in-class workplace for women to build a career in the oil and gas industry.

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Oil and gas companies may need to think beyond compensation and create a positive working environment if they want to attract and retain talent—especially as they face increasing competition from new energy industries requiring competencies that are easily transferable from the oil and gas industry.

By improving leadership styles and company dynamics—and therefore EVP scores—employees may want to stay with their company longer, allowing institutional knowledge to grow within the workforce, and ensuring fewer resources are spent on hiring and onboarding.

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Powering up new leadership for a changing energy environment

Realizing it can no longer be 'business as usual,' industry chiefs need to transform themselves and their organizations to succeed.

*By Anton Derkach, Ignacio Fantaguzzi, Neil Pearce, and Micah Smith
Published on McKinsey.com, February 3, 2023.*

Technological, economic, regulatory, and geopolitical forces are driving a rapid evolution of the global energy landscape. Although opinions vary on the pace and extent of the resulting transitions, attempts to balance energy security, affordability, and long-term decarbonization ambitions are contributing to unprecedented uncertainty about the global energy future.

While transformation of the global energy mix is not new, the current transition is larger in scale and more complex than previous ones due to the multitude and sometimes divergent drivers of the transition. As one industry CEO summed it up: “The energy industry has basically been static for a long time, although we did not know it was static. We’ve now moved from a largely internal, incremental agenda, to a whole set of existential risks and opportunities in front of us.”

On one hand, the increasing urgency around climate change and reducing greenhouse gas emissions is driving the transition to cleaner energy sources.³⁰ Many countries and corporations have committed to achieving net-zero emissions within the next few decades. Early movers—industry incumbents and pure-play, clean-energy players—are leading the paradigm shift, disrupting traditional business models and making permanent structural changes to these industries.

On the other hand, the rebound in energy demand after the first wave of the COVID-19 pandemic, coupled with supply-side constraints over the past year, have revealed the magnitude of the challenge in achieving climate change ambitions. Global energy demand and supply-side variability are expected to increase over the next decade. Until alternative energy sources are universally efficient, scalable, and affordable, traditional energy sources and related infrastructure will continue to play an essential role.

These considerations introduce a high degree of uncertainty about the path ahead, including how energy supply and demand, competitive and geopolitical dynamics, and societal implications will evolve. One thing is clear, however: the search for sustainable, reliable, and affordable energy will be at the core of global aspirations.

Five ways leaders can transform to succeed in this shifting landscape

These unprecedented and evolving challenges need to be tackled by all leaders of companies in the energy sector, from pure-play, new-energy start-ups to more traditional oil and gas companies balancing old and new business models, risk profiles, and cultures.

Many of the elements of what it takes to succeed in the evolving energy environment will likely differ from those experienced in the past. Fresh demands may be placed on leaders, and a fundamentally new approach to leadership will likely be required for incumbents and start-ups. This is irrespective of the business strategy adopted—which may range from a full pivot to clean energy, to a combination play, to an ongoing focus on a core hydrocarbon business but with the introduction of emissions abatement.

Overall, we see companies—and leaders—needing to operate with substantially greater speed and entrepreneurialism, and this is especially applicable in the new energy sector. They may need to develop and practice fresh ways of collaborating, both within their organizations and in the emerging energy ecosystems. A major challenge is attracting and retaining talent in an environment where traditional energy companies are under intense negative public pressures.

³⁰ *Global Energy Perspective 2022*, McKinsey, April 26, 2022.

We interviewed 15 C-suite executives across organizations in the energy sector to gain their perspectives on the critical leadership capabilities required to succeed in this new energy era.³¹ The interviews were complemented by a global survey of more than 140 senior industry leaders. The survey asked leaders to identify and rate the importance of different leadership capabilities against the backdrop of the current macroenvironment, and to offer their perception on how leaders in their organizations are currently performing across

these capabilities. Finally, we layered in data from our extensive body of leadership research and decades of experience helping organizations with their leadership transformations.

Based on our experience and research, we defined five key roles that leaders typically perform, from setting focus and direction to showing up as a leader, and identified two broad categories of leadership qualities and mindsets, which we have called “traditional” and “emerging” (Exhibit 11).

Exhibit 11

Traditional and emerging leadership capabilities can be applied across five key roles.

	Traditional	Emerging
Setting focus and direction	Executive: ensure profits are predictably delivered to shareholders, through stable performance and effective risk management	Visionary: engage people with a compelling purpose to deliver impact and value to customers and all other stakeholders
Designing how value is created	Planner: focus on beating known competitors to capture increased share of existing value	Architect: focus on working with customers and broader stakeholders to generate new value through reimagining and disrupting industry norms
Organizing how people work together	Director: develop defined organizational structures with clear roles, responsibilities, and authorities	Catalyst: develop empowered teams and cross-unit networks, encouraging transparency, collaboration, and inclusiveness across the organization and externally
Getting work done	Controller: operate through detailed analysis, planning, and control to deliver outcomes and minimize variances	Coach: operate through short cycles of rapid decisions, experimentation, and learning to respond to new challenges and uncover new opportunities
Showing up as a leader	Expectation-setter: lead with focus on setting clear professional expectations for subordinates and managing for defined delivery	Authentic leader: lead with authenticity and openness, encouraging personal well-being, creativity, and autonomy

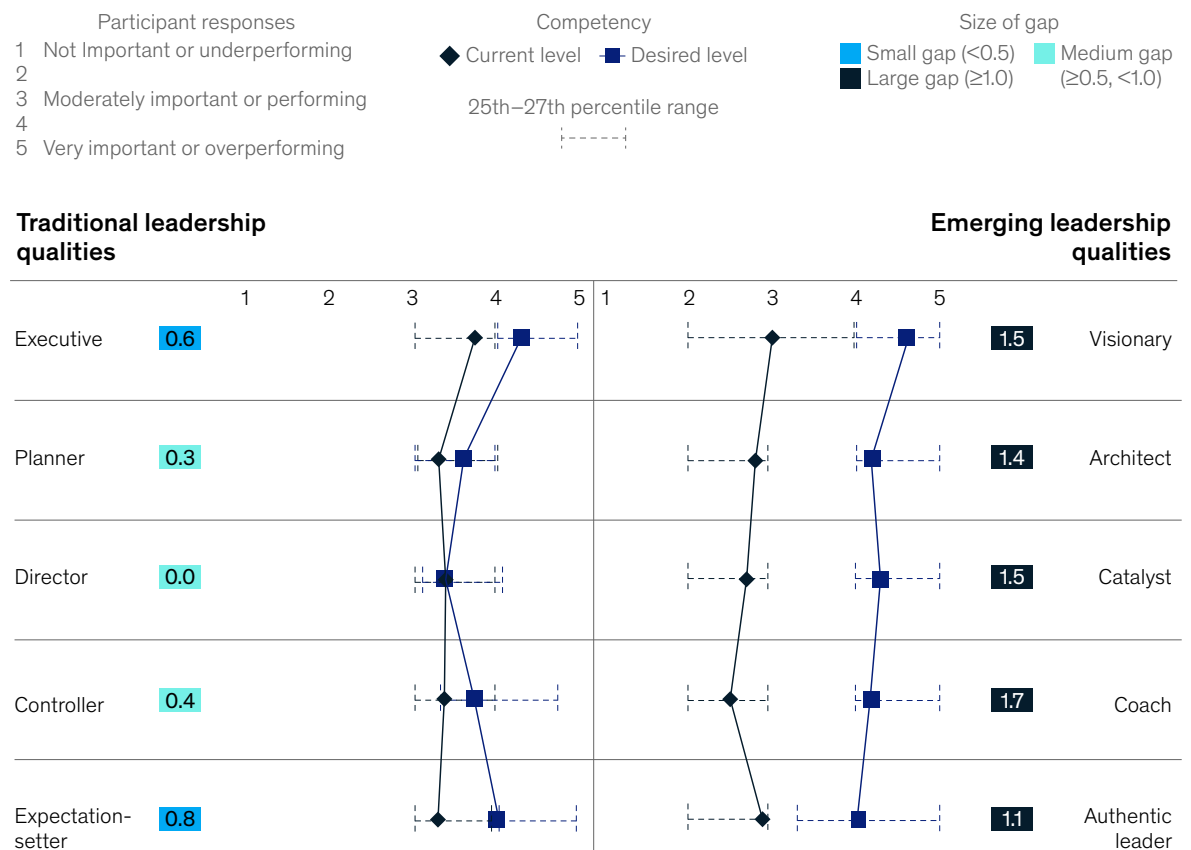
³¹ McKinsey global survey of senior industry leaders.

The survey results illustrate a high level of agreement from respondents on the importance of emerging leadership qualities and mindsets to succeed in the new energy environment, while reiterating the ongoing relevance of traditional qualities (Exhibit 12).

We observed a larger gap between desired and current levels of competency for emerging leadership qualities and mindsets. This is unsurprising, as successful leaders and executives have practiced and honed the traditional qualities for many years.

Exhibit 12

There is an increased gap between the desired and current levels of competency for emerging qualities and mindsets.



Global survey senior industry leaders; n = 140.

A closer look at the data suggests that some traditional leadership qualities are more important than others. For example, being an effective executive delivering financial returns for shareholders continues to be a prerequisite, and detailed planning and working toward defined delivery is still important.

In terms of emerging qualities, numerous respondents highlighted the importance of meeting stakeholder expectations, with growing pressure on energy firms beyond creating value for their shareholders. Furthermore, there is clear recognition of the need for new leadership approaches to operate through shorter decision cycles and with greater experimentation, and to take advantage of market fluctuations and emerging and uncertain new-energy opportunities.

Shifting one’s mindset and embracing emerging leadership qualities can be a challenge for senior leaders who have relied on traditional tool kits. However, there is also a great opportunity here. During our research, many sector leaders expressed excitement about building and leading new kinds of organizations, and designing them to succeed today and in the future. There was also much enthusiasm about the prospect of exhibiting greater purpose, promoting employee empowerment, facilitating collaboration inside and outside their organizations, and operating with higher levels of agility and entrepreneurialism.

What does this leadership transformation require? We see it as including five key unlocks, involving mindset and behavioral shifts (Exhibit 13).

Exhibit 13

The leadership transformation requires five key unlocks.

		Traditional leadership	Emerging leadership	
1. Setting focus and direction	Executive	Profit	Impact	Visionary
2. Designing how value is created	Planner	Competition	Cocreation	Architect
3. Organizing how people work	Director	Command	Collaboration	Catalyst
4. Getting work done	Controller	Control	Evolution	Coach
5. Showing up as a leader	Expectation-setter	Professional	Human	Authentic leader

1. Setting focus and direction: Beyond profit to impact

The purpose of any organization is to create value for its stakeholders. In today's open environment, where people have more information and options than before, leaders are well-placed to deeply understand how their organizations will add unique value to customers, colleagues, investors, partners, and other key stakeholders. While generating financial returns for shareholders remains critical, the purpose of an organization now extends to the role it plays in benefiting society.

The energy sector is becoming keenly aware of this need to widen the scope of value-add. The CEO of a downstream company emphasized what this means for leadership: "In the past, the oil and gas industry has been made up of engineers and accountants. In today's world, we need to include communicators in our leadership to help us find an emotional attachment to what we do. Their involvement will help demonstrate how using practical solutions to do things more sustainably can be exciting and inspiring." The CEO of a European private energy company echoed this sentiment, saying: "There is a huge opportunity ahead to have unbelievable impact. It's the kind of opportunity that only arises once in a generation. We can change our country, we can change our region, we can contribute to global change. Realizing this opportunity will be monumental, and stepping away is unthinkable. This is what is inspiring us now."

Top-performing organizations know that purpose is both a differentiating factor and a must-have. A strongly held sense of corporate purpose is a company's unique affirmation of its identity and embodies what the organization stands for, from a historical, emotional, social, and practical point of view. Future-ready companies recognize that purpose helps

attract and retain talent and ensures these individuals thrive. Investors understand why this is valuable, and factor purpose into their decision making.

Crafting a compelling, purposeful narrative is particularly important for companies navigating the energy transition. Leaders may look to build new, lower-carbon businesses while generating most of the cash flow and profits from the traditional core. A balance may then need to be struck between the past and the future in a way that is coherent and inspiring for employees in all parts of the business. On maintaining this balance, one executive reflected: "We originally got this wrong and over-indexed on the newer businesses when describing our purpose. This led to many in the traditional heart of our company questioning their role and even reconsidering their future with us. We quickly had to rebalance and find a more sophisticated narrative: celebrating our role in supplying secure and reliable energy to the world, while leading the charge to make sure this was ever cleaner through decarbonization and building new-energy businesses."

Nonetheless, few companies harness purpose fully. In a McKinsey survey of employees at US companies, 82 percent said organizational purpose is important, but only half that number said their purpose drives impact. Leaders may wish to spend time thinking about, articulating, and championing their company's purpose as it relates to the real impact of day-to-day business practices. One CEO put it this way: "We need to transform and unite our leadership. Leadership transformation will help us position our company and its culture to meet the new challenges. A united leadership is important to give our people and stakeholders a consistent message about the kind of place we want our company to be." This emphasizes the importance of an inspiring company identity beyond the attachment to functions and business units.

2. Redesigning value creation: Beyond rivalry to camaraderie

Leaders seeking to succeed in the new energy environment may look at moving beyond a win–win, “fixed mindset” approach, where the dominant focus is on protecting market share and beating competitors in existing businesses. Instead, they could make greater strides by adopting a win–win, “growth mindset” approach, by shifting focus to new value opportunities—working with suppliers, customers, and other stakeholders to introduce new technologies and solutions that will lead to new products, services, and businesses—and creating major new markets that do not exist today.

Such a shift in focus may require changes to capital allocation, operations, and performance management. Moreover, some changes may be contingent on actions by other entities. For example, mass uptake of electric vehicles depends on utilities expanding grid capacity to support charging networks. Companies may find they need to partner with other organizations to meet common needs, such as the necessity for industrial-scale networks in hydrogen production and distribution. Leaders may have to engage and work with a wide range of external partners and stakeholders to enhance and evolve the ecosystem within which the organization operates, exploring and generating mutually beneficial opportunities. They could benefit from developing connected thinking: joining traditionally separate sectors; fostering new links between companies, organizations, and citizens; and taking calculated risks.³²

An executive in an energy service company emphasized the profound challenges they face, and the need for new and often uncomfortable thinking and action: “We are moving away from stable businesses that we are familiar with to ones we don’t understand. This is uncomfortable. In ten years, we will look back and say we did not take enough risks.” Another executive said: “We instinctively play defense instead of offense, because we believe we have so much to lose. I don’t have a fear of losing, but I do have a fear of not showing up for the game. We need to take more swings, which will then help us get more hits.”

While leaders may be required to take risks and try new approaches, they are well-placed to do this while being conscious of the resources used and with capital discipline. In most organizations, the “old” is subsidizing the “new,” which needs to be managed. One CEO from our research stressed the challenges of managing this duality: “Both the old and the new need to be included in the energy transition. There is nothing sustainable about not making money.” He also said he needs to be increasingly clinical about “stopping some projects that don’t work” to create space for those that show more potential.

Further, there is the need for new forms of ownership and governance. In this context, one CEO commented: “It is very easy to lose investors if you say, ‘Don’t worry, we will lose money on this for the next ten years.’ But to succeed now, you need to find the oxygen and the space to develop the new and the uncertain.”

³² Roland Theuvs, “Energy transition: Strategies and insights from the C-suite,” Amrop, 2018.

3. Organizing how people work: Beyond command to collaboration

To survive and thrive, energy organizations and their leaders are well-placed to engage with their teams in ways that make them feel connected. Social capital—the presence of networks, relationships, shared norms, and trust among individuals, teams, and business leaders—is increasingly the glue that holds organizations together.³³ When teams feel connected, they tend to get more work done and do it faster. When colleagues trust their managers and one another, they are more engaged, more willing to go beyond minimum work requirements, and more likely to stick around.

Social capital matters to an organization's performance. By leaving frontline employees on the sidelines, companies miss out on critical information that could bring key strategic insights. An executive at a private oil and gas company noted how they are attempting to tap into their employee base: "Disruptive trends may start at the margins of an organization, where frontline employees operate. These employees' perspectives and ideas often do not get clearly communicated to leadership, making it easy to brush them off, thinking they are not important."

Leaders could engage and unleash the full potential of everyone in the organization by empowering people in small units (cross-network teams) instead of managing individuals through the narrow lens of rigid job descriptions. Small units might then be focused on a clear and distinct value-contribution mission, giving them the autonomy, access to information, guidance, training, and multidisciplinary capabilities they need to operate with high levels of entrepreneurship to successfully deliver on their goals. One oil and gas executive described this evolved leadership as "turning the whole pyramid

leadership structure on its head. The people doing the work are key, and everyone else supports them. Servant leadership, role-modeling, and listening to the people who understand how the work gets done are all part of this new approach."

Leading this empowered network requires high-performing leaders who offer effective and efficient leadership, beyond the management of internal politics inherent in a hierarchy of individual managers and traditional governance groups. It requires fundamental shifts in the mission, culture, and operating models of every leader and leadership team in the network.

This new leadership style is often challenging. One head of production at an international energy company said: "My biggest change was giving up control and delegating. It wasn't easy, but that's exactly the change that was needed. Instead of asking teams for updates and reports, leaders now focus on giving context, setting the mission, and defining the purpose and intent. Leaders ask, 'How can I help?' when engaging with teams, and focus on tackling problems. Teams are empowered to figure out how to deliver the mission within the boundaries defined by standard processes."

To amplify and realize the full potential of everyone in the system, leaders could foster peer-to-peer transparency, relationships, and workflow across the various "small units." This can be done by removing roadblocks that prevent empowered teams from bringing ideas to reality, fostering connections across the organization, helping people to connect what they're working on with the organization's vision and aspiration, and encouraging an inclusive and welcoming environment where people bring their authentic selves to the office and pursue the full range of their aspirations.

³³ Talor Lauricella, John Parsons, Bill Schaninger, and Brooke Weddle, "Network effects: How to rebuild social capital and improve corporate performance," McKinsey, August 2, 2022.

4. Getting the work done: Beyond control to evolution

Energy companies operate in a highly dynamic, unknown, and volatile environment, where major “black swan” opportunities and challenges are emerging with increasing frequency. As energy markets and related policies find a new equilibrium, organizations must keep an eye on the horizon to plan robustly for the uncertain future, while maintaining business continuity on their core value proposition.

Hence, in addition to the primary disciplined focus on executing today and cocreating tomorrow, leaders could build effective “first responder” capabilities to tackle major discontinuities within any business cycle. One senior executive in a traditional oil and gas company put it this way: “The old style was slow and steady decision making. But when you decided, you carried through with it. This doesn’t work in the energy transition. Instead of slow and flawless execution of large, incremental decisions, we need to rapidly learn and evolve.”

Successful leaders have traditionally managed their organizations through planning and control based on extensive analysis, while seeking to minimize disruptions. Today, leaders could learn to become comfortable with operating in shorter, rapid cycles. This requires increased focus on quick, low-risk decisions and experiments, learning from those that fail, and scaling those that succeed. Leaders could begin and end each rapid cycle with a retrospective to review progress, deepen learning, and plan for the next cycle. Each cycle could focus on a set of short-term outcomes, accomplished via prioritized deliverables and initiatives that reflect available short-term capacity and appropriately manage risk. Outcomes, deliverables, activities, and resources may be reprioritized during each cycle to reflect rapidly changing realities.

What this means for leadership in the new energy world is captured by the director of strategy at an offshore driller, who said: “In an industry where it is becoming increasingly challenging to raise capital, a sharp external focus and agile thinking can create opportunities.” The CEO of a traditional oil and gas service company summed up what many executives said: “We need to become entrepreneurial and nonbureaucratic. Being slow and considered may be important in large, traditional engineering projects, but this approach doesn’t work in the new energy space. Right now, we love to control and work in silos. This must change.”

The CEO of an integrated energy company emphasized the importance of empowering those who work in their organizations: “I want to see us acting more quickly, allowing employees to take decisions at the lowest level possible. We need to empower them to identify and make decisions without having to consult their bosses. It’s OK for us to make mistakes if we take accountability, fix them, and learn. It would be much worse if we didn’t make mistakes, which would tell me that we are not taking risks and are playing too safe.” Many of the leaders we interviewed emphasized the need to take risks to succeed in the emerging energy era.

For organizations to continually evolve in this emergent way, leaders may need to overcome status quo bias—to imagine a world or a market that is very different from what it is today. Recognizing the inherent challenges in such a transformation, a leader in a major energy company said: “In fairness, it is difficult as a leader to take your attention and resources from a business area that is already highly profitable, to focus on an extremely uncertain one.” Leaders in the energy sector may increasingly need to balance their attention between current activities and future opportunities.

5. Showing up as a leader: Beyond professional to human

Navigating this uncertainty is an immense challenge that will require best-in-class talent to solve complex problems. As traditional business models are disrupted, organizations in the energy industry will need to ensure they retain their core experienced workforce while attracting diversified talent in line with new business needs. The competition for talent is intense and potential employees are looking for more than financial compensation. Creating an attractive destination for top talent means fostering an inclusive employee experience. This influences whether employees remain and thrive, which in turn drives the company's financial sustainability.

Leaders across all levels have a critical role to play in creating an environment where employees can bring their full authentic selves to work and feel empowered to pursue a sustainable work-life balance. For this to happen, leaders themselves need to show up with greater wholeness and authenticity. One industry executive connected this with the impact of the pandemic: "In COVID-19, leaders had to become more authentic—we all went through the same war together. This is an asset now in terms of the leadership we need."

One way this leadership manifests itself is in relation to the demand by today's employees for more flexibility and autonomy.³⁴ Leaders can facilitate this by allowing employees a degree of autonomy—empowering them to do their best work where they feel deeply motivated and energized. Another executive in the energy business effectively captures this role for leadership using a metaphor: "Think of it as driving on a highway. You can set some limits, like the road barriers on left and right. But once you set some boundaries, you must let others drive. You cannot take everyone on the back of a lorry that you are driving." An executive in another global company reinforces this point: "Traditionally, there has been a lot of focus on presence in the office but, since COVID-19, employees demand flexibility. Many senior leaders find it hard to make this adjustment, and this could lead to high performers leaving the company."

These five mindset and behavioral shifts could contribute to a unique and more powerful kind of leadership. When leaders identify and build the culture they want the organization to embody, they can create a virtuous cycle, attracting the right talent that will thrive, unlock their value agenda, and turbocharge their performance.

Where do we get the entrepreneurs we need now to lead in the next phase of the energy industry?

³⁴ Dane Fetterer and Holger Reisinger, "Forget flexibility. Your employees want autonomy," *Harvard Business Review*, October 29, 2021.

However, the road to transformation is full of bumps and bends. Such shifts often require changing current systems and ways of operating, which will inevitably create some organizational resistance. Leaders may need to brace themselves for complexity and chaos, while demonstrating deep self-awareness, as they address their own embedded biases and overhaul their own mindsets for the new environment.

The transformation can also require organizations to commit to leadership development and a holistic cultural transformation—broad ideals and small incremental changes may no longer be sufficient. Emerging behaviors and mindsets cannot exist as mere slogans on a wall or in catchy email signatures. They require embodiment on a day-to-day basis, being continuously role-modeled by senior executives; integration into core business activities and specific actions; and demonstration in the moments that matter.

These are exciting times for the energy sector, given its placement at the center of the critical challenges

facing our world. Meeting these challenges requires the development of the extended characteristics of leadership we have highlighted here. The good news is that industry leaders are aware of the challenges and are consciously starting to address the demands of new leadership. This not only requires new talent from places outside the traditional energy sector, but also active transformation of existing leadership.

One sector CEO summed up the challenges: “Where do we get the entrepreneurs we need now to lead in the next phase of the energy industry? You need some new leaders from outside the industry, in balance with those from the existing business. You need the new-energy zealots to provide inspiration, but you also need leaders to demonstrate that real practical progress is being made on the ground. We are finding that there are many ‘entrepreneurs in residence’—leaders who are more incremental but who just need permission to be entrepreneurs. We need to activate them!”

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Transforming an oil and gas equipment leader: A case study

How one multinational services and equipment company embarked on a powerful transformation journey to overcome market challenges and position itself for a decarbonized future.

By Robert Belanger and Neil Pearse

When a leading oil and gas services and equipment provider embraced a new vision to become a champion for decarbonization, it set in motion a holistic transformation program that would result in a 20 percent lift in gross income and a 35 percent increase in EBITDA after just one year.³⁵

The need for drastic change became apparent in 2020 when the company saw sales drop by around 20 percent due to challenging market dynamics, including decarbonization and the COVID-19 pandemic. The company responded with a strategic shift—leading an “Energy Transition”—and sustaining its journey towards a low-carbon future with a large-scale cultural transformation.

The multinational organization, which designs, manufactures, maintains, and upgrades equipment across the entire oil and gas value chain, operates in more than 120 countries and has around 10,000 employees. To realize its new vision, the organization’s culture had to shift to be more inclusive, entrepreneurial, transparent, and globally diverse.

Starting with a common and inspiring change story

The organization embarked on a deep and sustained cultural transformation, taking a holistic bottom-up and top-down approach to shape and deliver a compelling change story. The main focus areas were to “aspire” and “assess,” ensuring the leadership team worked together while listening to their employees.

Focus groups acted as a cornerstone of the program. To develop the full change narrative, 80 employees attended three focus groups each, with the CEO and executive committee taking the insights, refining them, and sharing them back for further input. During these focus groups, people were:

Embraced by the organization: contributing to one common change story, delivered through a continuous organizational pulse.

Inspired by leadership: with leaders acting as role models for the new behaviors.

Encouraged to take ownership (inside out): taking deep personal ownership of change and engaging in energetic personal transformations.

Given targeted actions (outside in): with change agents acting as the engine of change, creating “viral” energy across the organization.

Grounded in vital moments: identifying and targeting moments of truth (MOTs) and driving participation in action planning and monitoring.

The organization’s change story leveraged six from-to shifts that defined the aspirations of the cultural transformation.

1. From a product mindset to a solution mindset. Employees needed to learn to think more like entrepreneurs—not simply making products function more efficiently, but also rethinking value propositions for customers.
2. From fear of failure to experimentation. The organization needed to reframe failure by shifting the focus from personal judgment to purposeful learning. To promote an “experiment and learn” culture, the organization would need to be willing to shut down projects when they led nowhere, without negatively judging project teams, and embrace the learnings that come from failure.
3. From slow, incremental innovation to fast, iterative innovation. The organization needed minimum viable products to launch into the

³⁵ EBITDA: Earnings before interest, taxes, depreciation, and amortization.

marketplace, in order to test them, fail, pivot, move forward, and change the speed at which it delivered innovation to customers.

4. From exclusivity to inclusivity. Success hinged on diversity of thought; embracing people from different backgrounds, and bringing in new ideas and capabilities.
5. From DIY to partnership. Partnering was encouraged with the broader organization, with outside partners, and, in some cases, by acquiring new capabilities and technologies to find paths to differentiation. This required a shift from a “control and threat” mindset to one of partnership as a win–win with partners and suppliers. It also required a shift from micromanagement to trust and respect.
6. From reactive to proactive. The organization needed to stop waiting for emergency signals before implementing change and to start leading the way from the get-go.

Change agents were engaged through focus groups, taking three key actions:

Architect action plans. Each business unit’s change agent created a detailed action plan, leveraging the Influence Model—a framework for how to change mindsets and behaviors in an organization. Plans were defined autonomously in a bottom-up approach: the central team provided advice and counsel but no instructions on specific actions.

Touchpoints to drive action. Regular touchpoint calls were organized in each business unit to support the execution of action plans. Plenary calls allowed change agents to celebrate successes and share best practices and lessons learned.

Advanced onboarding or renewal. Change agents who could no longer devote time to the transformation were given the chance to “retire,” with new change agents onboarded in business units that needed additional help.

Scaling initiatives: A three-layered transformation

The organization partnered with a McKinsey team and promoted change in two directions: “inside-out” change, which involved agents choosing to change their own behavior; and “outside-in” change, where agents were encouraged to change by external stimuli.

The team led the organization’s transformation across three layers, with three initiatives implemented in each layer to achieve maximum impact—operating across the self, team, and broader organization layers.

The ‘change self’ layer

The inside-out “change self” layer focused on management and change agents. First, each member of the organization’s top team was encouraged to formulate individual “from–to” goals, as part of their personal transformation. These were explicit, aspirational plans, based on where they were and where they wanted to be, according to specific indicators.

Next, two-day Personal Ownership Workshops were implemented to encourage participants to reflect deeply on their roles as leaders. More than 20 workshops were held, catalyzing transformation through commitment, a shared language, and set of habits manifesting the organization’s new culture.

Leadership coaching formed the third initiative in this layer. One-on-one coaching for the organization’s top ten executives helped to position them as role models in the changing organization.

The ‘change team’ layer

This outside-in “change team” layer focused on team dynamics. The first activity included team activation sessions, delivered through a series of tailored workshops reinforcing team collaboration and openness. These were designed to align managers with the overall cultural aspiration in order to support them in sharing the change story.

Next, cross-team collaboration workshops helped to unlock critical collaboration challenges between teams, in line with the themes of the cultural transformation.

Lastly, leadership capability-building sessions helped to stimulate dialogue and organizational learning on diversity and inclusion.

The ‘change organization’ layer

This outside-in “change organization” layer sought to foster change among all employees across the organization, through the creation of a powerful change story. This was reinforced by personal MOT stories, shared by employees. The fusion of personal MOTs with the organization’s story enabled employees to invest in the change and bring the overall change story to life.

Second, a series of focus groups was held to collect input on the change from 150 employees. The focus groups explored organizational challenges and employee suggestions of possible solutions.

The last initiative involved change agents—mobilizing more than 200 change agents to drive change activities on the ground.

The vital role of change agents

The initial focus group attendees became the core change agent group. Change agents were voluntary and did not have a dedicated time. They had a great deal of autonomy to develop bottom-up action plans and they also provided sensing and upwards feedback on transformation progress.

Measuring impact: Not just about performance

After two years, around 200 change agents were active across the network, and after 30 months, the transformation produced meaningful impact on the organization’s performance and people.

In the first quarter of 2022, the organization witnessed an increase in sales growth of more than 50 percent from the previous year. In the first year after the transformation, gross income grew more than 20 percent and EBITDA by 35 percent (2021 versus 2020).

After undergoing the various initiatives, 85 percent of people in the organization understood the “why” of the transformation and more than 75 percent could see the desired new behaviors in place. More than 90 percent of respondents to a culture survey started making conscious efforts to be proactive; 87 percent took actions to be more inclusive; and 62 percent noticed behavioral changes in the leaders of their units.

Respondents shared thoughtful insights about the qualitative impact of the intervention. One said: “This is a great initiative. It gives our organization the opportunity to reflect on our behaviors and the way we’ve been working for decades.”

Another reflected on the importance of recognizing growth: “We should all be proud of our progress. It reflects the commitment and hard work of our leadership, our change agents, and everybody in the organization.”

—

Shaken by challenging market conditions, the organization embarked on a broad intervention to align its culture with its vision to become a leader in decarbonization.

Through a powerful change story, workshops, focus groups, and a three-layered, bidirectional process of transformation, the multinational achieved the wide-scale participation and ownership needed to achieve its vision. The transformation succeeded in growing sales and income.

One survey respondent described the importance of the program and maintaining focus going forward: “A vibrant, empowered, contemporary culture enables us to tackle business challenges and charge into the future with confidence and agility. We must keep up the momentum and focus on entrenching the ‘to’ behaviors in everything we do.”

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Success in the M&A rebound: Riding the coming wave of upstream deals

Historically high cash generation across the North American upstream industry could create the perfect market conditions for accelerated M&A activity for market leaders.

*By Robert Belanger, Jeremy Brown, and Tom Grace
Published on McKinsey.com, February 24, 2023.*

The oil and gas industry has a long and storied history of M&A transactions and strategic dealmaking. Inorganic investment decisions have shaped the portfolios of industry players and determined the ultimate success and long-term growth trajectories of these companies. With the industry on the precipice of historically high cash flows, we expect another wave of M&A to dominate near-term actions.

This article explores the cash flow landscape and major cash flow deployment levers and shows how the stage has been set for an upstream M&A wave. We introduce the M&A strategies driving consolidation and what it takes to succeed in the coming M&A wave.

Cash flow is king

Long gone are the days of “growth at all costs” with expanding capital budgets, acreage acquisition campaigns, and associated negative cash flow realizations funded by inexpensive debt.³⁶ Over the past few years, investor sentiment has driven the oil and gas industry to practice capital

discipline and prioritize financial resiliency and cash flow generation above growth.³⁷ When prices surged in 2022, upstream companies maintained their strategy of “no-to-low” capital growth. This focus on capital discipline and cash generation has resulted in record cash flows.

We examined historical cash flows and projected operational and financial performance for 25 leading North American exploration and production companies (E&Ps), and the results are impressive: operating free cash flows (FCF) reached approximately \$85 billion in 2022, with a year-end cash balance of \$70 billion to \$100 billion (Exhibit 15).³⁸ This industry turnaround is dramatic, given negative cash generation the previous three years. Free cash flows are projected to remain high, with levels of between \$70 billion and \$90 billion in 2023 and between \$50 billion and \$70 billion for the following four years—even if oil prices drop to around \$65 to \$70 per barrel over the coming years.

The primary tool left in the corporate finance tool kit is deployment of cash through M&A.

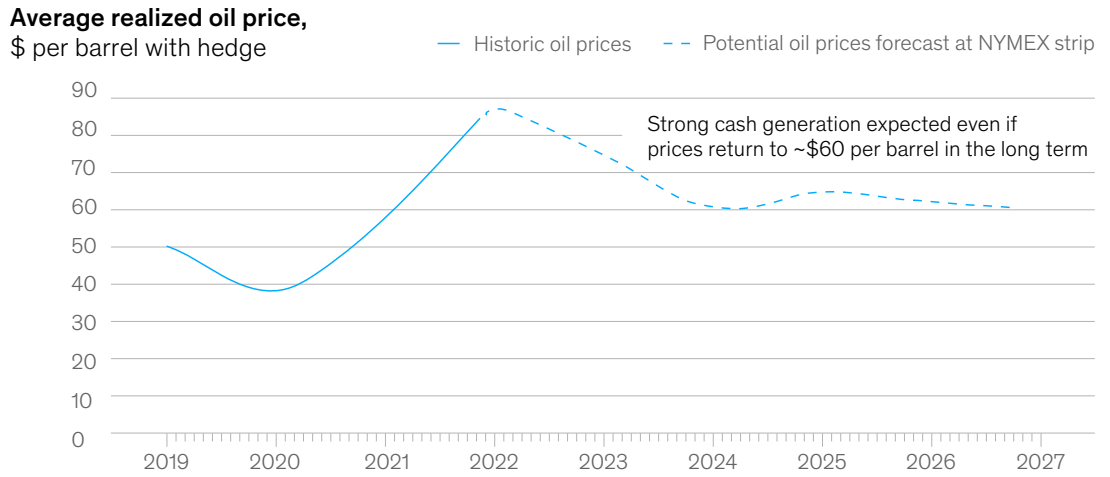
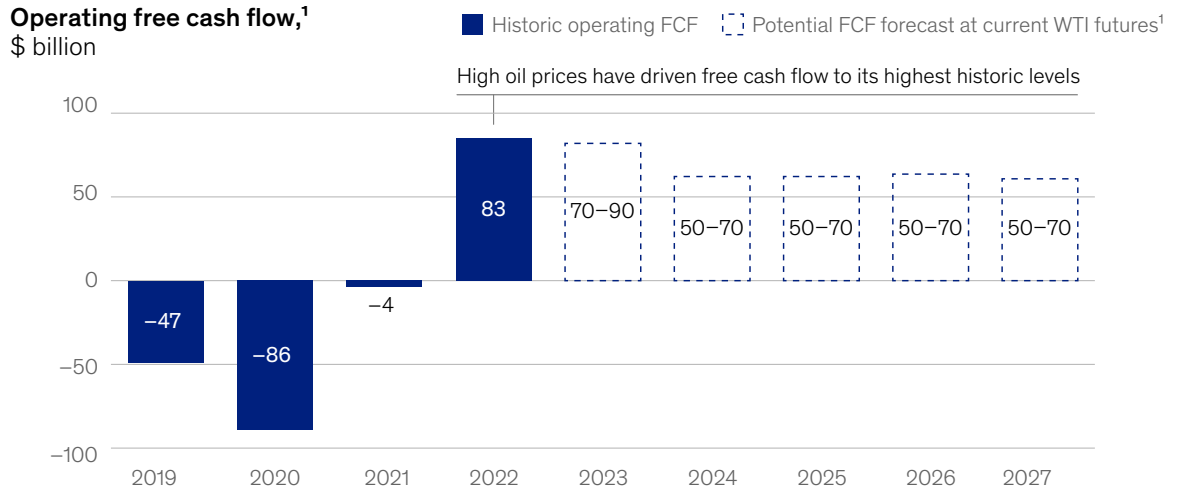
³⁶ Jeremy Brown, Florian Christ, Tom Grace, and Sehrish Saud, “Paths to profitability in the US unconventional,” McKinsey, August 12, 2019.

³⁷ Jeremy Brown, Florian Christ, and Tom Grace, “Value over volume: Shale development in the era of cash,” McKinsey, October 4, 2019.

³⁸ Includes projected range for the fourth quarter of 2022; published before public reporting for the fourth quarter of 2022.

Exhibit 15

High oil prices and capital discipline drive impressive oil and gas cash flows for the foreseeable future.



¹Cash flow analysis of 25 North American independent E&Ps. Forecasted cash flow assuming current trends in production, operating expenditure, capital expenditure, debt repayments, share repurchases, dividends, and other cash expenses for 25 companies analyzed.

Making all the right moves . . . until there's only one option left

Operators are taking advantage of their high cash flows by pulling all the traditional levers of capital management, shoring up their balance sheets, and returning value to shareholders (Exhibit 16). However, there is so much cash coming in that many of these levers are hitting a natural cap or are already exhausted. We analyzed how these companies are using operating cash flow across key levers, including:

- **Capital expenditure (capex) reinvestment.** E&Ps across the sector have explicitly announced their intention to maintain capital discipline going forward, only increasing in line with inflation, even if prices remain high.³⁹ If this trend continues, capex will likely be constrained to current guidance issued by these companies, indicating a cap on future cash flow allocation for this purpose.
- **Debt reduction.** Debt load for the 25 E&Ps decreased by \$25 billion from 2021 to 2022 and is forecast to decrease by another \$15 billion to \$20 billion by 2027.⁴⁰ Forecasted net debt for many operators may approach zero—an outcome unthinkable just a few years ago. Payments are expected to be capped at expiring notes only, reaching up to \$10 billion in 2023.

- **Shareholder returns.** With debt burdens reduced, direct returns are expected to be the priority. Share buybacks tripled from 2021 to 2022, reaching a high of \$21 billion for 25 leading independents and representing approximately 5 percent of total outstanding shares.⁴¹ Likewise, dividends doubled over this period to reach an all-time high of \$23 billion, and are expected to climb to between \$30 billion and \$40 billion over the next year. However, direct returns will likely also have a natural ceiling in the range of 25 to 30 percent of total sector operating cash flow.⁴²
- **Energy transition.** Many operators are investing to reduce their Scope 1 & 2 emissions or make early moves to participate in energy-transition value chains. However, we expect a ceiling of 5 percent of operating cash flow to be allocated to these efforts.⁴³

Even after these uses of cash have been exhausted, the industry is likely to remain cash flow positive in 2023 and beyond, with a “war chest” of hundreds of billions of dollars in 2023 alone for the 25 North American E&Ps analyzed, including estimated current cash balances. The primary tool left in the corporate finance tool kit is deployment of cash through M&A.

³⁹ “EOG Resources reports second quarter 2022 results, declares \$1.50 per share special dividend and reiterates unchanged full-year 2022 capital and oil volume plan,” EOG Resources, August 4, 2022; “Devon Energy reports second-quarter 2022 financial and operational results,” Devon Energy, August 1, 2022; “Marathon Oil announces 2022 capital budget and reports fourth quarter and full year 2021 results,” Marathon Oil, February 26, 2022.

⁴⁰ McKinsey analysis.

⁴¹ McKinsey analysis based on industry-wide earning calls and quarterly company reports.

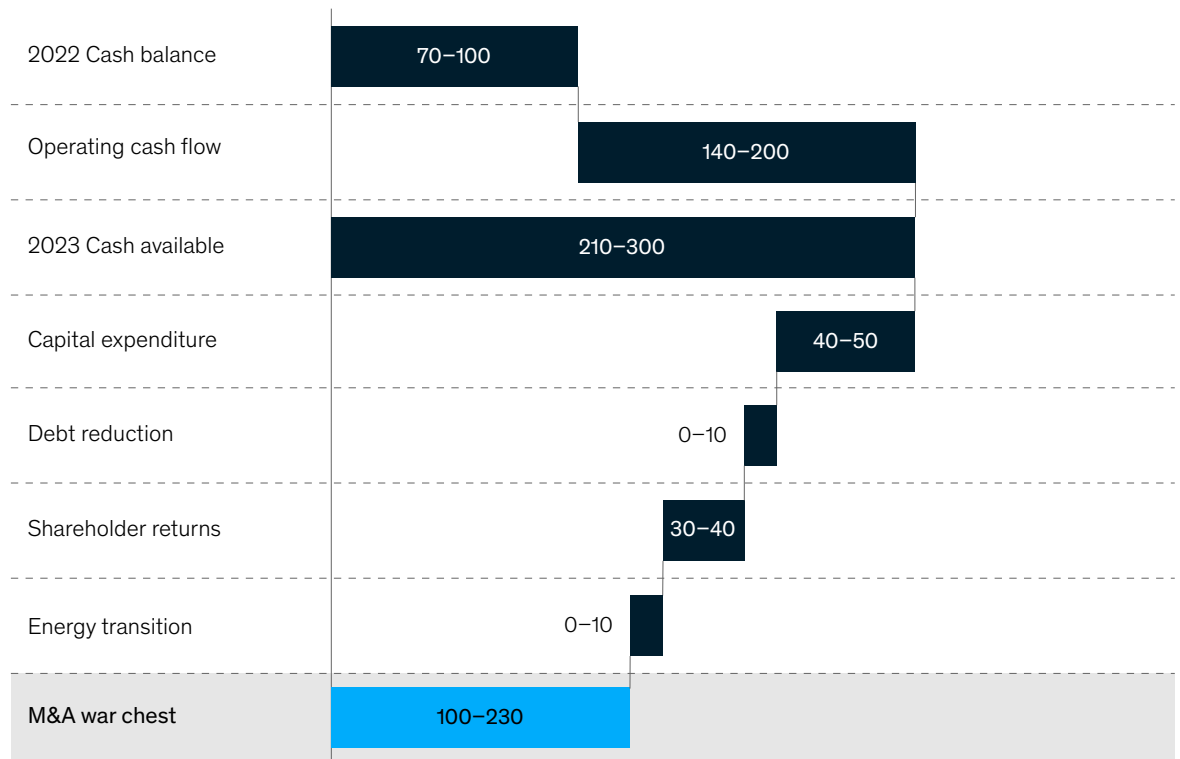
⁴² McKinsey analysis based on cash flow projections, company announcements, and interviews with E&P leaders.

⁴³ McKinsey analysis based on annual reports and expert interviews.

Exhibit 16

Another wave of upstream M&A is likely, with M&A as the primary remaining use of cash given current strategies.

Estimated breakdown of uses of cash for 25 large independents in 2023,¹ \$ billion



¹Based on cash flow modeling of 25 large independents; assumes constant production and product mix, operating expenditures, price per barrel, and general and administrative expenses.

Who’s coming to dinner?

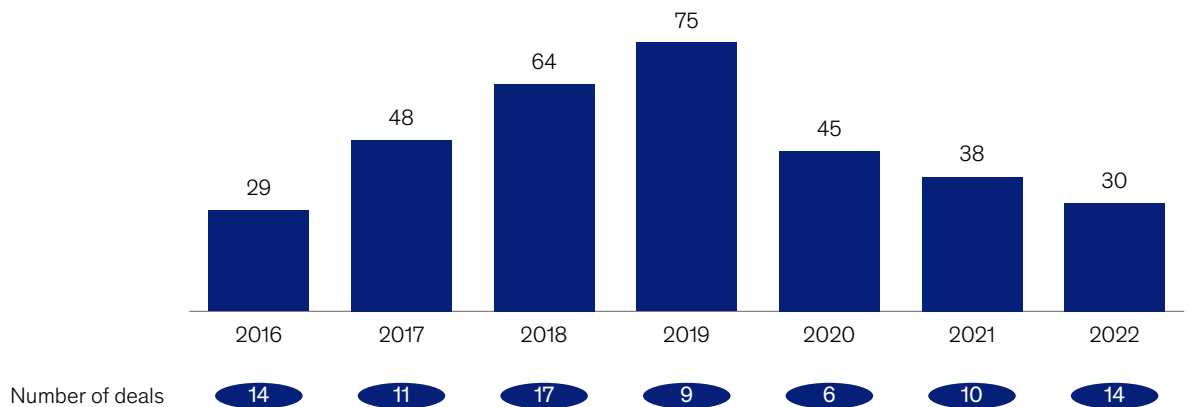
The oil and gas industry is, in many ways, the epitome of competition and free market capitalism. A common refrain from industry veterans discussing M&A is, “You are either at the table, or you’re on it.” This is a harsh reality, but companies with strong M&A capabilities and bold strategies often exit the cycle fully fed and healthy. Dealmaking in the North American

upstream sector in 2022 generated relatively low upstream transaction value compared to previous years, due to a range of factors in the upstream sector, such as high oil prices and macroeconomic factors impacting all sectors, including geopolitical instability, inflation, and the possibility of recession (Exhibit 17). However, our analysis of the fundamentals indicates that a new M&A wave is coming.

Exhibit 17

Dealmaking in 2022 generated relatively low upstream transaction value compared to previous years.

Upstream transaction value generated in North America by deals of more than \$1 billion, \$ billion



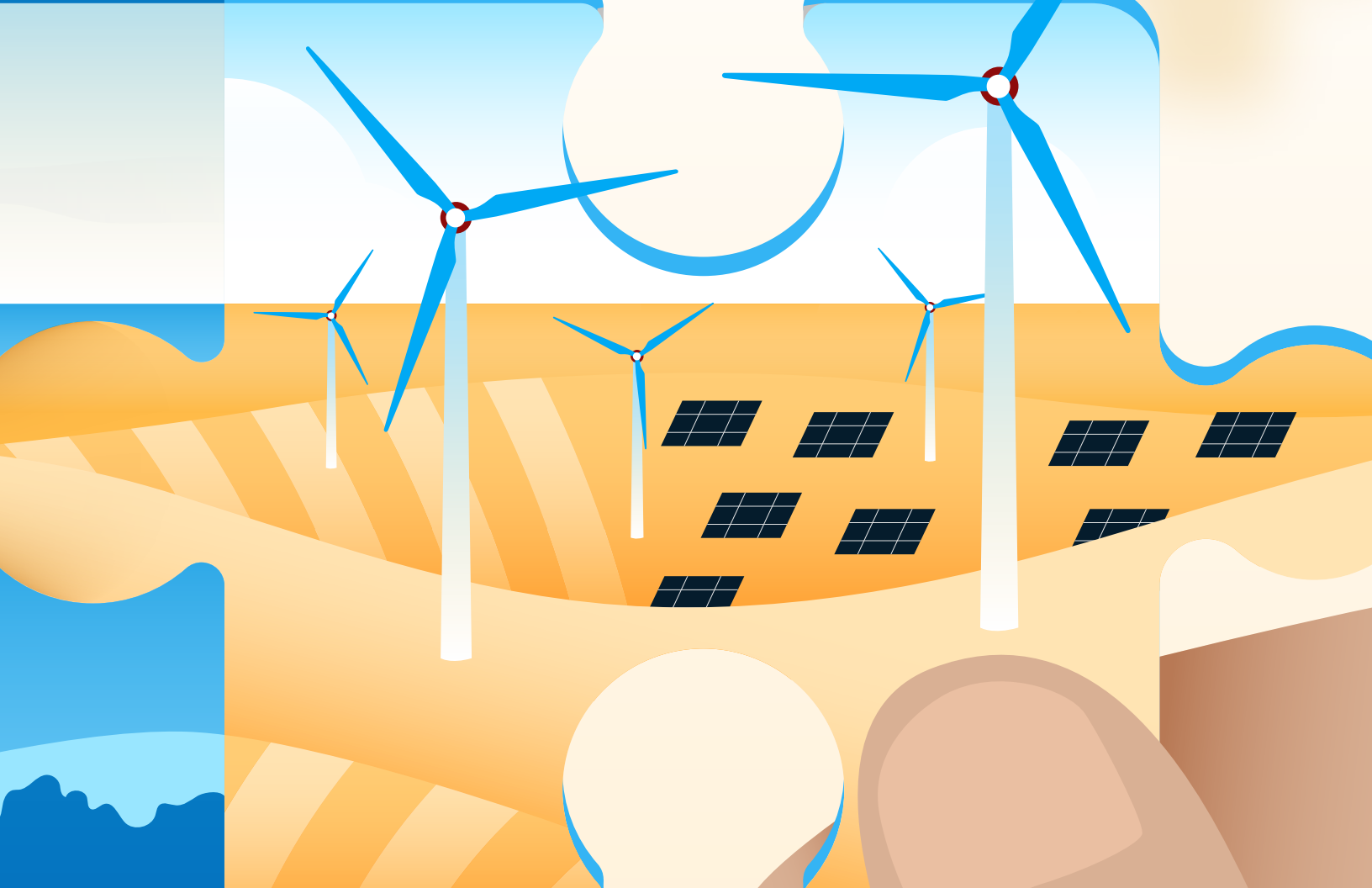
Industry trends suggest that multiple M&A strategies are driving this next wave of consolidation activity. Basin consolidators (such as Colgate and Centennial) will likely look to add scale and leverage operational advantages to achieve outsized returns. Integrators (like EQT with the acquisition of Tug Hill) may seek to add assets in adjacent portions of the value chain to expand margins and increase resiliency. The bold (for instance, BP and the acquisition of Archaea) will probably use a portion of their cash stockpiles to seed businesses to reshape their portfolios and position for the energy transition. Overall, consolidators (eaters at the table) will likely be those that have pulled the operational levers to have better cash flows than their geographically proximate competitors.

The oil and gas industry is entering a period of unprecedented uncertainty characterized by the energy transition, evolving investor sentiment, and mounting concerns around energy security. While our industry should be proud of recent performance, now is not the time to bask in the glow of success. As in the past, successful industry players will work tirelessly to define and deliver a strategy rooted in sound M&A investments—honing their evaluation skills and integration capabilities—to accelerate their future growth and performance.

The next article in this series will discuss what it takes to succeed. Until then, we leave you with one thought: “Who’s hungry?”

Robert Belanger and **Jeremy Brown** are consultants in McKinsey’s Houston office, where **Tom Grace** is a partner.

The authors wish to thank Joaquin Cancino and Luca Sivers for their contributions to this article.



Beyond G&A: Maximizing synergy from oil and gas mergers

In the coming consolidation wave, exploration and production companies can raise the aspiration on deal synergy and move beyond G&A.

*By Jeremy Brown, Tom Grace, and Steve Miller
Published on McKinsey.com, April 18, 2023.*

Mergers and acquisitions (M&A) are a key tool in a company's value creation toolbox. Despite a highly turbulent macroeconomic environment over the past decade, M&A activity in the oil and gas sector has continued, albeit at lower levels than prior years.⁴⁴ Now, a new M&A wave is expected, driven by record cash flow in the exploration and production (E&P) sector, among other factors.⁴⁵

In this next wave, differentiated value creation will likely underpin M&A success, and set M&A winners apart. Many upstream firms view acquisitions as a "bread-and-butter" activity that they do well. However, more than 50 percent of deals in the E&P sector don't create value for shareholders.⁴⁶ Many deals are limited to a focus on reducing general and administrative (G&A) expenses and ignore any operational synergies that may exist. There is a lost opportunity here for firms to raise their synergy aspirations and look beyond G&A, as M&A deals pursued for operational

synergies typically outperform those based on G&A savings. In addition, the choice to publicly announce synergy targets can impact the total return to shareholders (TRS). By making clever decisions, companies can reap the most from their deals.

In this article, we explore two steps that upstream companies could take to maximize value from their deals and build resiliency ahead of the next cycle.

Most deals don't create value

Over the past 12 years, there have been roughly 750 upstream deals with a transaction value of at least \$100 million.⁴⁷ Although most deals were less than \$1 billion in size, deals greater than \$1 billion have contributed the largest portion of transaction value since 2016 (Exhibit 18).

The most successful mergers are usually those that adopt a transformative approach to value capture.

⁴⁴ Robert Belanger, Jeremy Brown, and Tom Grace, "Success in the M&A rebound: Riding the coming wave of upstream deals," McKinsey, February 24, 2023.

⁴⁵ Ibid.

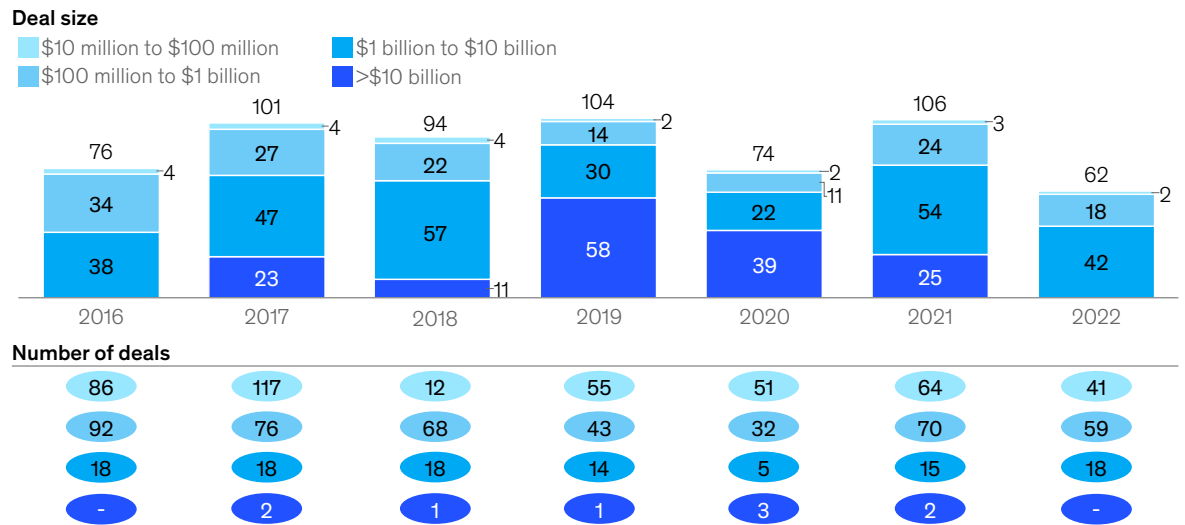
⁴⁶ McKinsey analysis based on global upstream transactions involving 100 percent ownership stake. Includes only exploration and production company transactions; excludes oil field service and equipment, drilling, midstream, or downstream transactions. Data from Capital IQ as of January 2023.

⁴⁷ Ibid.

Exhibit 18

Although most deals were less than \$1 billion in size, deals greater than \$1 billion accounted for the largest portion of transaction value since 2016.

Global total upstream transaction value by deal size,¹ \$ billion



¹Includes global upstream transactions involving 100 percent ownership stake. Includes only exploration and production company transactions; excludes oil field service and equipment, drilling, midstream, or downstream transactions. Data as of January 2023. Source: Capital IQ

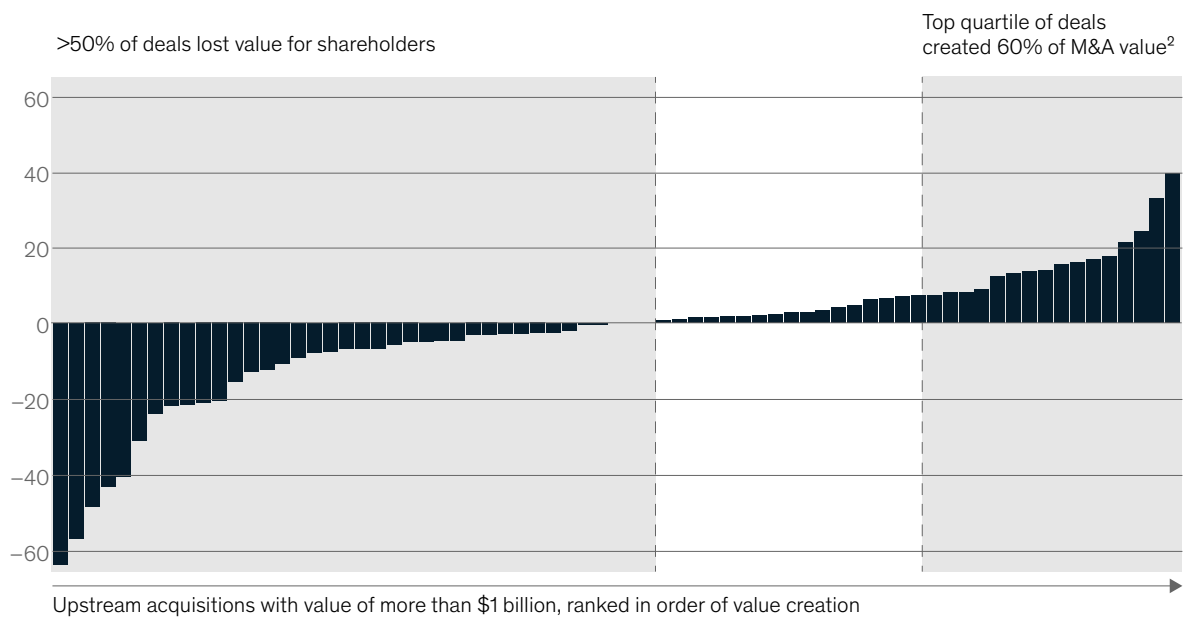
Taking a closer look, most deals greater than \$1 billion in size haven't created value—but the best deals have created outsized returns for their shareholders (Exhibit 19).⁴⁸

⁴⁸ McKinsey's Merger Integration Practice analyzes value creation through M&A deals across sectors using the metric of excess total return to shareholders.

Exhibit 19

Establishing a plan for capturing synergies can ensure a deal creates value, which most transactions fail to do.

Excess TRS by deal from 2011 to present,¹ %



What could be the make-or-break factor determining deal success? Multiple components are at play, such as predeal diligence, asset-performance uncertainties, outlooks for oil and gas prices, and transaction management.⁴⁹ But in all cases, the ability to accrue differentiated value creation is a key factor determining merger success and may determine the winners in the next cycle.

One plus one equals three: Maximize value by moving beyond G&A

All too often, upstream deals have limited their synergy goals to the low-hanging fruit of G&A reductions. Our experience shows, however, that operational synergies are almost always larger than G&A savings—often by a factor of three or more.

⁴⁹ Jeremy Brown, Tom Grace, and Zach Kimball, "The dos and don'ts of M&A in shale," McKinsey, November 2, 2020; Pat Graham, Maximillian Mahringer, and Andy Thain, "Ten principles for successful oil and gas operator transitions," McKinsey, January 31, 2020; *Global oil supply-and-demand outlook to 2040*, McKinsey, February 26, 2021.

The most successful mergers are usually those that adopt a transformative approach to value capture, systematically pursuing synergies across financial categories and functions, including operations. Upstream companies can open the aperture across revenue and production, operating costs, and capital efficiency in addition to G&A, using the merger as a “moment in time” to catalyze performance improvement across both entities.

Pursuing operational and production synergies with rigor equal to (or greater than) G&A cost synergies also has an important change-management dynamic.

While reducing headcount and other expenses is usually viewed as a necessary evil that often generates negative emotion, developing additional revenue through operational excellence can drive energy and excitement and offer teams a point of pride to rally around. Operational synergies have the added benefit of being a buffer in case G&A synergies are harder to obtain than expected.

Our work has highlighted that successful mergers approach operational synergies from three main angles (Exhibit 20).⁵⁰

Exhibit 20

Successful M&A drives operational synergy in three levels of ambition.

Synergy examples by function	Direct operational synergy	Best-of-the-best	New opportunities
Development planning	Accelerate best inventory across combined portfolio	Optimize timing and orientation of stacked-pay development based on total program net present value (NPV)	Embed fracking-interference mitigation into combined development plans with supporting data collection
Production operations	Combine and optimize well surveillance, workover campaigns, and water management	Maximize uptime of wells or facilities based on combined data and learnings, including design and vendor	Expand digital capabilities in surveillance and pilot new artificial lift technologies
Drilling and completion (D&C)	Increase equipment and infrastructure sharing across more rigs and fracking spreads	Standardize execution based on combined data and expertise, accelerating spud-to-sales and minimizing cost	Increase piloting of new techniques, as a smaller share of larger total D&C budget
Supply chain and procurement	Institute integrated contracts with larger volume and lower unit costs	Leverage combined data and expertise to simplify designs and build supply chain resiliency	Empower and integrate procurement teams to proactively combat inflationary pressures
Level of synergy ambition			

⁵⁰ McKinsey analysis based on synergy planning processes used during recent client work in M&A.

Leading companies often ask the following questions when considering M&A:

1. What are the direct operational synergies to be extracted, either from an overlap (or adjacency in footprint) or from an expanded size and scale?
2. How can we leverage the best-of-the-best capabilities from each organization, using both data and capabilities to scale opportunities across portfolios?
3. How can new opportunities be catalyzed in this unique moment to realize step changes in performance?

Firms that strive to become world-class serial dealmakers may engineer answers to these questions into a repeatable “deal machine,” which they continually improve while proactively strengthening the muscle memory of how to run it.

Publicly announce synergy goals

To announce, or not to announce, that is the question. Once synergies have been planned and targeted, they can be announced—internally or externally. At a minimum, targets, or goals, can be clearly communicated internally, with discreet goals set for each part of the combined business. This mobilizes the entire organization to drive performance, while offering a clear rationale for decision makers to anchor the many tough calls that will likely be required during the integration process.

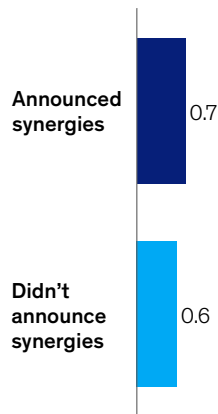
But announcing targets externally can increase the chance that deals create value (Exhibit 21). While there is a negligible link between communicating additional information about the deal and the initial market reaction, announcing cost-synergy expectations may be tied to significant long-term outperformance over peers. Our analysis of 776 deals across sectors showed that companies that announced synergy targets outperformed those that did not by an incremental 7 percent TRS over a median of two years.

Companies that announced synergy targets outperformed those that did not by an incremental 7 percent TRS over a median of two years.

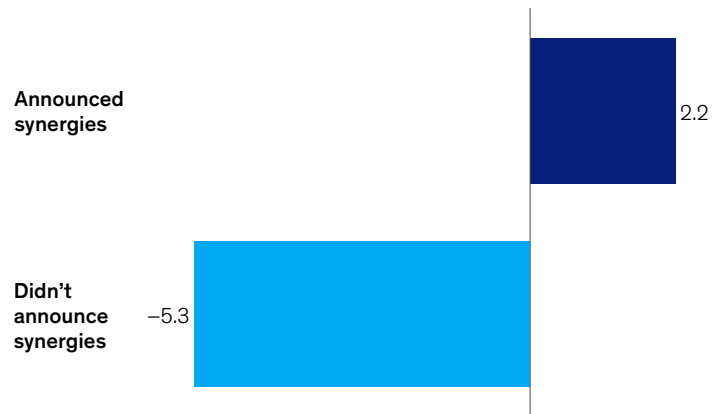
Exhibit 21

Deals that announce synergies tend to outperform those that don't.

Initial market reaction,^{1,2}
% improvement above peer index



Median two-year excess TRS,³
% improvement above peer index



¹Excludes nonstrategic deals (for example, acquirer is a real estate investment trust or investment bank). Includes transactions of companies acquired with a market cap representing 30 to 500 percent of the acquiring company market cap, and a total acquired market cap larger than \$500 million, for announced and completed deals between 2010 and 2019.

²Median acquirer short-term TRS in excess of industry sector TRS (MSCI) for 2 days predeal versus 2 days post deal. n = 973.

³Two-year excess TRS involves the median acquirer long-term TRS in excess of industry sector TRS (MSCI) for 1 month predeal versus 2 years post deal. n = 776.
Source: Synergy Lab

Publicly announcing targets can contribute to putting healthy pressure on the executives and support teams who will have their compensation linked to meeting targets. As the onus is on the company to deliver, this can encourage executive teams to tackle the difficult decisions included in initial synergy estimates instead of opting for an easier route. To ensure delivery,

publicly announced targets are typically supported by internal targets that are up to 200 percent higher, even in the case of value leakage.⁵¹ Public announcements also allow investors to understand where the synergies are coming from, instead of the deal being a black box.

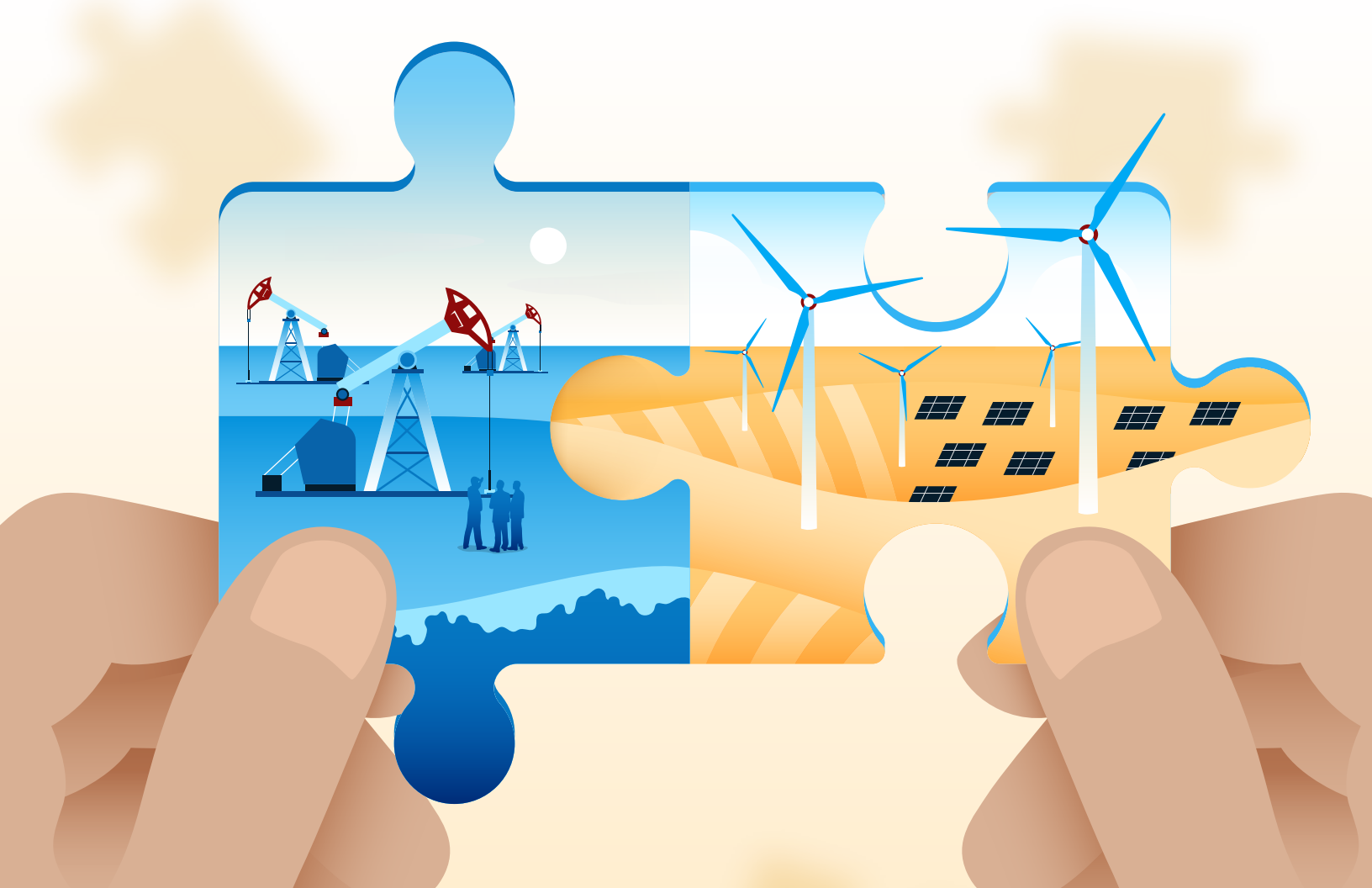
⁵¹ McKinsey analysis based on synergy planning processes used during recent client work in M&A.

After the deal, some organizations may be tempted to adjust the synergy goals used in approval to better match the actual delivery. To counter this behavior, top CEOs may require their teams to place a record of synergy objectives in a figurative time-locked safe with the initial opening set for the first executive lookback on deal success. There will likely be both positive and negative variances against the goal, but only by knowing where gaps exist can teams fine-tune estimation and delivery methods to continually improve.

In the next wave of upstream M&A, differentiated value creation may be a key factor underpinning merger success. By pursuing operational synergies beyond G&A and publicly announcing synergy targets, companies can maximize the value from their mergers—and accelerate their growth and performance.

Jeremy Brown is a consultant in McKinsey's Houston office, where **Tom Grace** and **Steve Miller** are partners.

The authors wish to thank Robert Belanger, Joaquin Cancino, and Luca Sivers for their contributions to this article.



The importance of cultural integration in M&A: The path to success

Culture management is a vital aspect of integrations during mergers and acquisitions and, with the right measures, cultural alignment can drive vastly improved returns.

By Ignacio Fantaguzzi and Christopher Handscomb

For many companies, successful M&A is a critical aspect of their long-term strategy—and a clear pathway to accelerated growth. In the past decade, M&A accounted for \$8.3 trillion of capital deployment for the world's 2,000 largest companies across all sectors. M&A is also a large contributor to growth, and McKinsey analysis has shown that it can be responsible for driving 75 percent of growth.⁵² Despite this, the rate of failure is high, standing at between 70 and 90 percent.⁵³

Organizations that acquire successfully have distinctive capabilities at every stage of the process. Qualities they have embedded at deep institutional levels include reallocating M&A capital regularly, having clearly defined “go” and “no go” criteria, knowing when to walk away from deals, and the ability to focus relentlessly on value creation in integration planning and execution. A capability that is often overlooked, however, is the ability to manage culture throughout the M&A process.

In this article, we explore how culture can be used to drive success during integration and how by managing culture efficiently, companies in the energy sector could improve costs and revenue following M&As.

Culture can improve M&A success

Culture—both within the acquiring firm and throughout the integration planning process for targets—is critical to creating value through M&A.⁵⁴ This is especially true for cross-border or step-out integrations, for example, to gain a foothold in new lower carbon segments.

Differences in the cultures of organizations can exist at any level and have the potential to seriously disrupt operations and jeopardize integration processes. For example, companies may differ in their cultures around decision making—one may have a top-down, directive culture while the other's is consultative and process-driven. Such issues are especially common where large, established energy players are acquiring smaller start-ups.

Failing to align culture could meaningfully inhibit the companies' prospects of smoothly integrating and capturing the anticipated value. Similarly, parties in an M&A must align in areas such as accountability, communication, innovation, and operational management.

Our research shows that companies that manage culture effectively in their integration planning are around 50 percent more likely to meet or exceed their synergy targets—across both cost and revenue synergies (Exhibit 22).

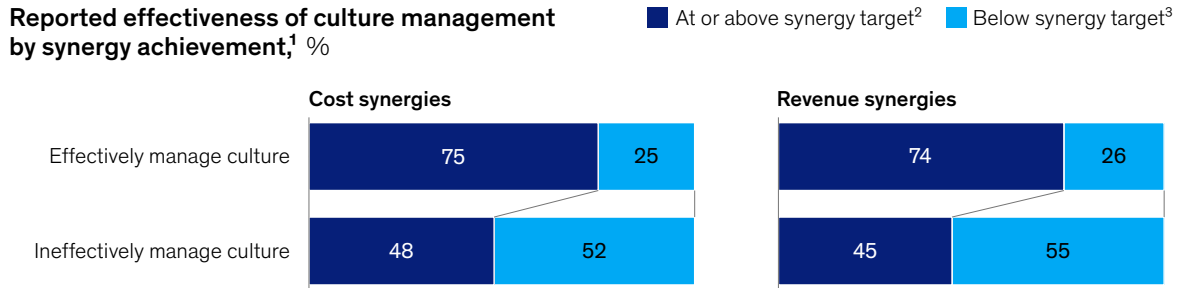
⁵² McKinsey analysis; Growth Decomposition database; Activist Investing 2018 Annual Review.”

⁵³ Richard Alton, Clayton M. Christensen, Curtis Rising, and Andrew Waldeck, “The big idea: The new M&A playbook,” Harvard Business Review, March, 2011.

⁵⁴ Oliver Engert, Becky Kaetzler, Kameron Kordestani, and Andy MacLean, “Organizational culture in mergers: Addressing the unseen forces,” McKinsey, March 26, 2019.

Exhibit 22

Companies that effectively manage culture during integration planning are more likely to capture cost and revenue synergies.



¹n = 1,587.

²At target defined as within 10 percent of synergy target; above target defined as greater than or equal to 110 percent of synergy target.

³Below target defined as less than or equal to 90 percent of synergy target.

Source: McKinsey analysis of deal database and OHI databases; 2018 McKinsey Global M&A Capabilities Survey

Three steps to improve cultural integration

Evidence from McKinsey’s integration engagements in energy and beyond suggests that managing culture through the M&A process successfully could depend on three steps:

Diagnosing “how work gets done” by establishing a cultural baseline. Doing this allows for the identification of common strengths that can be built upon between the organizations, revealing potential transformation opportunities, as well as differences that may cause friction. While recognizing differences, it is important not to exaggerate them or think of them as differences between “good” and “bad” cultures: companies can succeed equally with

very different cultural strengths, and aspects of each culture can be brought in during the transition.

Prioritizing cultural aspirations for the integrated company by articulating the future culture and tailoring the integration approach to support these priorities. The cultural program can’t be viewed as an isolated job—it must be interwoven with all integration initiatives. And, for the program to achieve true behavioral change, it must resonate with people on a personal level, requiring rational and emotional intervention throughout the change management process.

Driving change, with leaders in both companies developing a ‘change story’ to plot the desired cultural transformation and determining a set of targeted initiatives for building toward the desired culture.

Here, communication must go in both directions (to both the leaders and employees in the acquirer and target organizations). Alignment among the top team—as well as role modeling—is crucial for success. These new leaders may be called upon to sponsor activities to keep things moving forward.

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Lack of attention to culture management can be a major hurdle to the success of M&As. But by applying an integration strategy giving due attention to culture, this need not be the case. Research

suggests that M&A deals that deploy advanced culture management strategies far outperform those that do not. Companies in the energy sector could replicate these successes by performing a cultural diagnosis, prioritizing cultural aspirations, and driving change among the leadership in the target organization and acquirer alike.

Ignacio Fantaguzzi is a partner in McKinsey's Houston office and **Christopher Handscomb** is a partner in the London office.

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