

Adaptive Leadership in the U.S. Energy Sector

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The Challenge of Climate Change: Reset or Hunker Down?

The question facing every energy CEO today is whether climate change can be viewed as simply another risk, like ensuring security of supply, amenable to known techniques and best practices or, rather, if it requires a strategic adaptation in their company's DNA. Critical to remaining competitive in a rapidly evolving economic and political landscape will be CEOs' ability to recognize the moment at hand as not merely a bump in the road but, rather, a sea change that demands a fundamental, and relatively swift, shift in the assumptions that have until now served the energy industry well.

The good news is that energy CEOs have successfully managed complexity for years. The bad news: tried and true best practices and organizational competencies are insufficient in the face of climate change. From a prolonged state of uncertainty about carbon markets and environmental regulations to increasingly concerned investors, climate change and climate change policy pose risks that cannot be managed using existing norms and procedures.

Distinguishing which current business practices are essential and need to be preserved going forward and which are expendable and must be let go of in order to make room for progress and innovation is a critical and difficult leadership challenge facing energy CEOs.

A History of Adaptation in the Energy Industry

Since the early 20th century, energy companies have successfully adapted to unprecedented challenges. Many of the techniques and organizational competencies they pioneered are now deeply embedded in the lexicon, lore, best practices and identity of the industry.

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California's first large-scale energy development, for example, was shaped by the famed '49ers, who left behind the hydraulic knowledge and technologies later exploited for widespread hydroelectric development. A similar story unfolded across the nation leading to the development of a vast social, political and technical infrastructure that has successfully weathered everything from supply shortages to the changing whims of oil cartels and foreign competition.

Not everyone adapted however. When in the early 1900s it became apparent that California's in-state coal industry could no longer compete, the last remaining coal mining companies pinned their hopes on a new coal "briquetting" technology. The technology failed miserably and brought with it the unceremonious end of what was once a thriving industry. One wonders what the 21st century equivalents of coal briquetting might be.

Moving Beyond Best Practice to "Next" Practice

More, and more severe, heat waves, drought and extreme weather events reduce the economic life of energy infrastructure, such as transmission lines and off-shore drilling rigs. According to one Oliver-Wymann study, asset damage and loss due to Hurricanes Rita and Katrina, while not directly attributable to climate change, cost the energy sector in excess of \$700 million.

This presents CEOs with a formidable challenge: how to convince investors to put their capital to work in upgrading existing infrastructure or buffering the access, development and transportation of energy rather than targeting more lucrative exploration projects. Energy companies who cannot meet more stringent energy project approval thresholds will be forced to seek alternative, more expensive financing mechanisms. The result: increased volatility of cash flow, increased operating costs and decreased earnings.

But the climate change and climate change policy conversation has moved significantly beyond risk mitigation and survival toward growth and innovation. During the height of the financial crisis Jeffrey Immelt, the CEO of General Electric, cut the treasured annual GE dividend, a symbol of GE's consistent growth and stability, for the first time since 1938. He also shrunk GE Capital (GE's finance unit) by 30%, recognizing in part the fact that GE will be much more highly regulated than it has been in the past. At the same time, he committed GE to an ambitious \$10 billion plan to invest in technological research and development. What makes his approach significant is his willingness to let go of what has historically been core to GE's organizational DNA in order to make room for innovation.

A recent survey by McKinsey and Co. found that 60 percent of global energy executives view climate change as important to consider within their companies' overall strategy in such varied areas as product development, investment planning, and purchasing and supply management.

Yet, only one-third of respondents say their companies place more emphasis on climate change than on most other global trends.

Nonetheless, the future will be vibrant for those who do not hunker down into business as usual, but rather, rise up and develop “next practices” while executing today’s best practices. Doing so requires leadership that can adapt and even embrace uncertainty. It requires leadership with the will and the skill to refashion the norms and practices of an industry rich with potential and, for now at least, a virtually unbroken history of success.