Beyond the Boardroom

John Buchanan reflects on leading global change, the role of non-executive directors, and corporate governance

An interview by Darilyn Kane

Birgit Utech Photography, www.birgit-photography.com

UABR: In your time at BP, particularly the last six years, you were involved in some large-scale change. What was that like?

Buchanan: An exciting journey and a seriously full-time job as CFO.

BP has transformed itself in the last decade. The BP board set a number of strategic objectives in the mid 90s, the intent being to create a globally competitive oil and gas company with the scale and reach to meet the opportunities of the new century. The various large deals since then were part of that plan. Having clear goals helps set context and provides motivation for the wider team.

However, any merger or acquisition activity creates disruption and uncertainty, with different cultures, organisations, processes and systems, and with many jobs at risk.

The $US50 billion combination of Amoco with BP involved a huge process of change for everybody. That was compounded by a succession of further acquisitions over a short period. These included Arco (Atlantic Richfield), a $US30 billion California based oil company, and Burmah-Castrol. To capture the resulting strategic opportunities by upgrading the new business portfolio led to the consequent disposal of $US17 billion of assets. Employee numbers were rationalised from over 100,000 to 80,000. That series of deals yielded more than $US4 billion per annum, post tax, of synergy benefit.

Those activities tested fully all leadership, people management and organisational change skills. Overall, it was a monumental series of tasks to achieve successful results. BP moved from a distant number three to a strong two behind ExxonMobil.

UABR: What do you think are the key aspects of leading a company successfully through that sort of change?

Buchanan: Business School research suggests that some three-quarters of mergers and acquisitions fail to deliver on the objectives set by their management. So this is a good question. There are a number of factors in my view, all of which have to be delivered to a high standard to secure success: Strong leadership, clarity of purpose and rigorous project implementation are essential; clear quantified timelines and goals, not just financial ones; respect for legacy company cultures, even though one will likely provide the future core; and being seen to be fair in appointments to help the new company get the best of all employees and experiences. There are some other key components:

- Targets that can be cascaded through the organisation and which employees understand. That helps expectation management, which is often given too little attention.
- Rapidly putting in place the new organisation with clear accountabilities and explaining the new rules of the game, with incentive structures to reinforce new performance contracts.
- Recognising that there are inevitably winners and losers in a merger or acquisition requires straight forward explanations and support structures for people being displaced, important both for those going and those staying.
- External messaging is vital too. Setting and meeting expectations, keeping investors enlightened, and avoiding any financial or reputational surprises.

That's a long agenda but all those factors are determinants of success.

UABR: How can you keep people motivated during so much uncertainty?

Buchanan: The way the company treats people during the process is a factor that will affect both short and long term success. Providing clear, credible explanations of the processes, timescales and likely outcomes necessary to achieve the higher goals for the new company and its employees is a basic requirement. So is being clear about the intended organisational model and new rules of the game, reinforced with incentives. Explicitly adopting best practices from the legacy companies helps establish respect and emphasises continuous learning. Having a robust implementation timetable helps avoid prolonged uncertainty and gives the new group a fast start, not forgetting the promises made to investors - the real world of competition goes on.

To help manage the process and keep close track of motivational issues, the leadership took a bold step in the early stages of the BP Amoco merger, when there was still great uncertainty. People were bound to be unsettled but it was decided to undertake a comprehensive, anonymous employee survey, asking two sets of questions.

Firstly, seeking to measure the state of job satisfaction by business, function and location. This gave a base for monitoring implementation progress, sharing learning from the best and setting new targets. People had the opportunity to express their views on merger progress, the level and timeliness of information being provided, inclusive behaviours, level of pride in the new goals, quality of local and corporate leadership etc. This survey was repeated at regular intervals to monitor and accelerate progress. Secondly, employees were invited to contribute to the emerging new value set being established for the new company, deriving from the values familiar to the legacy companies. This provided powerful

John Buchanan is a New Zealand-born graduate of the University of Auckland. He is a non-executive director on the global boards of Vodafone, AstraZeneca, Smith & Nephew and BHP Billiton. Until his retirement from full time executive roles in late 2002 he had a wide-ranging 33 year career with BP, culminating in the role of Chief Financial Officer (CFO) on the BP plc Board. He played a major role in leading the company through a number of mergers and acquisitions, including the combination with Amoco, which at its time was the largest ever industrial merger. Buchanan furthered his education at Oxford University and at Harvard Business School. He has served on a UK Cabinet Office think tank and was a member of the UK Accounting Standards Board. He is also the Chairperson of the UK Friends of The University of Auckland.grade titles. His interests include current affairs and all sports.

insight for the leadership and communicated inclusive intent, while offering a sense of ownership to employees.

UABR: With so many stakeholders being impacted by that sort of change, how do you balance multiple interests?

Buchanan: Many companies spend much time considering what they do and what financial outcomes they wish to achieve. It is essential, I believe, to consider both what is done and how it is done. The "what" is satisfying the owners, the shareholders with capital at risk in the enterprise, and is critical if the company is to survive. There is much debate about other stakeholders and who is the more important—customers, employees, or the community? They are all important. If you take care in defining what you do, the financial goals and metrics for rewarding shareholders, and how you do it, you can reduce much of the apparent trade-offs and conflicts.

For example, clear policies and enforced standards on health, safety and environment; ethics; treatment of employees; and managing relationships for mutual advantage (e.g. communities, suppliers) will in many cases not just reduce potential dissatisfaction from other constituencies but will also reinforce sustainable financial goals. It is important to be listening to all stakeholders, taking account of what they are saying. This is not only a source of valuable information; it is a source of competitive advantage against the less attentive. I suspect Enron would be in much better shape if attention had been given to how things were done as well as the what.

UABR: One of the ways that BP appears to differentiate themselves is by publicising their focus on environmental issues. What was behind that focus?

Buchanan: I can't speak for BP now but let me offer my view. In BP's petrochemicals division in the early 1990s we discovered from listening to our employees that people wanted to see the company do more on environmental issues. As a petrochemical company, you're often in the crosshairs of the media or various interest groups. We'd set very high internal standards – reducing emissions to air and water, and reducing solid waste, some way ahead of regulatory requirements at that time. That encouragement prompted some employees to ask why we didn't communicate these targets externally and also why we weren't seeking employees' ideas on a more systematic basis. There appeared to be considerable scope to improve environmental performance. So we put out a questionnaire and got an enthusiastic response. A lot of the ideas didn't require large investment and had very quick paybacks. So there was an enhanced economic imperative and many of the ideas were implemented. We called in the NGOs and went public on our targets and committed to regular reporting. Many people liked this. Perhaps the biggest surprise was the response from employees - feedback from surveys indicated a high level of pride in the company's environmental policies. At this time similar thinking was emerging in other parts of BP.

John Browne (Lord Browne of Madingley), the CEO, has taken the thinking a step further with a group-wide initiative. While not claiming any particular environmental science insight, BP adopted the precautionary principle, publishing self-set targets to reduce emissions of carbon dioxide and hydrocarbons. The demanding targets required new approaches to building and operating plant. This lead role has since been followed by various competitors. For each and every BP business there are explicit health, safety and environment targets in place—now part of the annual performance assessment, affecting compensation.

UABR: So in that scenario the financial effect is almost secondary?

Buchanan: Well in many cases the financial impact has been positive, as it happened, but it's not secondary. You're not going to do something that costs the shareholder for purely philanthropic reasons - unless you're very clear that you've got shareholder support for it. But if you are doing things that are actually enhancing value over the long term – enhancing your licence to operate, then that's good for everyone. Who wants to operate plant inefficiently, releasing hydrocarbons to the atmosphere when they cost more than $US40 barrel?

"Strong leadership, clarity of purpose and rigorous project implementation are essential"

UABR: What do you think are the characteristics of an organisation that has the ability to create growth from change, rather than just surviving it?

Buchanan: Leadership, proactively looking for opportunities and seeking mutually beneficial relationships. Companies that I'm working with now are doing some stunningly good work. For example, BHP Billiton decided to build a new aluminium smelter in Mozambique. The location met various requirements: there was a deep water port, electricity was available and the new regime was looking for foreign investment. They chose a site south of Moputu, where malaria affected around 80% of the population, HIV was a big issue, the average education of people was about three years primary, and there was no fresh water supply. There was a little school with no roof and a rudimentary clinic. Then the company comes in and puts in infrastructure for the site. Now it's a flourishing community. You need a lot of staff to run a plant like that and you can't fill it with expatriates, so the level of local education was encouraged. Not only was a new school put in, talented people are now getting education to a tertiary level. The hospital was rebuilt, the malaria rate has dropped substantially and HIV programmes were brought in. So locating the plant there was a transformational process in a country that only fifteen years ago was one of the poorest countries in the world measured by GDP per capita. The plant now has a sizeable effect on export income for the nation. When I visited, I found it an inspiration. Companies don't tend to talk about such things externally. The media are sceptical and usually won't print the positive because 'good news doesn't sell'. However it is quite extraordinary what the process of change, resulting from big companies acting in their self-interest, can do.

UABR: What do you think about the criticism that this type of development causes a sudden increase in revenue that can't be managed wisely, or goes into the pockets of only a few?

Buchanan: There are issues in some countries. The oil companies have found that the 'economic trickle down' can get blocked or diverted before reaching the host community. Part of the answer is for companies to be more transparent, publishing details of investment and 'signing on' fees for resource access. A few have done this. Not all host governments like it. Now the United Nations and others are talking about imposing compulsory publication of access fees as a standard for all companies. Good companies take care to support direct investment in the local community infrastructure, whatever is done at national level.

UABR: Do you think that should be a responsibility of global companies that do have the power to assist?

These are often issues that may affect a company's reputation, so it's important to get them right. Examples mentioned include, health, safety, environment, ethics, relationships with customers, employees, suppliers, regulatory bodies and communities, as well as sound, effective financial controls. Damage to reputation can be more costly longer term than financial damage. Non-executives can contribute by providing a view through a different lens. They have seen things done in different ways and bring experience from other organisations and sectors. Top management succession, remuneration and audit all benefit from independent oversight. Non-executives have major contributions to make on strategy development and performance management.

UABR: So there's a big benefit from having that variety and breadth of experience?

Buchanan: Yes, but you also need to get your own assurance that things are being done in the right way. You get a series of financial reports that show that the company is doing well. But how do you really know that what you're being told is right? Apart from hype or spin are you just seeing the most favourable profile? How do you get to the deeper issues? It's about putting all the pieces of the puzzle together, getting out and meeting the people. Seeing if that smooth presentation at the board meeting resonates with what you're hearing in Africa and Asia.

UABR: So the role goes beyond attending board meetings?

"Your contribution is in thinking about the long-term interests of the shareholders and about *how* things are done"

Buchanan: Yes. There is of course a limit to what one company can do without impinging on sovereignty issues. Again it's about how companies choose to operate.

That's what turns me on about working for good companies. When I got invitations to join various boards, I did my own due diligence on each and every company. I wanted to know if they were companies that I would want to be part of. In addition to the ability to invest to produce distinctive returns and long term value, I looked at how they go about doing things, their success in implementing policies on health, safety, the environment and ethics, and whether they are following the sort of standards I'd come to expect. Choices were made accordingly. You only have one reputation.

UABR: Recently there has been a lot of focus on corporate governance and the role of non-executive directors. How would you describe that role?

Buchanan: It is very different from that of an executive director. One way of characterising it is that as an executive you often have to make choices between dealing with the urgent and important. There's always something urgent to do so the important can get deferred. When you're a non-executive you're not there every day or even every week. Your contribution is in thinking about the long-term interests of the shareholders and about *how* things are done.

Buchanan: Absolutely. You have your Rubik's cube gradually sorting out the different patterns and colours, which may or may not be consistent. Where they're not, you need to get out into the business, follow-up and probe until you're reasonably satisfied. Trust is good, but trust with verification is better. Take it from a former CFO.

UABR: Do you think that in New Zealand there is a sufficient pool of talent to draw on to find non-executive directors?

Buchanan: Some people suggest that there is not. I have another point of view. I think that if we draw on the talent in existing corporations, not just the chairperson or the chief executive but also folk at slightly less senior executive levels, then there's a good talent pool and potentially a new learning experience. Of course, for larger New Zealand or Australian companies, attracting international calibre non-execs from the US or Europe will have time and remuneration constraints.

UABR: So where non-executives traditionally come from the CEO level, you would suggest looking at the next level down?

Buchanan: Yes. To be developed early it's helpful to have looked through both ends of the telescope. I found it very helpful in terms of my own development. I was as CFO facing up to the BP audit committee and having to answer questions informatively but was never quite sure how that played out through other people's ears. When I became a non-executive member of another audit committee and had executives reporting to the committee about what was going on, it gave me another view of what was communicated and how. It's another level of insight that you don't necessarily get as an executive. So I think it's a good way to develop young executives.

UABR: Do you think there's an issue in New Zealand about the level of remuneration for these roles?

Buchanan: In New Zealand, as elsewhere, I think fairness and equity alone would suggest that non-executive compensation needs review. When you look at what a corporation pays for professionals such as external auditors, lawyers or investment bankers and compare that to daily rate compensation for high quality non-executives directors there is often a large gap. There is not necessarily anything wrong with that, because in the past people have been prepared to do it. Now, as non-executives become aware of the greater responsibilities and potentially greater liabilities (Enron in the US, Equitable Life in the UK) that gap, were it to persist, would create an issue. There is also the alternative attraction of involvement with private equity where the reward/risk balance can be of a different order. From data I've seen, the compensation for non-executive chairmen and directors has been moving up. There is still some way to go to match other professionals. Over time, supply and demand will shape the outcome.

UABR: There has recently been a lot of discussion about the role of regulation in corporate governance, particularly in the US and Europe. How do you think this has impacted organisations around the globe?

Buchanan: With too many corporate failures in the US and Europe, heavy intervention on governance matters was inevitable. New regulation is well intentioned and there will be various benefits. In US listed companies, having the CEO and CFO sign off explicitly on the numbers and systems of control will tighten the nuts and bolts in many places. However there is a lowest common denominator problem. Priorities in good international companies have become distorted. Time taken on addressing the, sometimes conflicting, requirements of national regulators detracts from the various strategic and performance issues. From a company's point of view it's great to do things well, with transparency and accountability. They don't need frustratingly different forms and regulations in various statutory regimes. The governance reaction risks taking up disproportionate time and setting up so many safety nets that there will be no room for the trapeze artists.

Possibly, the laudable new international accounting standards (IFRS) risk a similar fate in some countries. Some national accounting standards boards are offering their own 'interpretations', which, needless to say, are sometimes inconsistent. That is dysfunctional bureaucracy in my view.