

Back to petroleum

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On the sixth floor of County Hall, the slightly tatty Edwardian building on the south bank of the Thames that once housed the Greater London Council, there is a modest office suite that tells a revealing story about the future of the global energy industry.

With neighbours including a Dalí exhibition, the Manga Studio and the London Aquarium, it is the perfect location for a creative start-up operating outside the mainstream. Only a discreet green and yellow sign with BP's "Helios" logo and the word "alternativenergy" reveals that it is the base for a division that was supposed to represent the future for one of Britain's biggest companies.

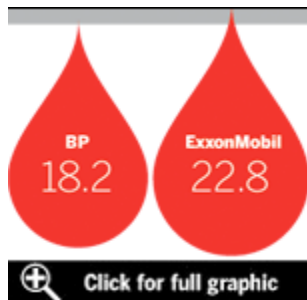
If **BP** is to go "beyond petroleum", as its slogan says, it is the Alternative Energy businesses run from County Hall, including biofuels, solar and wind power, that will take it there. Yet the office is being shut, investment cut and its chief executive has taken early retirement.

Under Lord Browne, its previous chief executive, BP positioned itself as a pioneer of the revolution expected to change the energy business. It was a standard-bearer for hopes that companies that dominated the old world of energy would also lead the transition to the new one.

Although worldwide investment in renewable energy has taken a knock in the recession, the level of interest remains as strong as ever. The election of President Barack Obama has raised the prospect that Washington will sign up to an international agreement to curb carbon dioxide emissions, transforming the outlook for low-carbon energy sources.

Yet having led the charge, BP is now leading the retreat. When the world does move beyond fossil fuels, neither BP nor any other big oil company is likely to be in the vanguard.

Tony Hayward, who succeeded Lord Browne two years ago, is pinning BP's hopes for the future more firmly than before on oil and gas. As one former BP executive puts it, "oil and gas are in the company's DNA". Another says that, while the rest of the world is trying to move forward, Mr Hayward is "turning the clock back".



Alternative energy provides less than 1 per cent of BP's revenues and none of its profits. Capital spending will be about \$20bn this year, of which at most 5 per cent will go into renewable energy. But the reason behind the faltering of its ambitions for the business are telling – both for the future of the oil industry and for the world's energy supplies.



As Peter Sutherland, chairman, prepares to hand over to Carl-Henric

Svanberg at the end of the year, BP is in many respects on a high. When Mr Hayward took charge, the group's profitability lagged far behind that of **Royal Dutch Shell**, its closest rival. Now that gap has been closed.

After the plunge in oil and gas prices, this year's profits will be much lower than last year's record \$25.6bn, but a cost-cutting drive, taking more than 5,000 jobs out of the business, has left BP better positioned than Shell to cope with lower revenues. On the stock market, it has in the past year outperformed Shell and **ExxonMobil**, the biggest western oil group.

A slogan that was too successful

Rarely have two words proved as powerful, or as troublesome, for a company's reputation as "beyond petroleum".

Launched in July 2000, the slogan – with a new logo and a lavish advertising budget – sent BP's brand awareness soaring in the US and helped it craft an image as the world's best-run oil company.

Critics argued that it also sent a message to the majority of the company's workforce that theirs was an outdated part of the business. It also set BP up for attacks from green campaigners, who could never be persuaded that the company had done enough to live up to its promise.

Lord Browne, then chief executive, had staked out his position on climate change, in opposition to the oil industry's tendency to deny or ignore it, in a speech at Stanford University in 1997.

When he set out the strategy, advised by Ogilvy, the public relations group, some BP executives were sceptical; others were enthusiastic.

In May, Tony Hayward, BP's present chief executive, described the company when he took over in 2007 as having "too many people that were working to save the world".

Yet for all those achievements, there is deep uncertainty among investors about the company's future, expressed most starkly in the ratio of its dividend to its share price. The shares yield more than 7 per cent: a remarkable return at a time when 10-year US Treasury bonds pay just 3.5 per cent. The figure indicates the markets think that BP has no prospect of long-term growth.

Industry trends suggest those fears are well founded. Western oil groups face pressure from assertive governments of resource-rich countries, and from ambitious rivals emerging in China, Russia and Brazil. BP and other western "majors" are being driven to the most difficult, high-cost reserves, such as Canada's oil sands.

They are also beginning to run up against "peak demand". As a result of the rise of biofuels and improvements in energy efficiency, oil consumption in developed countries may have passed its peak. Demand will continue to rise in emerging economies such as China, but western companies find it harder to operate in these markets.

"This recession has brought forward the point at which demand for one of our principal products, gasoline, will probably be in terminal decline in mature markets," Mr Hayward says. "So one of the tasks is to figure out how we reposition our business to access more of the growth."

A year ago, it looked as though he too thought renewable energy would be an important part of the answer. It starts from a lower base but is growing faster than oil and gas: by more than 10 per cent a year for wind and more than 20 per cent for solar during 2006-30, even without any additional incentives, according to projections by the International Energy Agency.

Many renewables are not profitable without subsidy, but governments are increasingly committed to them, most notably in the US. A global deal to curb greenhouse gas emissions at the United Nations climate change conference in Copenhagen in December would provide fresh impetus for all forms of low-carbon energy.

Fiona Paulus, head of energy at **Royal Bank of Scotland**, argues that a fundamental shift in the world's energy supplies is coming. "A hundred years ago, the world's fuel was primarily coal. Today it is oil. In the future, it will be renewable energy. By 2050, perhaps 50 per cent of our energy will be non-carbon-based."

As a sign of BP's determination to join that revolution, the Iternative Energy division last year moved to its County Hall offices from the group's grand St James's Square headquarters: a short distance physically but a long way in spirit. The idea was to encourage the entrepreneurial spirit that drives the small companies plotting a shift in the world's energy supplies. The move also created a more autonomous unit, which could have brought in outside investors or even gone for a stock market flotation. Now the experiment is being put into reverse. Alternative Energy is being moved back to St James's Square to use free space opened up by job cuts.

Vivienne Cox, who had led the renewables business since 2004, left BP at the end of last month. The group's investment in alternatives, rising fast

Not that the motivation was purely altruistic. In a business heavily dependent on government relations, a good public image is an advantage. The advertising blitz helped BP in the US, where it had transformed its business with the acquisitions of Amoco and Arco.

The sense that BP could go beyond petroleum was also seen as important for attracting the brightest and the best recruits.

One former BP executive remembers: "John Browne said: 'I don't want this company to turn into another BAT [the tobacco-based conglomerate]: we need to show that BP has a future'."

However, even the biggest enthusiasts failed to predict the slogan's impact. While the detail of BP's advertising made it clear the company was setting out in a new direction rather than changing overnight, the impression was created that it was no longer in the dirty – and sometimes hazardous – old oil and gas business.

There was substance behind the slogan: BP committed more strongly to renewables than other oil companies. Its downfall was that it failed to maintain the highest standards in its core business. When problems emerged, they were seized on vigorously by BP's critics.

to a peak of \$1.4bn last year, will fall to just \$500m-\$1bn this year. The idea of bringing in outside shareholders has been shelved indefinitely. Mr Hayward says he is "weeding" the business, to remove the unpromising activities that stand no chance of being commercially viable.

BP's wind business has been focused on the onshore US, avoiding the more expensive offshore projects seen as the future of the industry in the UK. Solar manufacturing facilities are being shut or cut in the US, Spain and Australia and production shifted to Chinese subcontractors. In biofuels, the company is focusing on a Brazilian joint venture to produce sugar cane ethanol, cheaper and more environmentally friendly than the US corn-based variety, and is backing research into advanced biofuels. However, its project to explore the use of jatropha, once seen as a "wonder crop" for biofuel production, appears to have stalled.

Over the next three years, BP is likely to invest about \$2.5bn in renewables. In the same period **Eon**, the German electricity and gas group with about half BP's market capitalisation, expects to invest more than twice as much in wind and solar power.

"What BP are doing shows a lack of commitment," says a former executive. "When you decide to do something, either you do it wholeheartedly or you shilly-shally around it and you don't get anywhere." He believes that, under pressure from the falling oil price, BP's leaders are retreating to familiar businesses. "A lot of it is instinctual, and the instincts of Tony Hayward and Andy Inglis, head of exploration and production, in particular," he says. "They are dyed-in-the-wool old-fashioned oilmen. They are extremely smart and clever people but they are trying to cling on to what they know best."

Given the skills and culture of the group, BP's Alternative Energy division was always going to be fighting uphill. The business is very different from oil and gas. Securing planning permission for a wind farm, for example, has little in common with negotiating an oil exploration licence. There are also fundamental differences of business model and mindset.

"What BP is really good at is finding oil: high-cost investments that can create big increases in value," one former BP man says. Renewable energy, by contrast, "is a slow grind, where you just don't get that big-value uplift". Another former executive argues that the lesson of BP's experience is that companies need to concentrate on doing what they do best: "With the benefit of hindsight, it's appropriate for companies like BP to stick to their core business."

BP would not disagree, arguing that there is still a hugely successful long-term business in oil and gas. Mr Hayward describes concerns over western companies' access to resources as "somewhat overstated", pointing to BP's 2007 deals with **Libya** and Oman as evidence. Last week it became the first western company since the US-led invasion of 2003 to agree a deal with the Baghdad government to operate in Iraq's vast oil fields.

At some point, however, the shift in the world's energy system will come. Lew Watts, an independent consultant, says the future will bring growing electrification, including of transport. "What we are likely to see, and are already seeing, is that energy will continue to de-carbonise and will ultimately move to the electron," he says. "Any energy company of the

future will need to be in the electron or power business. Companies that do not do this become merely commodity suppliers."

Viewed that way, groups such as Eon or **EDF** of France or **Duke Energy** of the US have more chance of dominating the future energy landscape than BP. Or, just as IBM failed to realise the potential of the personal computer, established energy companies may be superseded by new ones able to exploit the new forms of energy.

BP is thinking now about what the changing global market will mean for its business. Talking about the appointment of the new chairman, currently chief executive at Ericsson, the Swedish telecommunications group, Mr Hayward says: "This is the end of chapter one of getting BP back on the rails ... We now need to sit down and begin to craft what is chapter two." Whatever it holds, that chapter seems certain still to have oil and gas at its heart.

Two steely oilmen



It is hard to imagine two men more superficially different than Lord Browne, pictured left, and Tony Hayward. Lord Browne, BP's previous chief executive, is formal, reserved and thoughtful; his protégé and successor, Mr Hayward is relaxed, youthful and active. Lord Browne was a famous cigar smoker; Mr Hayward is a triathlete. The former's corner office was notorious for its lavish, Viscount Linley-designed furniture; his successor's is functional, brightened up with pictures of his children and of a yacht battling through the waves (he is a keen sailor) – and not even on a corner.

BP insiders likened Lord Browne's trips to company operations to state visits. Workers in BP's US business disliked him, seeing him as emblematic of a remote London-based management culture. Mr Hayward is

more at ease among the workforce. "BP makes its money by someone somewhere every day putting on boots, coveralls, a hard hat and glasses and going out and turning valves ... And we had somehow lost track of that," he said in a recent talk.

What both share, however, is a steely quality that took them to the top. Lord Browne's deal-making, which built today's BP, and Mr Hayward's attack on costs in response to the falling oil price, display a common ruthlessness.



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