



Culture and strategy in the commodity sector

Due to the challenging macro-economic environment and the significant downturn in global demand, the commodity industry finds itself at an inflection point. Multiple factors are at play in the industry, including depressed commodity prices, oversupply, increased regulation, a continuing trend towards vertical integration, lack of liquidity and credit, and new entrants, from private equity-backed businesses to state-owned entities and sovereign wealth funds. These and other considerations are forcing businesses to address the critical importance of aligning their culture with their strategy. Without the right culture, strategic initiatives are easily compromised.

Traditionally, the culture of commodity companies has been built primarily around performance and compensation. Such cultures are often very strong, but when prices are depressed and trading and assets integrated, the culture has to adapt to accommodate both the short-term focus of a trading organization and the longer-term, customer-centric mindset required of an asset owner.

In this report, Spencer Stuart explores the views of senior executives from many of the leading commodity businesses on the relationship between strategy, culture and performance.

We believe that the current market makes it essential for commodity companies to think carefully about how they pursue their strategies and to ask themselves what cultural changes may be necessary in order to realise their goals.

Executive summary

- > Many commodity businesses have changed their strategy in recent years and some have evolved from trading companies to organizations that also manage assets.
- > These strategic shifts demand a different set of cultural behaviours.
- > One of most important tasks that leaders have is to align culture with strategy and to instil the right behaviours throughout their organizations.
- > Cultures that were traditionally aggressive and individualistic are having to become more open, accountable, collaborative and diverse.
- > Integrated businesses need cultures that can accommodate both the short-term focus of a trading organization and the longer-term, customer-centric mindset required of an asset owner.
- > It is impossible to transform the culture without also addressing the question of compensation.
- > Commodity leaders are challenged by Millennials whose attitudes and expectations sometimes grate, yet the ability to manage and communicate effectively with Millennials is going to be vital.
- > Companies need to elevate their client-facing skills and also build their functional expertise in areas such as risk management, regulatory, compliance, digital, IT and HR.
- > Many companies have not fully embraced the possibilities of digital transformation and data analytics; the industry needs an influx of skills in this area.
- > When asked to rank the impact that culture has on organizational performance, most of our interviewees rated it as 10 out of 10.

“If it was a bull market and everyone was making money you could not have this conversation, people would laugh in your face. But today’s culture model is not sustainable.”

STRATEGY AND CULTURE

As commodity companies adjust to a period of change and consolidation they need to foster new behavioural norms. This need is partly driven by macroeconomic uncertainty and where we are in the cycle. “It is very easy to make money in a bull market, but what now?” says one executive. “I am curious if people will change their behaviours. The question is: Do you want a culture for a bull market or do you want a culture for all markets?”

The other imperative driving cultural change is the continuing move towards vertical integration. Trading firms that buy assets yet maintain their original culture are saving up trouble. “Building a culture around integrated assets is very different from pure trading. You need much more customer focus, because customers do not only look at price but also at service. Trading companies don’t always get this.” Put another way, how do you mix the culture of competitive marketing and trading with one of sustainable value creation?

Peter Drucker’s much-quoted assertion that “culture eats strategy for breakfast” is a useful reminder that the spirit of an organization can have more influence over outcomes than its leaders have. As trading companies

change strategy, leaders need to make a concerted effort to change the culture along with it. If the two get out of synch, they have a problem.

Commodity companies have always had strong, some might say aggressive, cultures, often built around the personalities and temperaments of traders who, as one person put it, “need to create value from nothing, so the culture will always be different from most other types of company.” However, there are signs that the traditionally heady culture of trading is giving way to one in which risk management, regulatory, compliance and cross-functional collaboration are given equally high priority.

Commodity trading companies need to find a way of enabling aggressive, entrepreneurial and agile traders to do what they are good at, while imposing clear boundaries and accountability. “An open and accountable culture is essential,” says a trading and marketing executive from a fully integrated utility. “Our greatest fear is a rogue trader, but we minimize this risk with mark to market accountability, best practice processes and a professional culture. Values drive our behaviours. We have disciplined and even removed traders who have breached policies. It sends a message that we treat this very seriously and act accordingly.”

Vertically integrated businesses require a broader range of skills than pure traders. Asset ownership calls for strong risk management, governance, compliance, operations and safety capabilities, as well as what might be described as a more balanced set of temperaments. Asset-backed companies or producers have more options to diversify their talent and some make a deliberate effort to dismantle barriers between functions. “If you want to build a stronger culture, give people something to do other than trade, such as the responsibility of running a big project.”

Culture should serve strategy, rather than drive it. There is no one-size-fits-all solution; rather, a company’s culture should match the part of the value chain it covers. “You need to think, ‘How can we be competitive in a certain area, product or geography?’ and then build a culture around this strategic decision,” says one executive. Others take the view that the choice of culture depends entirely on risk appetite and how this relates to the balance sheet.

Given the unpredictable nature of commodity cycles, every business needs to review its culture just like it reviews its strategy: carefully and with an understanding of the importance of building in flexibility so that it can gain full advantage when the market takes a different turn.

“What culture you choose depends entirely on your risk appetite and how this relates to your balance sheet.”

“The world is moving east. We have a lot to learn. We don’t understand Asia that well yet. How do you deal with different cultures that are becoming more powerful?”

Does culture matter?

Talking about culture can be problematic; people have different views about what culture is and how it is shaped. It is easy to confuse culture with formalised company values or employee engagement levels, for example. Unlike company strategy, which leaders articulate with the explicit goal of guiding the organization's activities, culture is pervasive and invisible, working silently in the background and directing how people throughout the organization think, make decisions and behave.

Culture represents the “unwritten rules” for how things really work in the organization. It is the manifestation of the shared values, beliefs and hidden assumptions that shape how work gets done and how people respond to one another and to marketplace developments. Culture, then, matters a great deal.

There is no one “right” culture. The right culture for a business is a function of the outside environment in which it operates as well as its mission and strategy. Ideally, the culture will allow the organization to both respond to the opportunities and threats it faces in its environment and support the internal requirements of the organization itself, such as engaging people, motivating the right behaviour, and aligning with the strategy and organizational structure. The culture may need to evolve if it prevents the organization from responding effectively to marketplace changes or if internal dynamics become toxic.

A company's culture determines and is defined by how the organization responds to the external environment — the continually evolving customer demands, competitive pressures, technology advancements and macroeconomic developments that affect every business — and how individuals within the company interact and coordinate to accomplish their work. To really understand an organization's culture, then, the most important dimensions to consider are how the organization responds to change — particularly in the environment (“orientation toward change”) — and whether it tends to think of its people as individuals or groups (“orientation toward people”).

Research has found that companies with an aligned culture reap twice the return on investment and significantly better sales growth and return on assets than those with weaker or misaligned cultures.¹ On the other hand, an unhealthy or misaligned culture can impede strategic initiatives, erode business performance, discourage employee engagement and diminish loyalty. Lack of culture fit is responsible for as many as 68 per cent of executive new hire failures.

For a more information, read “Leading with Culture: Driving Business Performance through the Alignment of People, Strategy and Culture”, available on www.spencerstuart.com.

¹ Denison, Daniel R., and Aneil K. Mishra. “Toward a Theory of Organizational Culture and Effectiveness.” *Organization Science* (Mar.-Apr. 1995): 204–23.

COMPENSATION

One of the most telling indicators of a company's culture is its system of compensation. Trading companies, inevitably, have a strong performance-based management culture. Incentives tend to drive behaviours, and with high rewards available to top performers it is impossible to transform the culture of a trading company without also addressing the question of compensation. One company achieved a cultural shift by abandoning five-year guarantees. Another refuses to pay a percentage of book value as it drives the wrong behaviours, using 360-degree reviews to help ensure the right behaviours.

Other companies are moving towards bonuses based on team performance rather than individual performance, although this idea is anathema to most traders and problematic for management. "In an ideal world we need to work better together, with more focus on the customer and on our younger people, but hey — who creates the value? The traders. How do you remunerate in a more collaborative culture? It's not easy. You need to make everyone happy and feeling good about themselves. It's a hell of a job. All your good ideas are influenced by these dilemmas around pay."

These concerns were echoed by another executive who remarked that if you want a closer alignment between culture and strategy, then you have to place more focus on the team than on the individual. "Make team targets instead of individual targets. A lot of people will despise this in our industry, but that is the only way you can achieve better alignment. Compensation is the biggest obstacle. You see the difference in environments where remuneration is based on group rather than individual results."

The dilemma is particularly acute for trading companies that vertically integrate, since they are forced to address the huge difference in culture between traditional trading and asset-backed companies. In vertically integrated businesses, it is essential to compensate the key people well — not just the traders but those in key functional roles from compliance and risk to IT and communications.

"Compensation is the biggest obstacle."

MILLENNIALS

To several of the people we interviewed, getting the most out of Millennials (those born between 1982 and 2004) presents a significant cultural challenge, particularly during the present cycle. They were seen as expecting quick promotions, a lot of money, needing significant support and, if these are not readily available, they are likely to jump ship. “If we want to change the culture we need to make Millennials part of it. They will change the industry,” said one leader. Clearly, Millennials are more likely to possess the kind of digital fluency that the industry needs, but they do not fit the conventional mould of commodity traders. They are ambitious, yes, but they are “very comfortable with their lives”. They want to work for organizations that respect their values, ambitions and sense of purpose; and they expect work to be compatible with their lifestyles rather than fit their lives around the exigencies of a more traditional commodities career.

Several people pointed out the irony that while Millennials are the most globally connected generation thanks to social media and the internet, they can be reluctant to explore new market opportunities, get on a plane and take risks originating new business. “This younger generation has less appetite for adventure,” said one trading executive. “They are too comfortable to make big sacrifices. They are also more demanding.” Another described the new generation as being “smarter, better informed, but they expect everything on a plate. What has happened to real originators? I don’t see them.” Yet another was even more blunt: “They are complacent, naïve, habitual complainers and they don’t understand pain. They are cautious and not used to being knocked back. Finding competitive deals is all about turning a no into a yes.”

“The best leaders are those who can develop and manage young people.”

Despite the attitudes and expectations of Millennials being a source of frustration, some commodity industry executives acknowledge that they have many qualities — for example, they are less hierarchical, less respectful of the established order, and have more entrepreneurial genes. They are also a critical demographic. “We need to work on our communication style with Millennials. How can we appeal to them? How can we make them part of the operation? This industry is just discovering that cultural change starts with adapting your communication.”

Attracting the best talent into the commodities sector is far harder than it used to be, partly because we are going through what The Economist has described as “one of the great bear markets”, and partly because some of the best talent is being channelled into other, burgeoning industries, or being lured by private equity or hedge funds.

Commodity companies are starting to work on their employer branding but they are also finding that once they have people on board, they have to use the talent they acquire in the right way and maintain a culture that keeps them motivated and wanting to stay. “I have one piece of advice for the new leaders in this industry,” says one executive. “Listen, listen, and listen to younger people. The biggest potential disruptions come from their generation.”

DIVERSITY: A CATALYST OF CULTURAL CHANGE

In our 2014 report, “Commodity Trading Leadership”, we stated that trading organizations will benefit by having leaders who reflect the diversity of the world in which they operate. We recommended ways to develop traders into leaders, but acknowledged that only a few will be motivated or capable of making that transition.

While researching this report, it became clear that any discussion about culture in the commodities sector inevitably leads to the question of diversity (or the lack of it). This is clearly a leadership issue. Those at the top need to make a conscious effort to address the deep-rooted homogeneity of the trading culture and adopt a less conservative approach to talent acquisition — if not, broadening the universe of high-quality potential recruits to the industry will remain painfully slow. What’s more, highly talented MBA graduates who might once have considered going into the commodity sector are choosing to pursue opportunities in Silicon Valley or private equity instead.

Businesses need to be able to accommodate a diversity of mindsets and behaviours and be prepared to hire people who see the world in different ways and can challenge the underlying assumptions of the organization. “We have always had an Anglo-Saxon white male population — very typical for trading. We are trying to change this, but there is a massive unconscious bias in trading and we need to tackle the problem if we want to go forward as an industry.” This view was echoed by other executives, one of whom acknowledged that many companies are successful because “it’s very much sink or swim. They depend on strong personalities with unique qualities but those people are not necessary strong leaders. They are not always good at hiring or creating a management team: they tend to look for people like them who will take risk in a similar way. They don’t much like diversity in all its forms.”

“Ensuring the right culture is the most important focus for me as a leader.”

“Teamwork is key. We strive hard to think and act like one body — it gives us an edge in the market.”

BUILDING FUNCTIONAL TEAMS

In a more vertically integrated world, companies have to hire the best possible functional leaders and respect the skills they bring with them, for example experts in operations and health and safety. A culture built on the behaviours of traders may be ill-suited for a more integrated cross-functional organization. What have often been referred to as “support functions” or “secondary positions” are now becoming more critical players. For example, with technology now recognized as a major disruptive factor in the industry, the IT/digital leader has to have transformational capabilities but must also be seen as playing an integral part in the alignment of culture and strategy.

Other functions such as finance, HR, risk and compliance, also need to be valued more highly. “We need to get a stronger focus on team work; we are too focused on the individual. There is clear misalignment between the front office and available resources like functional staff.”

CUSTOMER FOCUS

The vertical integration undertaken by many of the big trading companies has posed a major cultural challenge. To adopt a strategy of integrating assets without attempting to change the corporate culture will only handicap the business.

One of the ways the culture needs to change is to become more customer-centric. “You need much more customer focus, because customers not only look at price but also at service. Trading companies don’t get this. The difference is simple. If all you are doing is trading, you have no real customers, just counterparties. With assets, you have real customers.” In the words of another executive, “We need to go for longer-term relationships instead of shorter ones. Customer management has become key.”

Transforming a company into a customer-focused business takes a concerted effort, a new set of skills and a different temperament. This means moving towards a more interdependent culture where listening, learning, curiosity and a solutions-driven mindset are to the fore. “Our culture has always been more focused on trading behind desks and screens. I want them to return to the fundamentals of origination and trading, to go out and see their customers, find new customers. Many people in this industry have become fat and lazy.”

“If we want to get more focus on customers we need to start learning more about them, how they behave. Our business culture will be changed by this.”

This view is echoed by another executive who believes that trading is and has always been a customer-focused activity. “It is a physical business, a physical contact sport. When you build your organization you need to focus on people who get this. Getting information is not logging into Google. It is communicating with people, including your customers. Strategy should bubble up. You need to listen to people, inside and outside the business. The unsuccessful people don’t do this, they think they know it all.”

DIGITAL AND ANALYTICS

In this vertical environment, success means understanding the full value chain “from resource to customer” and using every possible means to gain competitive advantage through insight. Data management and analytics are growing in importance, but most trading companies are barely scratching the surface of what is possible in this new digital era.

While big data holds great potential, companies are unlikely to realize that potential unless they build a data-literate organization, which has implications for the business culture. It means having a leadership willing to invest in and use data and analytic tools, and hiring engineering experts and data scientists with in-depth knowledge of machine learning, data visualization, predictive analytics and other new approaches to distilling actionable insights from data.

With the notable exception of Asia, where some companies have advanced further in implementing their digital strategies, the commodity sector has been relatively slow to embrace the digital revolution. As with other sectors, there are the pioneers and those who lag behind — but no one will be exempt from the effects of digital transformation. “We are in the middle of a digital revolution,” says one leader. “But our sector has only just started to look at it. This is ridiculous. I understand that there isn’t much money around in this market, but you need to invest in digital otherwise you will lose to new players entering the market who really get what digital is all about.”

Conclusion

Culture plays a critical role in business success and nowhere is this more evident than in the commodity sector. Commodity companies are facing challenges on all fronts and having to pay much closer attention to the suitability and effectiveness of their cultures than ever before. Numerous factors are affecting the industry — integrated models, volatile markets, the onset of digital, regulatory and compliance considerations, risk management, attracting the next generation — and together they demand that adjustments be made to the culture that has prevailed in commodity businesses.

In today's environment, it is becoming increasingly important for commodity companies to put their culture under the microscope, consider how it can be better aligned with strategy, and take practical steps to bring about the necessary cultural change in order to maintain competitive advantage.



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