

EXXON MOBIL IN 2021: ACTIVIST SHAREHOLDERS IN ACTION

ABSTRACT

This case study of ExxonMobil reviews the company's operations, vertical integration strategy, and the oil & gas extraction and petroleum industry. The focus of the case is on recent shareholder activism that resulted in voting 3 new external members to the Board of Directors.

INTRODUCTION

The origins of ExxonMobil can be traced back to Standard Oil and its founder John D. Rockefeller. While the ExxonMobil of today would only be partially recognizable to Rockefeller, his relentless focus on efficiency, financial discipline, technical advances in production and vertical integration have endured as key components of the current company's business model. However, recent efforts to adjust capital expenditures while reducing costs and improving efficiencies in response to low oil prices and the precipitous drop in oil consumption resulting from the Covid-19 pandemic have not restored the company to its storied profitability and the company has fallen far from its former position as the world's most valuable company.

The Covid-19 pandemic is not the only challenge that the management team at ExxonMobil has contended with as of late. In early 2021 a small group of shareholder activists pointed toward the long and significant decline in company performance and a need infuse the Board of Directors with outside members who have the experience to guide ExxonMobil through turbulent times and the transition to a lower carbon economy.

OPERATIONS, STRATEGY, AND FINANCIAL PERFORMANCE

Exxon was incorporated as Standard Oil of New Jersey in 1882 and Mobil was incorporated as Standard Oil of New York in 1911. On November 30, 1999, the two companies merged to become ExxonMobil. To gain a fuller understanding of the challenges the company is navigating it is beneficial to have a fuller understanding ExxonMobil's operations, strategy, and financial performance as of late.

Company Operations

The company's principal business "involves exploration for, and production of, crude oil and natural gas and the manufacture, trade, transport and sale of crude oil, natural gas, petroleum products and petrochemicals" (ExxonMobil, 2021b).

As a multinational corporation ExxonMobil seeks to identify low-cost hydrocarbon supplies around the globe and claims to have "one of the most active exploration programs in the industry" (ExxonMobil, 2021b). The company's *upstream* operations involve the extraction of both heavy oil and liquified natural gas through both conventional and unconventional methods. The company's unconventional methods include horizontal drilling and hydraulic fracturing and these methods have been applied to extraction of oil and natural gas from the shale regions of the United States. Some of the greatest supplies of shale oil are believed to exist in West Texas and its Permian Basin. During 2020 the company realized a 35% increase in year-over-year production from its operation in the Permian Basin and projects an ability to recover up to 10 billion oil-equivalent barrels from this that region.

ExxonMobil also maintains a particular focus on deep water exploration, and the company is actively exploring and developing operations off the coast of Guyana. It is projected that these operations will yield more than 750,000 barrels of oil per year by the year 2026. A significant

interest in an acreage position in Brazil is also part of ExxonMobil's effort to develop deep water operations.

The company is a leader in the production of liquid natural gas (LNG), and it operates an export facility on the Gulf Coast of the United States. Future developments in Papua New Guinea and Mozambique are also part of the plan to develop its LNG business. Upstream operations include activities in 40 countries and the company produces about 4 million oil-equivalent barrels of net oil and nature gas every day.

ExxonMobil's *downstream* operations make it one of the world's largest manufacturers and marketers of fuels and lubricants (ExxonMobil, 2021b). Such operations involve the acquisition of crude oil and the manufacturing of fuel products at its 21 refineries. The sales and distribution of fuel products occurs through commercial channels and via its 20,000 retail stores. The company's lubricant business includes the development, production and sale of motor oils and its Mobil 1 syntenic lubricant is the best-selling brand of motor oil in the United States (ExxonMobil, 2021b). The company sells approximately 5 million barrels of petroleum products per day.

An albeit smaller but significant portion of ExxonMobil's business is derived from the production of light gas and petroleum-based chemicals. The company claims to be either the number one or number two producer for the vast majority of the chemicals in its product portfolio and such chemicals are the basic building blocks for materials such polyethylene, polypropylene, and fibers that are used for clothing and insulation. ExxonMobil's chemical product portfolio also includes *performance products* that are used in a wide range of consumer applications such as food packaging, vehicles, and diapers (ExxonMobil, 2021b).

Company Strategy

ExxonMobil aspires to realize competitive advantage via its technological leadership, partnerships and investments in science and research, which it positions as leading to “lower operating and project costs and the creation of high-value products that meet societies evolving needs” (ExxonMobil, 2021b). The company also attributes its advantage to the scale of its global business, which enables the broad deployment of its expertise, cost efficiencies, operational learning and the pursuit of preferred partnership opportunities. The company relies upon integration across complex global value chains that allow for operational flexibility, security of supply and the sharing of activities. The company further attributes its advantages to its execution capabilities and a workforce that brings deep knowledge and expertise from across a wide range of critical disciplines.

Financial Performance

Throughout much of its history Exxon has been considered to be unstoppable. From its inception as Standard Oil of New Jersey through its efforts to maintain control over production and prices through partnerships in Saudi Arabia and Venezuela and its more recent acquisition of Mobil, the company has maintained a steady run of profitability. In 2008, ExxonMobil realized profits of \$46 B, a then record for an American corporation; and it was just eight years ago that ExxonMobil was the world’s most valuable company with a market capitalization of in excess of \$415 B (Matthews, 2020).

More recently the company has stumbled amid a prolonged period of low oil prices that has been partially attributed to the abundance of oil and gas that has been extracted via hydraulic fracturing. The company has been criticized for being late to the shale boom in the United States, a poorly timed acquisition of natural gas producer XTO energy and for bets on global projects (e.g., Canadian Oil Sands; Deep water drilling in Russia) that have failed to meet expectations

(Egan, 2020; Matthews, 2020). The company's poor performance has been further exacerbated by the decline in demand for oil as result of the pandemic.

In August of 2020 ExxonMobil (traded as XOM) was removed from the Dow Jones Industrial Index after being a member of the benchmark measure of stock market performance for nearly a century (Egan, 2020; Matthews, 2020). Overall, the energy sector now represents just 2.1% of the price-weighted index as investors are increasingly drawn to tech and renewable energy stocks (Langley, 2020).

In February of 2021 ExxonMobil announced its fourth consecutive quarterly loss. While ExxonMobil did announce a return to profitability in the second quarter of 2021, XOM has lost roughly 60% of its value in what one Wall Street Journal reporter called “a stunning fall from grace” (Matthews, 2020) . Second quarter 2021 earnings were \$4.7 billion which is a \$5.5 billion increase over the loss of \$1.1 billion reported second quarter 2020. The increased earnings come from increased demand for oil and gas and the best ever contribution to earnings from its chemical and lubricants division. Oil production was at 3.6 billion gallons per day which is down 2% from second quarter 2020 production (ExxonMobil, press release, July 30, 2021). In the past five years, ExxonMobil's stock price has gone from a high of \$90.26 on December 1, 2016 to a low of \$32.62 on October 1, 2020 and in October 2021 is trading at \$62.13 (YahooFinance.com, October 8, 2021).

Engine #1 and a Proxy Battle

During the Fall of 2020, Engine #1, an activist hedge fund with just .02% ownership in ExxonMobil stock, kicked off a proxy campaign to install “new board members with relevant industry experience” needed to “drive transparency and create the accountability needed for long-term value creation for all ExxonMobil shareholders” (Engine #1 , 2021). Engine #1 cited

ExxonMobil's 50% decrease in market capitalization and its 3-, 5- and 10- year (pre-Covid) underperformance relative to its industry peers as partial rationale for its action. The activist group also laid claim to a lack of a credible strategy to "create value in a decarbonizing world" as further justification for its proxy campaign.

In early 2021 Engine #1 began to interview potential board candidates as it sought to refresh the board with what it considered to be more experienced and better qualified independent directors. The group also called for 1) greater discipline in long-term capital allocation; 2) a more significant investment in clean energy; and 3) a strategic plan for sustainable value creation. Engine #1 further called into question ExxonMobil's management compensation as the company's market capitalization and profitability continued to decline relative to both its closest competitors and energy industry benchmarks.

On March 16, 2021, ExxonMobil's management team filed its own definitive proxy and issued a shareholder letter urging them to vote for the company's 12 nominees for board Positions. In a press release CEO Darren Woods cited the need to have experienced directors who lead "some of world's largest, most complex and successful companies and bring to the board a wide range of backgrounds, knowledge and skills relevant to ExxonMobil's business and future success" (ExxonMobil, 2021). The proxy fight came to an end during the May 26th shareholders meeting when large institutional investors that included Blackrock, Vanguard and CalPERS joined Engine #1 and cast their votes in to support of three of the four candidates that were put forth by activist group. Engine #1 was successful in installing what it considered to be independent and experienced directors.

ExxonMobil's official stance on climate change came in 2014, well after its competitors had announced their respective positions and subsequently began to diversify into renewables. In

the lead up to their announcement the company began to scale back its lobbying efforts and financial support of organizations that call into question the human causes of global warming. While ExxonMobil does currently claim to be the industry leader in carbon capture it was their comparatively slower response to concern for the environment that prompted action on the part of Engine#1 and the activist group was quick to point towards its influence over the management at Exxon Mobil when the company announced emission intensity reduction targets (December 14, 2020) and the formation of a Low Carbon Solutions Business Segment (February 2, 2021).

U.S. OIL DRILLING AND GAS EXTRACTION & PETROLEUM REFINING INDUSTRIES

ExxonMobil is considered to be primarily in the Oil Drilling/Gas Extraction and Petroleum Refining industries. The U.S. Oil Drilling & Gas Extraction industry revenues grew 2.3% between 2016 and 2021 and is expected to grow 2.6% through 2026 to a total of \$372.7 billion. Crude oil (petroleum) is used in many consumer products such as gasoline, diesel, kerosene and plastics. Natural gas is primarily used to generate electricity. Oil and gas prices are highly volatile due to constant changes in demand and supply in the world market. Oil and gas industries are influenced by OPEC production, vehicle miles driven, new technologies, and regulations. Hydraulic fracturing and horizontal drilling techniques have allowed industry operators to better reach marginal deposits. Legislation in 2015 allowed US companies to export oil which encouraged US producers to increase oil extraction. Passage of USMCA encouraged trade among the U.S., Mexico, and Canada with new pipelines built and fields being explored. Although OPEC+ (Organization of Petroleum Exporting Countries Plus) countries still produce a majority of the world's petroleum, the U.S. is decreasing reliance on foreign oil and became a net exporter of oil

and gas in 2019. Emerging countries continue to require greater amounts of petroleum-based products as they build infrastructure and as consumers use greater amounts of oil. Alternative sources of energy such as biofuels, solar, wind, and other renewable energies are in a growth stage and pose a substantial threat to the use of oil and gas (Ross, 2021).

The related petroleum refining industry experienced 6.3% revenue growth between 2016 and 2021 and is expected to see a 1.2% revenue growth through 2026 for a total of \$610.1 billion. During the pandemic with more consumers staying home there has been a weaker global demand for industry products creating over supply and decreased profits. However, growth in China and its increasing GDP is indicating an increased demand for oil. Recently, the U.S. has been a net importer of petroleum products and it is estimated that imports will satisfy 10.5% of domestic demand in 2021. This industry is subjected to numerous regulations. Most notably environmental regulations will limit new refinery development. Costs of renewable fuel mandates will be passed to consumers. Expectations for more fuel-efficient vehicles may limit increased revenues – the EPA requires vehicles produced after 2016 to have a minimum fuel efficiency of 35.5 miles per gallon. The Energy Independence and Security Act mandates the advanced fuel use to increase to 21.0 billion gallons by 2022 and 36.0 billion gallons by 2026. Main products of the petroleum refining industry include gasoline, diesel, jet fuel, and liquefied petroleum gases. Gasoline contributes 49.8% of industry revenue. Diesel is mainly used in heavy industry and shipping although it is widely used in Europe for passenger cars. Car manufacturers may reintroduce diesel cars in order to meet fuel economy standards. Diesel generates 21.8% of industry revenue. Jet fuel consumption has declined in recent years due to the pandemic and it accounts for 7.4% of industry revenue. Liquefied petroleum gases are used for heating. Due to increased worldwide temperature increases, demand for LPG has decreased. Liquefied petroleum gas accounts for 9.8%

of industry revenue. With the lifting of the ban of US crude oil exports, exports have increased and account for 12.2% of industry revenue. (Rodriguez, 2021).

The four largest companies in the oil/gas extraction industry have a combined market share of 22% of oil drilling/gas extraction. In 2021 there is a total of 47,552 companies in the industry. Larger companies are fully integrated and operate in all phases of the oil and gas industry that includes drilling, production, transporting, refining, marketing, and retailing oil and gas products.

Chevron Corp:

Chevron has a presence in both industries with a 6.7% market share in oil and gas extraction and 8% market share in Petroleum refining. The company was founded in 1911 after the breakup of Standard Oil Co. Inc. The Chevron name was adopted in 1984. Texaco Inc. was acquired in 2001. In 2020 the company employed 47,736 workers globally and reported \$94.7 billion in total revenue. Extraction facilities in the Gulf of Mexico, California, and Texas account for 75% of its US oil production and 50% of its natural gas production. The company controls 5 US refineries with a production capacity of 900,000 barrels per day. From 2016-2021 the company focused on increasing international investments. In 2020, 79.4% of the company's oil refining capacity is based in the U.S. (Rodriguez, 2021; Ross, 2021).

ConocoPhillips Co.

The company was formed in 2002 when Conoco Inc. and Phillips Petroleum Company merged. With exploration and production facilities in 17 countries, it maintains a 5.9% market share in the oil and gas extraction industry. U.S. operations contribute 64% of the global liquids production. In 2020 the company earned \$19.3 billion in total revenue and employed 9,700 workers. Phillips 66 Company maintains a 6.5% market share in the petroleum refining industry and earned \$64.1 billion in total revenue in 2020. Phillips 66 has 13 refineries, production capacity

of 2.1 million barrels per day and controls 2,000 miles of pipeline in the U.S. In 2021, approximately 87.3% of the company's total refining capacity is based in the U.S. (Rodriguez, 2021; Ross, 2021).

ExxonMobil Corporation

ExxonMobil has a 5.8% market share in the oil and gas extraction industry. The company was formed in 1999 when Exxon Corp and Mobil Corp. merged. Extraction properties in the US account for 34.3% of the company's total oil production and 55.8% of its gas production in 2020. In 2020 the company earned \$181.5 billion in revenue and employed 72,000 workers. Exxon Mobil has 8.8% market share in the petroleum refining industry. The company has 21 refineries around the world with capacity of 4.8 million barrels per day. Its US facilities account for 36.8% of the company's total refinery throughput (Rodriguez, 2021; Ross, 2021).

BP PLC

BP is headquartered in London. It merged with Amoco Corporation in 1998 and acquired Atlantic Richfield Company in 2002. Most of BP's directly controlled oil reserves are located in the United States with revenue of extraction accounting for 19% of the total company revenue in 2020. BP employed 63,600 workers and earned \$180.4 billion in total revenue in 2020. BP PLC maintains 6.8% market share in the petroleum refining industry and owns 10 refineries worldwide. The company experienced a massive oil leak at its Deepwater Horizon site in the Gulf of Mexico, the largest off-shore oil spill in US history. An explosion killed 11 platform workers and injured 17. In 2014, BP PLC reached an agreement with the US Environmental Protection Agency that allowed the company to conduct business in the US again. Due to this incident, BP downsized its US refining operations (Rodriguez, 2021; Ross, 2021).

CONCLUSION

Exxon Mobil Corporation continues its growth strategies to improve revenues. Recent actions to improve its environmental impact include signing MOUs to participate in carbon capture and storage projects in Scotland and France. The company has also expanded its agreement with Global Clean Energy to purchase 5 million barrels of renewable diesel with commercial production beginning in 2022. This is part of the company's commitment to produce low-emission biofuels (Exxon Mobil, press release, July 30, 2021).

The Board of Directors, with new external members, needs to evaluate the future of Exxon Mobil and what actions should be taken to address Energy #1 issues along with pressures and changes in the macro environment.

TEACHING NOTE

Case Overview

Exxon Mobil is a fully vertically integrated company that focuses on deep water extraction of oil and liquid natural gas. It also uses hydraulic fracking and horizontal drilling to extract oil and gas. The company refines the extracted oil and sells gas at about 20,000 retail outlets. The company produces lubricants along with petrochemical feedstocks used in medical equipment, electronics, clothing, vitamin capsules, tires and other products. Exxon Mobil reported a net loss at the end of second quarter 2020, but by second quarter end 2021 reported an increase in earnings.

Engine #1, with a .02% ownership interest, demanded increased transparency of company operations and long-term value creation. Engine #1 interviewed and proposed 4 new, external members to the Board of Directors. Three of their 4 candidates were voted onto the Board.

The Oil & Gas extracting industry is expected to see a 2.6% growth through 2026 and the petroleum refining industry is expected to see a 1.2% revenue growth through 2026. The industries are experiencing greater pressure from legislation and policies to improve gas efficiencies in automobiles and environmental regulations, along with increased demand for oil/gas in developing countries, increasing US reliance on foreign oil, and competition from renewable energy sources. Major companies in these two industries include Exxon Mobile, Chevron, Conoco-Phillips, and BP.

Suggested Use of the Case:

This case provides a good example of shareholder activism, changes in the macro environment, decreasing dependence on oil/gas products, and vertical integration. Suggested courses that would use the case include Strategic Management and Corporate Governance.

Learning Objectives:

1. Analyze the pros and cons of implementing a vertical integration strategy.
2. Evaluate the effects of shareholder activism and external influencers on company decisions.
3. Analyze the macroenvironment.

Suggested Assignment Questions:

1. Evaluate the Oil/Gas industry macroenvironment. How might changes influence Exxon Mobil's Directors' decisions and future company actions.
2. Governance and trends toward Shareholder activism. Was ExxonMobil right to proxy for its own board candidates? Have we in fact entered a new era whereas a well-organized coalition can truly exert its power and vote out board members that some would consider to be insiders? What are other possible external influencers?
3. What are the pitfalls and benefits of implementing a related diversification strategy that includes full vertical integration?
4. The oil/gas industry is a common target of criticisms. What are some of these criticisms? Are they justified?
5. What recommendations would you suggest to the executives and board of directors of Exxon Mobil.

Answers to Suggested Assignment Questions:

1. Evaluate the Oil/Gas industry macroenvironment. How might changes influence Exxon Mobil's Directors' decisions and future company actions.

Social Trends:

- During the pandemic more employees worked remotely. This option is expected to continue as businesses revert to post-pandemic operations. This will decrease demand for gas with fewer commuters.
- Citizens are concerned about clean energy, emissions.
- As air travel increases, demand for jet fuel will increase.
- Consumers expect environmental friendly products.

Legal/Political:

- The US became energy independent in recent years. Policy changes have decreased federal land available for extraction activities; suspension of the Keystone pipeline has affected US production; changing local/state laws affecting fracking and hydraulic drilling has decreased extraction activities. The US has increased its dependence on foreign oil.
- Increased auto emission expectations and decreasing gas consumption.
- Renewable energy mandates
- Biofuel use will increase to meet Energy Independence and Security Act requirements.
- EU tax policies favoring diesel fuel.

Global:

- Growth in Chinese GDP will increase oil demand
- Changes in amounts of products shipped affects demand for diesel fuel.

Economics:

- Increasing wealth/income of consumers in developing countries will increase demand of oil, gas, and petrochemical products used in consumer products.

2. Governance and trends toward Shareholder activism. Was ExxonMobil right to proxy for its own board candidates? Have we in fact entered a new era whereas a well-organized coalition can truly exert its power and vote out board members that some would consider to be insiders? What are other possible external influencers?

Dess, et.al defines shareholder activism as “actions by shareholders to protect their interests when they feel that managerial actions of a corporation diverge from shareholder value maximization” (pg. 283). This is reflective of the concerns of Engine #1 who offered a solution to perceived poor management decisions by finding and supporting external candidates for the Board. Dess et.al. note a growing trend in activist investors.

Opinions may vary on Exxon Mobil’s actions, however the current board and company executives are acting within their rights to support board members during the voting process.

Other external control mechanisms include: shareholders selling shares, auditors and their analysis and reports of a public company’s financial records, banks when they analyze a company’s ability to repay loans, financial and investment analysts who make buy/sell/hold recommendations, government regulatory agencies, and media reports on a company’s actions that may influence public perception (Dess, et.al, 2021).

3. What are the pitfalls and benefits of implementing a related diversification strategy that includes full vertical integration?

The largest companies in the oil/gas extraction and oil production industries are fully vertically integrated. Exxon Mobil extracts oil/gas from shale, land basins, and deep-sea sources. The oil is sent to company-owned refineries and the gas is sold in gas stations around the world. Implementing a related diversification strategy allows Exxon Mobil to gain synergies across its operations as it provides a major input (oil/gas) to the refineries and then provides inputs (gas/diesel) to its gas stations. This helps the company with control of inputs and decreased prices and transaction costs as product moves from one company division to another. Management knowledge of the spectrum of activities will help executives in finding efficiencies throughout the organizational processes.

Risks may be present if demand for all products of the industry decrease. Exxon Mobil is completely invested in all phases of the oil/gas which may adversely affect long term earnings.

4. The oil/gas industry is a common target of criticisms. What are some of these criticisms? Are they justified?

Criticisms may include emissions, disrupting communities and citizen health with fracking activities near schools and neighborhoods, etc.

Answers about justification may vary. The media and regulating bodies may focus more on the emissions and health concerns and students may not be aware of the number of products used every day that use oil.

A partial list of products include: plastics (and any product made of plastic – autos, electronics, household items, skis, etc.), ink, clothes, drapes, vitamin capsules, mops, denture adhesives, shampoo, antifreeze, heart valves, dentures, cosmetics (cold creams, lotions), medicines (antihistamines, cortisone, antiseptics, aspirin), crayons, car enamel, movie film, insect repellent, deodorant, fertilizer, parachutes, artificial limbs, soft contact lenses, toothpaste, shaving cream, insecticides, perfume, and many other everyday items.

5. What recommendations would you suggest to the executives and board of directors of Exxon Mobil.

Suggestions will be varied. Some possible responses may include:

- Positive media/advertising/messaging about the products for which oil is necessary
- Marketing the positive actions taken to address environmental concerns
- Consider diversifying out of the oil/gas related industries – however this needs to take into consider management expertise

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