The Strategy Trilemma

Assessing oil and gas transition strategies through the Capital Allocation Triangle

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- Oil and gas companies' response to the energy transition needs to be assessed across all three uses of capital: core investment, diversification and returns to shareholders.
- bp's allocation is now more heavily weighted towards core investment than ExxonMobil's, following its strategy reset. Does bp have access to sufficient investment opportunities to maintain its 2026 guidance into 2027, or will it change course again?
- Variability in position on the Capital Allocation Triangle may be a leading indicator of changes in market valuation, with increasing variability potentially preceding declining valuation multiples.
- Relative capital allocation provides a consistency check on management's stated view of the future and the assumptions embedded within valuation models, including commodity prices, terminal values and asset lives.
- Comparing the level of renewables investment with core oil and gas investment is a poor measure of transition strategy, potentially under-reflecting the value of pursuing a capital return strategy.

The electrification of the energy system presents a structural challenge to the oil and gas industry through increasing demand substitution. Unlike policy-driven transition risks, which primarily affect the conditions under which products are produced, this challenge requires management to decide how much to continue investing in core businesses and how to allocate remaining capital between diversifying into new businesses and returning capital to shareholders.

This note introduces the Capital Allocation Triangle, a framework for considering the three-dimensional nature of this decision space, and uses it to compare the strategies of three leading oil and gas companies, including the consistency of individual companies' actions over time.

Investor and societal pressure drove divergent transition strategies

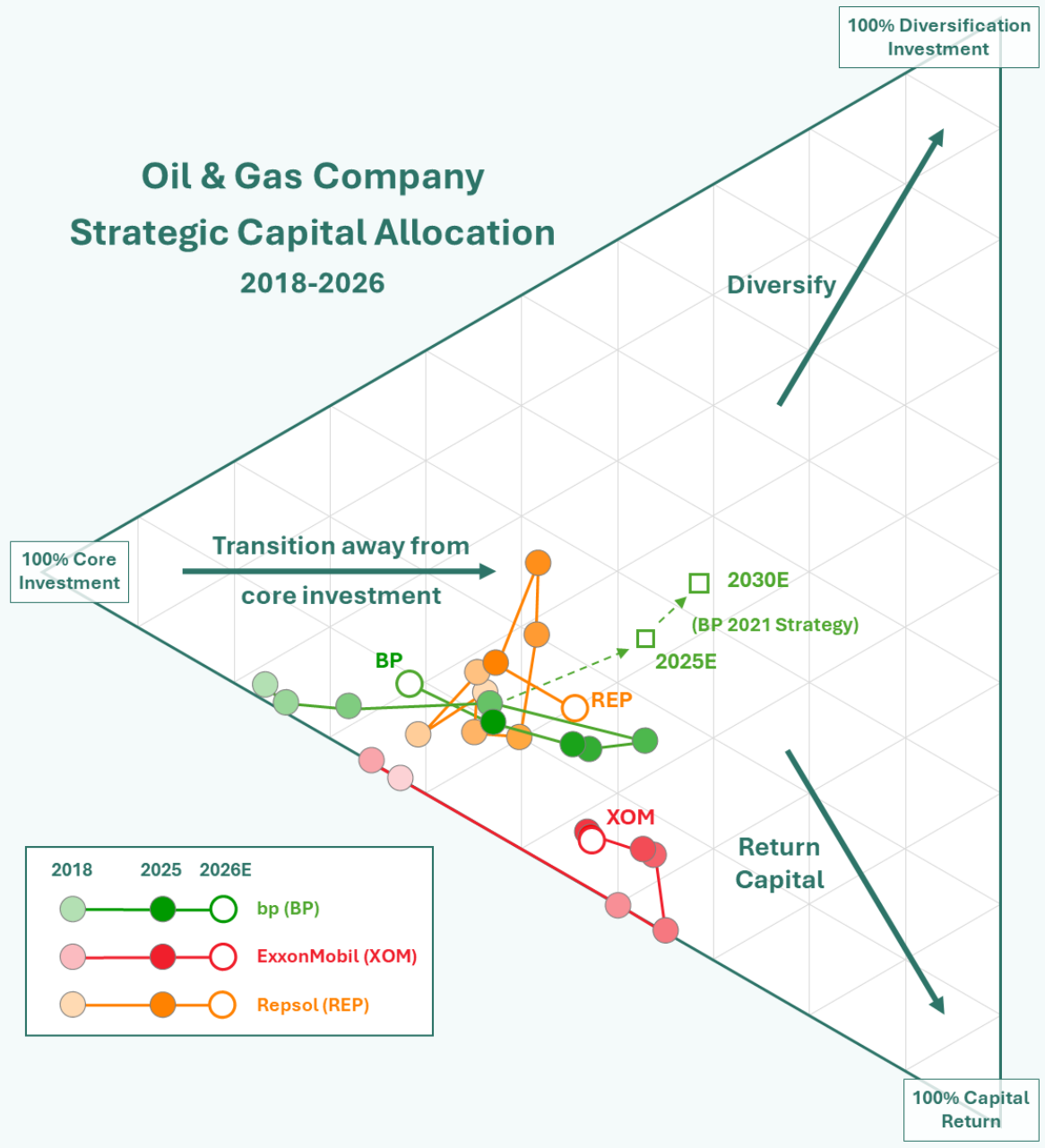
From 2018 to 2020, oil and gas companies felt increasing investor pressure to pivot strategy and reduce their climate impact, with the implication, particularly in Europe, that they "should" become renewable energy providers. In response, companies indicated a range of differentiated strategies, primarily in the extent to which they intended to diversify into renewables and other low-carbon business activities.

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Many investors used relative capital allocation between the two to assess companies' preparedness for the transition and the degree to which their business model could be considered "Paris-aligned". Yet, such measures excluded the third use of capital: returning it to shareholders. Considering any individual allocation measure, or ratio between two measures, can obscure materially different strategic choices.

The Capital Allocation Triangle brings these choices together in a single framework in a ternary plot. Figure 1 applies this to bp, Repsol and ExxonMobil since 2018.

Figure 1: Strategic capital allocation for selected oil and gas companies



Sources: Company disclosures including Financial Statements, accompanying notes, Management Reports and Capital Markets Day presentations.

Notes: E = estimated, based on company guidance where available.

Upstream players returning capital despite investment rhetoric

The trajectories show how individual companies have pursued markedly differentiated capital allocation strategies in response to the energy transition, the changing geopolitical landscape and evolving investor sentiment.[1] They also show that diversification is not the only alternative to continued investment in core businesses; increasing capital returns to shareholders is a valid strategic response, rather than evidence of a failure to transition. The three companies shown have collectively shifted significantly away from investment in core hydrocarbon businesses over the period, notwithstanding recent corporate messaging emphasising hydrocarbon production growth amid a retrenchment from diversification.

ExxonMobil significantly increased its share of capital returned in 2020 to 60%. Its all-share acquisition of Pioneer Natural Resources in May 2024 was accompanied by a further increase of $2.5 billion in annual buy-backs; we classify this as core investment,[2] lowering overall shareholder distributions slightly. Yet capital returns remain well in excess of pre-Covid levels, demonstrating that ExxonMobil's strategy has pivoted materially despite low diversification spend relative to core investment.[3]

bp's 2020 strategy reset saw it increase capital allocated to diversification. Higher-than-anticipated earnings associated with the energy crisis in 2022 saw shareholder returns increase substantially, before a pivot back towards core oil and gas investment following the market's rejection of its strategy.

bp's 2026 guidance indicates that core investment will return to over 60%, the highest of the three companies shown, primarily at the expense of reduced shareholder distributions which are set to fall below 30%.[4] bp's position has also been the most variable over the period. Will bp pivot again as its debt position improves, or **does it have sufficient investment options for this allocation to remain consistent into 2027?**

Repsol had relatively high diversification spend of 12% in 2018 with this increasing through 2023 and 2024, peaking at over 25%. Repsol then reversed course, reducing diversification to around 15% for 2026 while guiding an increase in capital returns.[5]

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[1] Changes in net debt are excluded because, while a strategic choice, they are primarily financing decisions that influence the quantity of capital available rather than its relative allocation.
[2] ExxonMobil, news releases, https://corporate.exxonmobil.com/news/news-releases/2023/1206_exxonmobil-corporate-plan and https://corporate.exxonmobil.com/news/news-releases/2025/1209-exxonmobil-raises-2030-plan-transformation (both accessed 19 August 2026). As the level of share repurchases that ExxonMobil would have undertaken in 2024 and 2025 absent the Pioneer acquisition is unknown, the 2023 value is used for 2024, 2025 and 2026 guidance.
[3] ExxonMobil, Annual Reports and Corporate Plan, https://investor.exxonmobil.com/company-information/press-releases/detail/1134/exxonmobil-announces-corporate-plan (accessed 01 September 2026).
[4] bp, Capital Markets Update, February 2025.
[5] Repsol, Presentation Capital Markets Day 2026-2028, March 2026.

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Relative allocation adds context to conventional investment analysis

The framework complements analysis of project options, future cash flows and sensitivity to commodity prices by providing a common basis for comparing strategic capital allocation. Variation in the relative allocation across the three broad uses indicates the consistency of management decision-making, allowing investors to assess whether capital deployed is aligned with stated strategy as well as their own sectoral analysis. By considering the three allocations simultaneously, the Triangle may reveal information not captured by any single capital allocation measure or ratio.[6]

Where attractive reinvestment opportunities are limited, investors must accept that companies may become smaller over time (even if delayed through industry consolidation). Getting smaller should not necessarily be viewed as corporate failure. Investors must also ensure that management incentives and engagement priorities do not penalise the pursuit of an orderly contraction where attractive investment opportunities are limited.

Variability in positioning may be a leading indicator of valuation changes

The relationship between strategic positioning, market valuation and shareholder returns is an important area for further analysis. One hypothesis is that variability in positioning within the Triangle may provide a stronger leading indicator of valuation changes than conventional measures: increased variability may precede declining valuation multiples, while increasing stability in position or trajectory may precede upward re-ratings.

Relative capital allocation may also offer insight into management's expectations of the pace of the energy transition. Investors should therefore compare the commodity price assumptions implicit within management projections with those implied by strategic capital allocations. These expectations may also inform the inputs to intrinsic value models including commodity prices, asset terminal values and the timing of decommissioning liability recognition.

Investors with differing objectives can apply the same framework

The Capital Allocation Triangle is intentionally agnostic as to investors' ultimate objectives. Those with different investment goals and time horizons may legitimately differ in the extent to which they prioritise company-level financial performance versus portfolio-wide outcomes. Consequently, they may also prefer different capital allocation strategies and engagement priorities. Regardless of those preferences, the Triangle provides a common basis for analysing management's capital allocation decisions in the context of the energy transition.

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[6] This framework can also be applied to other sub-industries (e.g. E&P, Refiners, Services), and elsewhere where demand is being substituted through technological innovation, for example the coal mining and automotive sectors. It can also be applied at greater levels of granularity to consider the relative allocation within a given broad use case. For example, core investment could be split between maintenance, development of short-cycle resources and investment into new long-cycle projects.

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Relative allocation provides a valuable basis for assessing corporate transitions

The Capital Allocation Triangle also provides a useful framework for stewardship and sustainability professionals assessing corporate energy and climate transition strategies. Existing approaches often assess corporate responses against normative production decline pathways and sectoral emissions intensity reduction targets.[7] Yet such measures are less suited to assessing transition risk exposure and the quality of management decision-making in sectors such as oil and gas, where transition risks are predominantly technology-driven rather than policy-driven.[8]

In these sectors, value creation depends on whether management is allocating capital rationally under structural demand substitution rather than whether firms are transitioning "to" any particular business model.

Reducing investment in the extraction, conversion and distribution of hydrocarbon fuels and products reduces transition risk exposure, but does not by itself define a company's strategy; management must still reallocate that capital, and diversification may not be in investors' best interests. The Triangle therefore provides a more nuanced basis for assessing corporate transition strategy than predetermined pathways.

[7] For example, the Transition Pathway Initiative (TPI) assesses oil and gas companies' carbon performance using an emissions-intensity measure of CO_2e per J of energy products sold. See Carbon Tracker's *Absolute Impact* series for further discussion.

[8] Oil and gas companies also face policy-related transition risks. Investors must ensure that investments to reduce exposure to such risks, e.g. compliance with methane emissions regulations, are not conflated with genuine diversification investments.

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Notes

The framework focuses on the disclosed and reported strategic allocation of capital by management rather than a strict accounting treatment, and thus there is not necessarily an exact equivalence to line items on relevant cash flow statements.

Core investment is investment directly related to the extraction, processing and transportation of fossil hydrocarbons and derived fuels and products. **Diversification** investment is other business activities, including (but is not limited to) renewable energy generation, investment in electricity grids and the provision of non-fossil hydrocarbon fuels and products. **Capital return** is the sum of dividends paid and share repurchases. Dividends are treated in the year in which they are paid. Investments are calculated on a gross basis, treating proceeds from asset disposals as fungible capital.

Debt repayment is excluded from the ternary plot. While changing the net debt position is a strategic use of cash, it is primarily a financing decision rather than a decision to either invest or return capital to shareholders.

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About Transition Analysis

Transition Analysis produces independent research and analysis on the interaction between structural changes in the energy system, capital allocation, climate-related financial risks, and stewardship and sustainability considerations. Its work draws on previous research and engagement with investors, corporates, policymakers, and other financial market participants to provide practical insights for assessing corporate strategy to support long-term value creation.

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26 October 2026: Layout updated; no changes to the analysis.

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