

Moving from talk to action: Why the Oil & Gas operators that act today will become the energy leaders of the future

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Executive summary

Time is running out on transformation for the Oil & Gas (O&G) industry. In just the past decade, O&G has already undergone significant change – from a “produce and grow” business model to a margin-focused structure that places a high priority on profitability (highest volume output at lowest cost) and differentiates through quality (low energy consumption and significantly reduced emissions). Additional change to operational structure, human capital and public/private partnerships needs to take place if the industry is to follow through on clean energy goals for 2030, 2040 and beyond.

While these pressures are top of mind, several obstacles to progress exist and many organisations have yet to operationalise and execute a future-proofed strategy that can take advantage of new business opportunities while also delivering on stakeholder expectations for decarbonisation and overall transformation. Closing the gap between strategic direction and implementation will be the deciding factor in who thrives and who is left behind in the near future.

A matter of trust

Stakeholder relations for O&G companies are increasingly complex. The industry must now manage the needs and expectations of society, government, consumers, employees and others. Stakeholders demands also hold greater weight than ever before on companies' social license to operate.

Within this context, O&G companies are operating in an era of unprecedented uncertainty. While there is general consensus on the pressing need to decarbonise and make strides towards energy conversion, O&G companies and government agencies expectations are misaligned, leading to a growing atmosphere of confusion and misalignment.

Many O&G companies are now building on their own concepts and pathways, independent of their peers, yet such moves are leading to a lack of collaboration and/or integration. The lack of joined up thinking among peers is also contributing to an overall lack of trust in the industry and suspicion from stakeholders. This lack of trust extends to government as well.

"It is a multi-faceted, multi-stakeholder challenge, and the lack of trust is sadly part of the fabric of the industry.

Uncertainty is the enemy of investment and in this case, it is most definitely a people problem."

Alexandre Oliveira, Director and Co-leader of Partners in Performance's Global O&G Practice

To cite a recent example: the U.K. Government hosted the U.N. Climate Change Conference (COP26). In addition, they commissioned the International Energy Agency to create a plan to achieve net-zero emissions by 2050. The plan included the recommendation to halt fossil fuel investment.

Despite this recommendation and the prominent status hosting the conference brings, the U.K. government stands by their decision to continue to allow exploration in the North Sea, with the only caveat being that those oil companies pledge to reduce emissions.

This example is representative of the inconsistency and misalignment between what is being said by government agencies and what is actually happening on the ground.

Mixed messages run counter to O&G companies' aversion to risk, especially when it comes to new endeavors that are not backed up by decades of experience in the field. In the absence of consistent government policy and a clear directive to commit long term, O&G companies are holding back on their energy transition investment because there is uncertainty around whether or not it will pay off. On top of that, companies are generating a much higher return on their core business. Without a clear indication or mandate to invest in energy transition, companies will naturally serve the needs of shareholders by continuing to invest in the more profitable part of their business.

"There is a lot of uncertainty on what the government position is going to be on a number of issues for the long term. We have a speculative discussion given the politics for each specific region; however, it is extremely important for long-term success of projects targeting the 'hard to abate' emissions.

These matters are beyond the control of the O&G operator and their specific asset base – this presents a very big challenge."

Andrew Gibson, Partner and Co-leader of Partners in Performance's Global Energy Transition Practice

Setting an example

The lack of trust between government and O&G companies stems mainly from a lack of clear evidence that conversion strategies are practical and profitable. Both government agencies and O&G companies are risk adverse and need to demonstrate to their respective stakeholders that funds will be allocated towards projects with a clear path to success. One solution is to seek implementation at the state and municipal level where that path is shorter, results can be realised faster, and fewer parties are needed to reach consensus. Case studies are already in progress throughout the U.S. which can serve as proof-of-concept examples for larger public/private partnerships.

Unintended consequences

This disconnect is also driving less investment in production and capital projects, which is reducing O&G production, and increasing costs for the public. For example, energy consumers in the U.K. face increases of up to 60 percent this year due to the shortage of gas. As the public demands lower-cost energy, governments could be forced to bring back less-expensive coal fired power stations — a truly unintended consequence.

This environment has led to a dichotomy in the O&G industry. Some EU companies are vanguards in terms of energy transition and committing significant resources toward achieving a cleaner model for operations and sourcing. Others have chosen status quo legacy strategies, waiting for a more general consensus to be reached, while laying bets that fossil fuel-based operations will always produce a favourable return.

“Many organisations will, by necessity, become unrecognisable from what they are today.”

Internal challenges

Currently, there is a general lack of organisational awareness around the degree of transformation required to fully align operating models to new strategies and operational imperatives, resulting in a lack of pace and urgency to implement. The extent to which the organisational structure, behaviours and culture will need to be transformed to be successful moving forward will be a massive undertaking — one that should already be underway.

One of the most important examples of this internal transformation is the changing role of human capital, which requires partnership, focus and personal commitment at every level of the organisation. This need frequently runs counter to embedded culture and expectations in the O&G industry itself. Line workers, accustomed to sudden spikes in hiring/layoffs depending on market conditions, do not necessarily embrace the increase in automation, monitoring systems and technology meant to enhance productivity with the implications of further reductions in employment. Securing their participation in transformation, and bringing others in line with corporate strategy, presents one of the most significant hurdles to implementation and success.

Transforming the Oil & Gas business

Amid these obstacles to progress, many O&G companies have not yet established a clear action plan for decarbonisation and energy conversion. Most have set aggressive goals but fail to realise that conversion on this scale comes with a wide array of unexpected variables, from long-term utility contracts, to securing permits on design changes, training an effective workforce and navigating the complexities of an increasingly divided political landscape.

Three core considerations are essential:

1. Managing current asset portfolio

Regional differences in demand-supply dynamics and regulations will drive the need for O&G companies to reassess their current asset portfolio and capital allocations. This drives the need for a more dynamic approach to capital reallocation and investment decisions.

As demand shifts to greener energy solutions, investing in O&G will require innovation and a more “Capex-light” approach: leveraging modular facilities and easy-to-decommission plants, and repurposing existing assets, e.g. turning refineries into carbon utilisation facilities and retail gas stations into charging stations.

Lastly, the successful divestment or exit from legacy assets will also require a credible path to lower emission or transformation.

2. Establishing strategies for new business

The growth of demand for “cleaner energy” solutions presents an opportunity for O&G companies to diversify into new energy businesses.

These businesses and markets act significantly different to traditional O&G businesses – often, they provide lower returns, more repeatable, shorter cycles and direct customer demand. It is important for O&G companies to determine an operational strategy and manage the expectations of their stakeholders accordingly – applying the previous operational strategies will not work.

The good news is that the economics of clean energy is changing. The base cost of wind, solar and battery/electric continues to decrease to the point where decisions made less than five years ago based on cost are no longer relevant.

To operationalise these new energy business opportunities, O&G companies will need to have an understanding of how the business will integrate with the existing core business and organisational model (e.g. should the new business be a separate entity with tailored financial performance metrics or be rolled into the existing organisation? Will the new business be used to “vertically” integrate energy for existing core business or as an entry into new markets?).

An operating model that fully aligns with the expectations of the new business and fosters innovation must be established and supported by organisational culture and behaviour of action, performance and continuous improvement.

3. Improving existing operations

Companies that wish to adapt and thrive need a clear, credible and compelling roadmap that they can measure against. Outcomes should be short-term and contain immediate questions for all to answer, such as:

- How can we accelerate decarbonisation of activities (including methane leaks and gas flaring) to meet emissions goals?
- How can we create a lighter, less permanent footprint that is easy to install and remove?
- Which technologies will support our goals and when can they be implemented?

Effectively responding to these questions requires a navigable roadmap that can be practically implemented and aligned with internal processes will enable successful execution.

Conclusion

O&G companies are at a crossroads. The interplay between stakeholders, government, society and employees is driving a lack of alignment and trust that is clouding the path forward. However, expectations for O&G companies have and will continue to change significantly. Intense pressure to reduce the industry's carbon footprint will only increase.

It is essential to understand that, while O&G companies debate internally on how they should participate in the energy conversion story, factors affecting this equation are changing faster than the industry's ability to act. The economics of change have evolved to the point where nearly 60 percent of all decarbonisation efforts are net positive. Conversion measures have also advanced such that even small, individual initiatives can make a significant impact. An army of workers is no longer necessary to make progress.

While each O&G company's journey will differ based on their global footprint, regional conditions, prevailing local legislation and regulation, every organisation should be evaluating their core business model and exploring the possibilities of 'new energy'.

While it will be a challenging road ahead, this is a unique opportunity for companies to redefine who they are and how they plan to diversify. The 'energy companies of the future' will have a roadmap for the future, a plan to operationalise it and measurable progress for others to follow. Those who fail to act now will not survive.

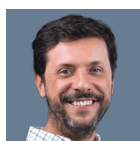
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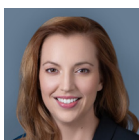
Alexandre's experience within the O&G industry spans more than 40 years, encompassing senior roles across operations, technology and asset management. As a Director within our Global O&G practice, he is focused on continuously improving both asset and people performance.



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