Black gold: The road ahead

Middle East Capital Projects & Infrastructure snapshot

Our Middle East Capital Projects & Infrastructure Survey, 'Building beyond ambition' asked over 130 of our region's most prominent project owners, developers, contractors, advisors and financiers for their views of the market. Here we look at what respondents currently involved and working on oil and gas projects think.

Irrespective of the recent decline in oil prices, the Energy sector remains the economic engine of the six countries of the Gulf Cooperation Council (GCC). Since oil first spurted from a well in Bahrain in 1931, it has been discovered throughout the Gulf and the ways of extracting it, refining it and transporting it have become more and more sophisticated. The best engineers from across the globe relocate to the region to work in some on the most complex, profitable and sophisticated energy projects in the world. That has helped the energy industry in the Middle East grow to such a size that income generated from it accounts for more than 60% of the GCC country's fiscal revenues in 2013, according to the IMF.

Investment levels

The number and value of new projects in the energy sector far surpasses that of any other sector in the region, and that is not likely to change as regional governments invest to boost production and diversify their economies by pushing into downstream industries. There are currently 456 active projects in the oil and gas sector in the Middle East, with a total value of around $540bn, according to data from MEED Projects.

Our survey suggests this could increase further as spending expectations for the next 12 months in the energy sector are higher than in any other sector.

Whilst this survey was carried out prior to the significant drop in oil prices, we have not witnessed any change in regional commitment to spending on major capital projects in the GCC.

This is in contrast to the global industry, which has already announced significant spend reduction and project deferrals. Not surprising as hydrocarbon sector investments in the Middle East are subject to significantly different investment criteria, as many of these mega projects also serve national needs and fuel domestic growth agendas.

Challenges remain

Given the maturity of the industry and its economic importance, it would be wrong to think that the industry is not beset by the same problems which plague the wider construction and infrastructure projects sector in the Middle East. Just like projects in other sectors, energy schemes are affected by delays and cost over runs. They also struggle to attract enough talented people and there is an increasingly significant gap between what is expected of them; and what they are actually able to deliver.

Overcoming these challenges will not be easy, but is essential to expand on the success already achieved in this industry and to ensure that the billions of dollars being spent over the coming years are used efficiently.

The overwhelming majority of the region's hydrocarbon sector mega projects are still financially viable in the $60-$70 oil price range, however the importance of efficiency in the capital allocated and spending incurred will be amplified. As we have seen in such market price cycles before, the region stands to reap significant benefit by working with their contractors and suppliers to optimise costs.

Big spenders

Even as governments around the GCC have increased spending on infrastructure, investment in the oil and gas industry is continuing to exceed other sectors. The survey found that 60% of oil and gas industry participants said that their organisations spent more than $1bn last year. 22% said that spending was more than $5bn. Looking forward, more than three-quarters of respondents said they expect spending to rise in the next 12 months, with over 40 % of respondents saying they expected expenditure would be more than 25 percent higher than last year, compared with only 7 % who expected spending would fall.

Complex and expensive

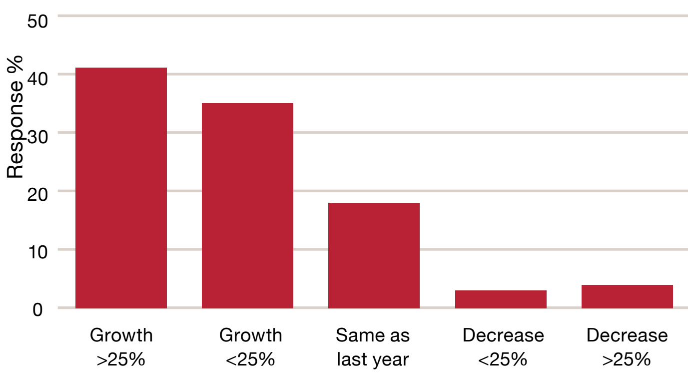
Part of the reason why spending on oil and gas projects is so much higher than spending on projects in other industries is because energy projects tend to be much larger, more complex, and consequently more expensive. Oil and gas projects also outnumber projects in other sectors, even as the region embarks on large scale one-off mega-events like the 2022 FIFA World Cup in Qatar and the Expo 2020 in Dubai.

But worth the investment

The phenomenal amount of spending that still goes into the oil and gas sector in the region is perhaps surprising for what is probably the most mature economic sector in the region, but is a result of two key factors. Firstly, as the main engine of the economy and source of government revenue, investing in maintenance is a key priority, as is expanding production to match rising demand globally. Secondly, regional governments have been trying to push further downstream to capture the full economic benefits of their natural resources. Petrochemicals projects can create jobs and allow more of the products derived from petroleum to be made in the region, rather than shipping off crude oil and natural gas to other parts of the world for someone else to refine, process and resell.

Reflecting the strategic importance of the oil and gas sector, 42% of industry respondents said they do not expect funding issues to constrain spending plans. Looking across all the other sectors in the GCC that level falls to 31%, indicating a much lower confidence in spending plans in other sectors will be funded.

What is your outlook for growth in the next 12 months?



Talent shortage

The shortage of skilled resources is a common feature across the GCC. What is interesting is that even a sector as vital to the regional economy and mature as the energy industry still finds this such a significant problem.

Availability of resources

The percentage of industry participants who cited the availability of skilled resources as a top external challenge, at 46%, is quite high. Worryingly, nearly a fifth of respondents said their internal manpower and resource planning teams were unable to identify the right number and skills of people to meet their needs.

With the recent price movements, we believe that it will be the marginal cost producers and oil sector services companies who will be impacted, and we already see those cutting spending and reducing workforce.

Whilst we may see more people on the market due to a number of firms and contractors reducing their staff, the volume (and core capabilities) of people on the market will still not be on the scale required or what is needed by the GCC market.

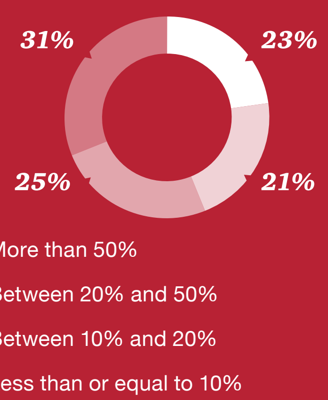
The war for talent

Given the scale of the investment currently underway in the region there is inevitably intra-regional competition for talent. Over 70% of respondents said competition with other countries is the largest threat to attract and retain talent, with 42% specifically saying competition within the MENA region was an issue.

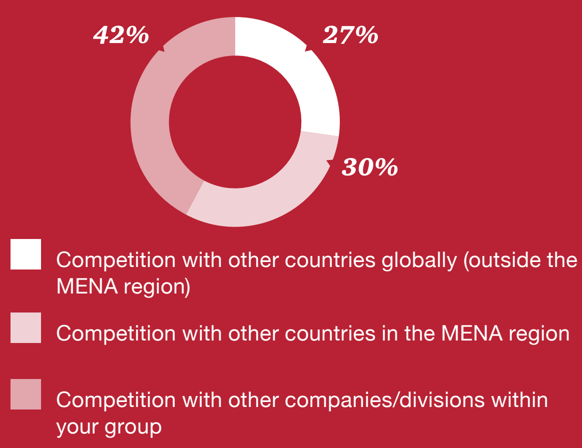
A rethink required

In order to overcome this issue more attention will need to be placed on a broader suite of benefits to attract and retain talented people. Over half of respondents said compensation and benefits were the most important things to attract talent, however, 30% said career progression was important. This to us marks a shift, where compensation alone is not enough to attract the right people. As the region develops and becomes a more attractive place for expatriate workers to live and raise their families, efforts have to be made to create opportunities that offer career progression and longer-term prospects. Developing people frameworks to create a long-term career path is essential to attract and retain both expatriate and increasingly important, national talent.

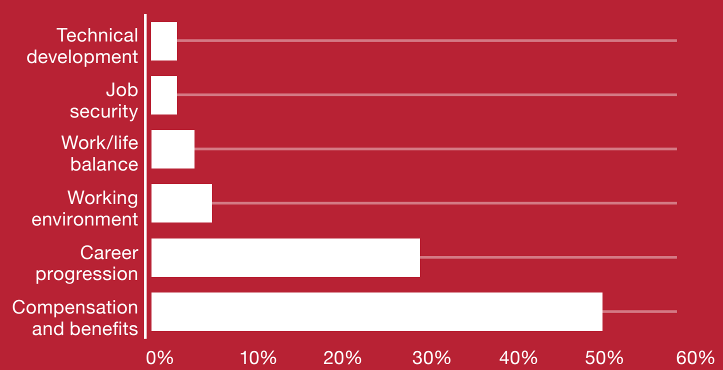
When dealing with technically complex developments, what percentage of specialist technical resources required for project delivery does the organisation hire from outside the region?



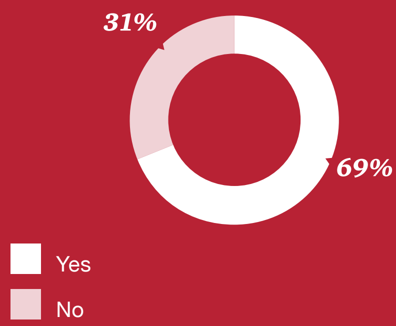
What do you consider the largest threat to attracting and retaining talent?



What do you consider the most important factor in attracting/ retaining talent?



Is your organisation able to on-board resources in time to meet the needs of its projects?



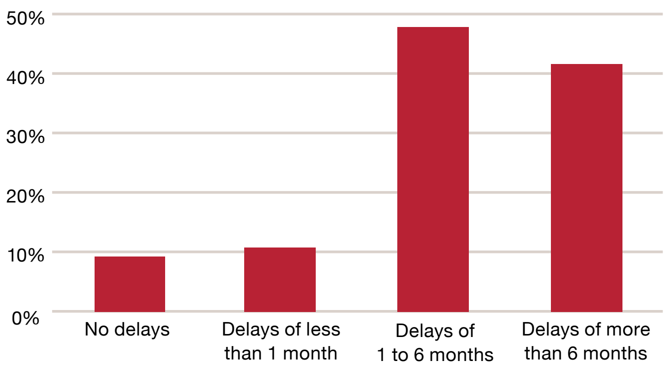
Implementation challenge

The most significant problem the industry faces is trying to meet the demands that are being placed upon it. Even after successfully developing some of the largest and most complex engineering feats in the oil and gas sector, there are still major short-comings in the ability of the industry in the Middle East to execute projects on time and on budget.

Delayed and over budget

According to our survey, 92% of oil and gas projects are delayed with 38% behind for more than six months. Coupled with this 70% of projects are over budget, including 9% that are more than 50% above their original cost estimates. The top two reasons cited by respondents are poor planning, with inadequate project scope at the outset, and scope changes during development.

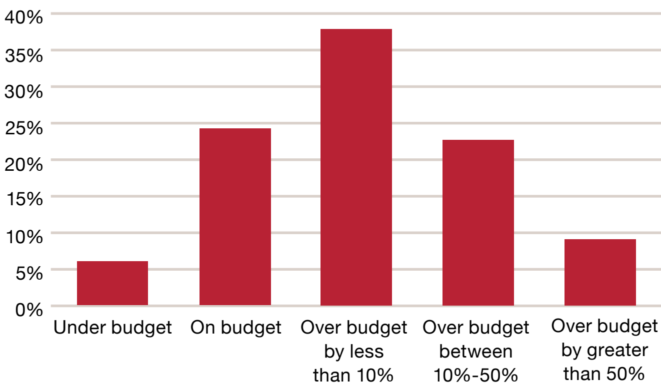
On average, to what extent have capital projects in your portfolio experienced delays in the past 12 months?



Not what you do, it's the way that you do it

Addressing these issues will require a systemic shift in the way the industry operates. Too often budgets are set in a vacuum away from the operational side of oil and gas companies – those responsible for delivery – whom discover too late in the planning cycle that the demands being placed on them exceed their ability to implement them. They don't get the chance to articulate core structural challenges in advance of the planning cycle. This leaves some organisations unable to spend even half of the budget allocated to them. So, a lack of planning coordination and integration leads to delays, claims and an inability to deploy capital effectively.

On average, to what extent have your capital projects experienced cost variances in the past 12 months?



The power in few hands

Part of this stems also from the concentration of power in client bodies. Because there is little delegation of authority, around decision making but particularly around the authorisation of spending, bottlenecks can quickly occur. In the oil and gas sector, where projects often cost several billion dollars to develop, senior figures can be inundated with cheques to sign because only a handful of people can authorise any spending over a few million dollars.

Information gulf

Finally, because the industry outsources so much of its project delivery to contractors and appoints external consultants to manage them, client bodies are often too distant from the development of their own projects. Different working styles and interpretations of scope can often weigh down projects and lead to delays, all of which impacts the bottom line and ultimately productivity and energy supply.

It is evident that there will be an increased focus on the timely completion of projects as the cost and technical complexity of extraction increases relative to the price of oil. Effective management of large projects will become increasingly challenging as reserves and recovery factors reduce whilst the need to attract and retain industry experts only becomes more acute. PwC Middle East's capital projects team have deep oil and gas experience and work with organisations daily to resolve challenges such as these at all stages in the lifecycle of major projects and programmes.

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