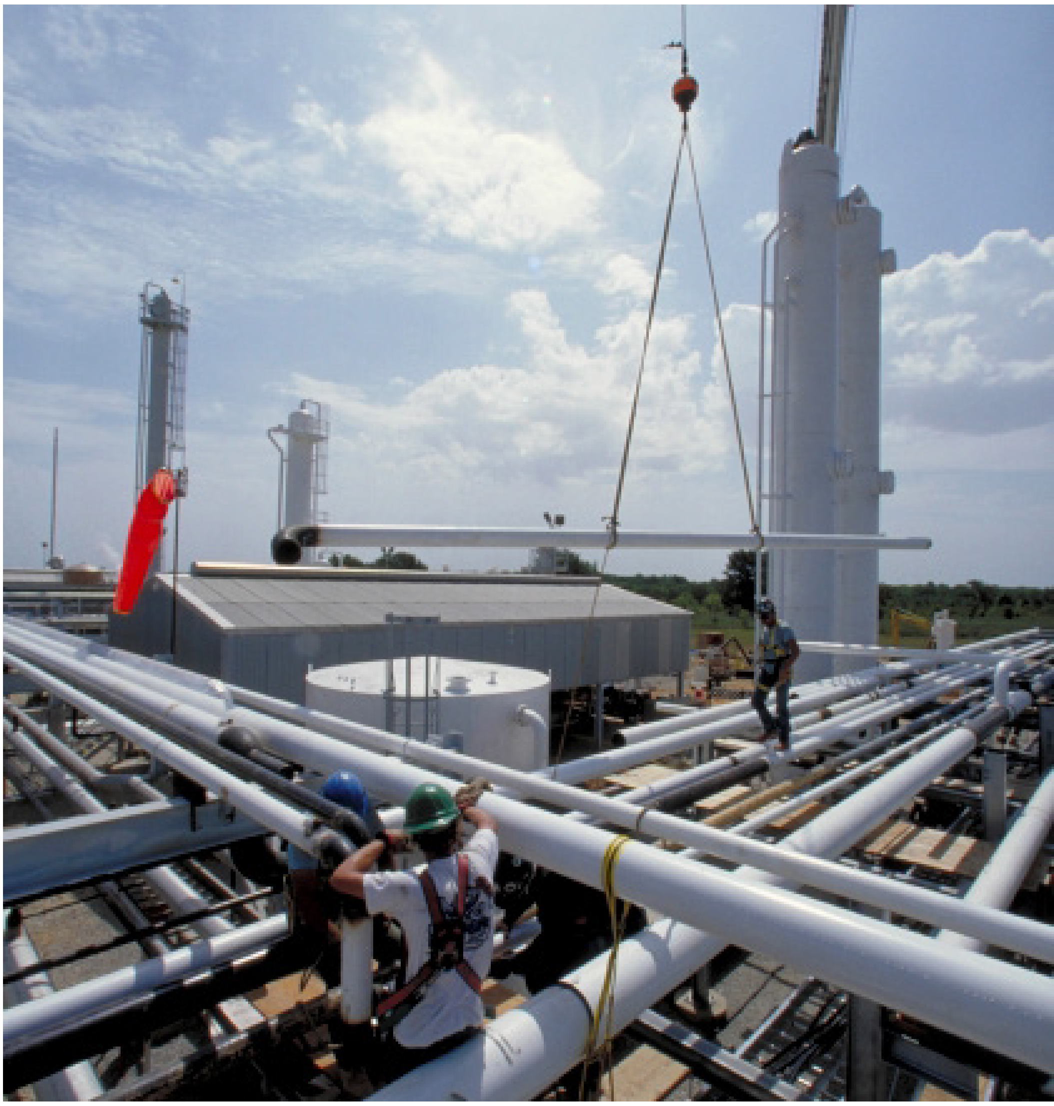
Being on the winning side of the equation

Operational strategies for success in a tough Oil & Gas market



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Some companies have demonstrated resilience in the face of declining oil prices; others have suffered significant margin deterioration.

Three operational strategies can make a big difference in managing and maintaining margins during tough economic times.

01 *Maximise your use of customer demand forecast and on-hand supplies data to help you get better pricing from suppliers and reduce wasteful spending*

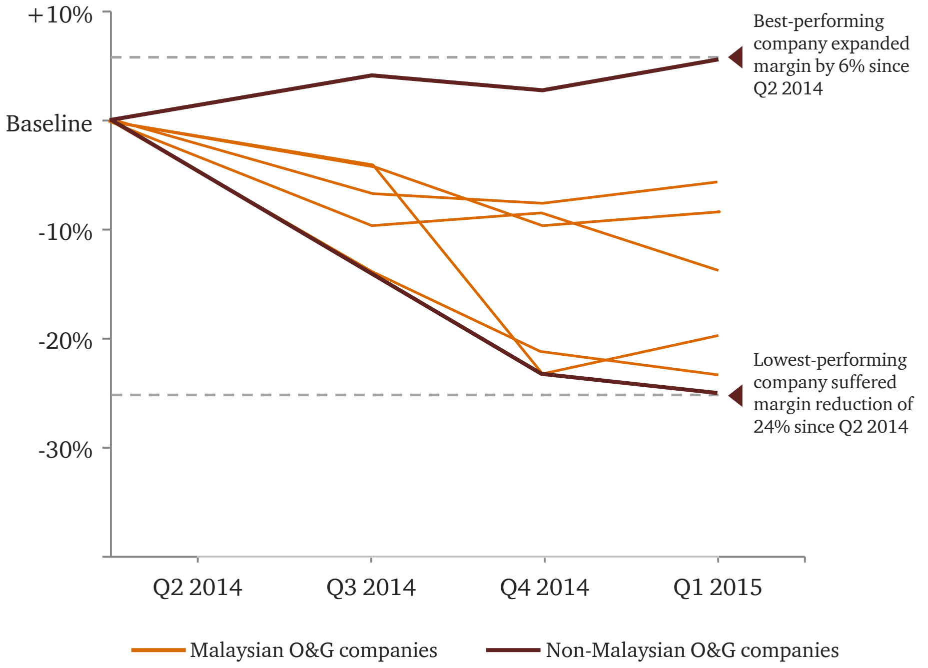
02 *Review your procurement data quantitatively so that you can buy at the lowest prices possible and realise the benefits of contracts you've negotiated*

03 *Involve teams from across departments; recognise their cooperation in order to maximise cost reduction and improve performance*

The drop in the price of crude oil puts the profit margins of all Oil & Gas value chain companies under pressure. But the reduced amount of profit flowing through the oil industry has not led to a proportional reduction in the profit margins of all participants in the value chain—some companies have won by maintaining or increasing their share of industry profits, while others have lost.

A PwC analysis of the margins of publicly listed Oil & Gas companies around the world since the second quarter of 2014 shows that while some companies—including some in Malaysia—have lost by suffering cumulative margin erosions of more than 20%, others have won by expanding their margins since the price of oil began dropping.

Cumulative gross margin % of publicly listed Oil & Gas companies indexed to Q2 2014



Source: Quarterly financial reports of publicly listed O&G companies

There are operational strategies that companies in the oil industry can pursue to increase the likelihood that they come out on the winning side of the profit equation. All of them are associated with aspects of management that on the surface will likely seem familiar—strong business information management, sound procurement practices, and the importance of collaboration. But each of the strategies have operational nuances that are specific to the present state of oil economics and the overall industry, and could therefore be easily overlooked or missed in a general review of a company's operations.

Take this opportunity to assess how your company is applying these strategies and the associated operational nuances in order to maintain profit margins in a challenging market. This will enable your company to be on the winning side of the profit equation.

Understandably, you may be concerned about your company's ability to thrive in this tough market. These operational strategies may serve as a good starting point for you to rethink what value means to you and your customers in this competitive environment.

Strategy #1:
Maximise your use of demand and supply information

Oil & Gas companies depend on their ability to focus on execution and deliver quality in the field safely—at the rig, in the yard, doing whatever it takes to get the job done. Field operations managers are highly empowered to make things happen, which often involves the procurement of equipment and materials and ensuring their timely delivery. But because many organisations fail to coordinate and share information regarding what their customers need, and what assets they have, purchases made to support local operations in the field are often duplicative or executed less efficiently than they should be.

Benefits of improved visibility to your demand and supply

- *Better purchasing economics from volume pooling*
- *Reduction in redundant capital expenditure*
- *More accurate forecasting of future performance*

Our experience with a major Oil & Gas services client demonstrated that better regional planning of assets based on usage volumes, customer demand forecasts, and logistics lead times makes a real economic difference. Our work with the client in the first year reduced inventories by more than 20%, enabled capex avoidance totalling 50% of previous annual levels, and resulted in more than 5% of overall P&L cost reductions.

In our experience, the problem isn't usually misbehaviour on the part of field operations personnel—it's because of the tendency for different departments to function in silos. For example, a field manager without visibility to equipment or tools that may be available elsewhere within her company's network will understandably over-order from suppliers to ensure that her customer or project is adequately supplied. A strategic procurement specialist without visibility to demand across multiple rigs will have no way of knowing what purchases could be potentially combined to get better overall pricing. Or, worst of all, without a shared view of demand and supply, companies won't know how their business is performing until it's too late, as the dust settles from processing invoices and paying out cash.

These problems can be fixed. Poor master data, long lead times, and demand forecasts that change unpredictably are each challenges. What you need likely will involve information technology, but it will not necessarily require the height of analytical or technical sophistication.

The questions that really matter are these:

- Can we see what we're expected to deliver in the future and when?
- Can we see what assets we've got on hand, and which are on the way?
- Are people in multiple geographies updating and using the data regularly?

If your answer today to any of these questions is a "no" or an uncertain "maybe"—then you've just found one variable to leverage more strongly to land on the winning side of the profit equation.

Strategy #2:
Procure strategically by the numbers

The capital intensive nature of the Oil & Gas business means that single procurement decisions and tender awards are often very meaningful. Many millions of dollars are committed in contracts to procure equipment. Site services procurement decisions impact operational efficiency in multiple locations. But, many companies don't do enough to coordinate and monitor the actual spending that occurs across their organisation on a daily basis, and they end up paying more money to their suppliers than they actually need to.

How strategic, quantitative procurement can grow profits

- *Lower supplier management costs by consolidating vendors*
- *Better realisation of previously negotiated volume discounts*
- *Reduction in purchase price variances paid to suppliers*

The point is that there is value to be captured by strategically and quantitatively assessing and managing the money your company spends on a daily basis. One challenge for many companies is that there often isn't a robust pre-existing process to manage this sort of activity; it's something that requires initiative, creativity, and persistence. Another challenge is that doing it well requires numbers: the retrieval and analysis of transactional procurement data which is often dispersed across multiple general ledgers, systems, and hard-copy documents.

There are *two* tendencies we've noted among Oil & Gas companies who have experienced success in this area. *First*, they acknowledge that their initial attempts won't be perfect. They accept that it may not be feasible to collect data for all of their spending, and that they might find some opportunities not worth chasing further. *Second*, they elevate the idea of spend assessment and management beyond the grunt-work analytical domain that it often occupies—with top-level executives and managers aware of and participating in the initiatives to better control and manage day-to-day spend.

A leading petroleum company saved over $50M by strategically assessing its procurement spend

PwC worked with a client to achieve 15% (over $50M) in recurring annual savings in the first category of spending it addressed, within the first year.

We helped the client identify and rectify purchase-price variances across business units, and also achieve better realisation of previously negotiated volume discounts and commercial terms. In addition, we also identified and targeted areas for supplier negotiation in which the costs our client paid for commodities were out of line with overall industry economics.

In times like these, every dollar saved and every bit of efficiency gained takes on a relatively higher level of importance as compared to times of rapid growth. Pursuing these savings with speed and strength will solidify your position on the winning side of the oil industry's profit equation. If you haven't recently seen a data-driven report where additional money can be found in your procurement spend, take a moment to ask your teams: *"Why not?"*

Strategy #3: Resist the temptation to retreat into departmental silos

Tough business conditions make doing the job more difficult for everyone. Top executives feel a different kind of pressure to uphold investor expectations regarding profitability. Staff members become more worried about getting blamed for the next event that occurs outside the plan.

Involving and rewarding both supplier- and customer-facing teams when pursuing cost reductions can double your rate of margin improvement

The most dangerous mistake a company can make as profitability pressure grows is to define accountability strictly along departmental or organisational boundaries. Given the historical strength of functionally-organised departments within companies in the Oil & Gas business, it's also an easy mistake to make. Companies fall into this trap, for example, by telling their head of procurement that their performance will be measured on reducing material costs by 5%, or by telling their head of field operations that his bonus—and no one else's—will be reduced if project delivery timeliness doesn't improve by 10%.

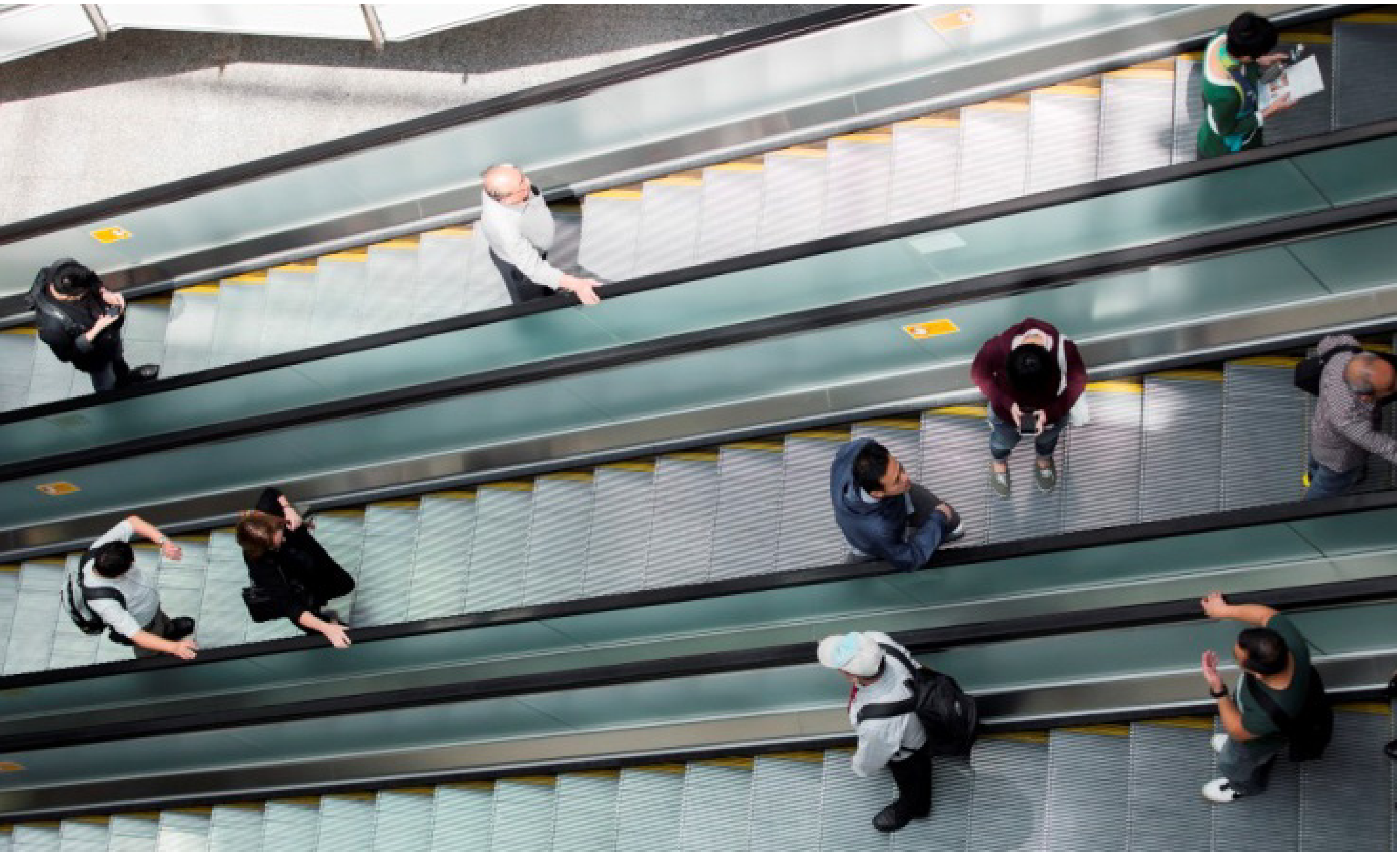
An oilfield services company reduced landed cost by 12% by improving collaboration and setting shared performance measures

PwC worked with a client to help break down departmental silos that had hindered standardisation, repeatability and growth. The client, an oilfield equipment company, was struggling with high costs and was frustrating its customers with long project lead times.

With stronger cooperation and shared performance measures across the client's engineering, procurement, and fabrication teams, the client was able to reduce lead times for their main equipment line by 40%, and reduce landed cost by 12%. Both of these results more than doubled the success of past efforts to solve these problems.

The organisations that pursue improvement most effectively do it by recognising the reality of what it takes to actually achieve operational performance gains—no one person or department can do it alone. For example, truly effective efforts at reducing the cost of procured items, or improving delivery lead times, require both effective supplier management and consultation with customer-facing teams to understand areas where trade-offs may be possible. These types of expertise reside in different organisational groups, both of which need to be constructively involved.

Where to go next



Your company may already be pursuing a number of the ideas mentioned here—if so, that's good news. Make sure that any efforts underway within your company are given the visibility and recognition that they deserve, because they are very valuable in the quest to maintain healthy profit margins in these tough business conditions.

If you're concerned, however, that your company may not be taking full advantage of the opportunities just described, then it's well worth your time to think about what more can be done.

Talk to us

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