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# Time To Revise Cost-centric Fundamentals For Sustained Growth

Introduction – The weak economy, unstable oil prices and low demand have deeply impacted the oil and gas industry but with some recent positive changes, the energy companies have geared up to witness some action. Alok Raj Gupta**,** Founder & CEO, ENVECOLOGIC, shares with us the opportunities lying ahead for the oil and gas industry as well as suggests ways to achieve sustainable profitability.

- **The oil and gas industry has survived tough few years with weak demand and low prices, what is the current status of the oil and gas industry?**

  **Gupta:** After reaching a peak of $54.3 per barrel in February, 2017, WTI crude oil average price is August so far has been $47.7. If you look at the trend, price has been oscillating between $45 and $55 per barrel over the last one year. Natural gas price (Henry Hub) is restored to the early 2017 level of about $3 per million BTU. Just to set the perspective here, remember that crude oil price is still 55-60% below the June 2014 level since the time hydrocarbon prices nosedived internationally. The biggest cause of low price levels has been oversupply. Obviously, production cut will help reduce the price levels and OPEC (Organization of the Petroleum Exporting Countries) has, thus far, failed to convince various oil producing nations of the world to cut back productions. There are still some hopes clinging on the outcome when the international body meets next in Vienna in November. However, neither the World Bank nor the EIA believe that crude price will exceed $55 per barrel in 2017 in their respective outlooks. E&P companies are still struggling to recover from losses. India's national oil company registered after tax loss of 8% and 10% in the quarter ending in June as compared to same period last year and preceding quarter, respectively.

- **As the market is emerging from great upheaval, according to you, is it still difficult for the companies to make strategic decision and plans for the future? What would be your advice to them in the current market scenario? With the continuous growing stress in the**

**Oil and Gas industry, could you also suggest how energy companies can adjust their business models to a period of recovery?**

**Gupta:** This oil & gas downturn did not give the industry players much option. They either had to adapt or perish. Cost rationalization had to be the most urgent and desperate measure to take because costs continued to be inelastic while revenues tanked as prices slashed. This is what most oil & gas players are resorting to. The companies must push themselves to make structural and fundamental corrections driven by change in strategies to achieve them. Cost reduction should be the primary guiding mantra. Strategically, both forms of cost reduction must be resorted to – cost management as well as cost cutting. While the former can lead to up to 25% of cost reductions, it has been observed that direct cost cutting approach typically leads to about 10% of cost advantage. Therefore, in order of priority cost management must be accorded first attention. Operations or supply chain management, smarter procurement strategies, harder negotiations, efficiency improvement via tighter tracking/monitoring and reporting and well planned spending/investment decisions are some of the things which can be considered under cost management. In so far as cost cutting is considered, it must be adopted in order to complement the preceding efforts. Difficult times call for non-negotiable increase in productivity. If eight staff members can now carry out the work of 10, then two must be laid off in favour of cost rationalization.

- **According to Barclays's latest E&P Spending Survey, oil and gas industry capital expenditures are expected to increase by as much as 7 percent in 2017, kindly share your opinion on the same.**

**Gupta:** Barclay's 2017 cap-ex growth looks like a silver lining and definitely builds hope for recovery. The average oil price, until date, shows at least 10-12% increase from the average of 2016 across various crude oil indices. Survey result, according to me, is reflective of expected increase in price for the year through automatic market corrections (not planned cuts).

But it must be looked at with a lot of caution. Recall that companies had slashed expenditures by as much as 40% over the last two years. Single digit rise in cap-ex sparks positive sentiments but we need much more significant and sustained push than just that. Overall recovery will ride on the back of improving top-line (revenue) as well as bottom-line (profit margins) of oil & gas companies, which in turn depends upon the price of hydrocarbons. And the price correction relies on production cuts possibilities, which as I said earlier has been very difficult to achieve. Therefore, in front of what levels we are expecting the crude price to reach, 7% rise in cap-ex is miniscule and may not mean much in terms of overall growth.

- **Profitability is the key of any business and thus it is one of the most important aspects of any organisation, how do you think the companies can achieve sustainable profitability?**

As mentioned earlier, the most imminent goal is to reduce costs to boost margins, which will come from both cost cutting steps and more importantly, cost management steps. But the juncture we are at, it is imperative that we integrate sustainability at every step as well. In fact, I would even go to the extent of saying that cost factors and sustainability will shape the new oil & gas landscape.

The long and complex supply chains in the hydrocarbon industry need foremost attention on supplier management in order to achieve cost effective and sustainable performance. Logistics play a significant role in the transition to low carbon economy, especially because the transport sector is one of the main contributors of GHG emissions. The long distance between O&G production facilities and the market requires solutions that are able to reduce emissions from logistics operations. Collaboration in logistics operation can result in cost savings and benefits associated with longer term contracts, safety, quality, operations and economies of scale. It can also improve the effectiveness of procurement activities and resource sharing for waste management and warehousing. Innovation is paramount to developing cost effective technologies and processes which improve the performance of oil & gas value chains. Today's low oil price scenario has created a new passion for efficiency, which highlights new technologies that can drive efficiencies. Advanced services—such as Logging While Drilling, which allows for the generation of well data during the drilling phase, Rotary Steerable drilling and smart (offshore) completions—are being sought by upstream operators. Many OFSEs (oil field services and equipment) now are redesigning equipment with more modular designs in order to drive out inefficiencies. In the absence of modular design, procurement and manufacturing cannot benefit from economies of scale and 15-30% cost saving if designing integrates optimisation of total cost of ownership. Increasingly, equipment used in oil & gas operations is becoming IIoT (industry internet of things) compliant. Need for adoption of IoT at oilfield is more than ever mainly on two counts. First, low oil & gas price situation has compressed margins, making it necessary for operators to optimize processes and tighten up the supply chains. Second, upstream oil & gas segment is an abode of highly energy intensive activities. In the pursuit of achieving sustainability, it is vital to check energy inefficient operations. In this direction, IoT based decision making, such as equipment capacity is optimised based on real time load information, for example, will lead to lower carbon footprints. Growing need may lead us to believe that the digital oilfield equipment and service market may grow at about 4-5% per annum until 2022.

- **The 3 years old Modi Government have introduced various reforms and policies, could you highlight that some major development which has boosted oil & gas industry?**

**Gupta:** If India has to achieve steady economic growth, oil & gas will continue to fuel it. Modi Government has recognized this fact very well and has been working towards increasing energy sufficiency and self reliance. Most of India's needs have been met by oil imports, but it becomes a challenging task when international markets are at their volatile best. In order to insulate the country from outside uncertainties, the Modi government has been focusing on developing the country's strategic petroleum reserves for enhanced energy security.

Under Phase 1 of the crude storage building, three facilities have been created at Vishakhapatnam, Mangalore and Padur, with a total storage capacity of 5.33 MT. In the second phase of construction the government has planned to build reserves of 12.5 MT, so that by the end of the second phase, India has strategic reserves of around 17.8 MT. This single step alone has importance beyond imagination. Additionally, moves like signing agreement with Abu Dhabi further add to our energy security.

PM is committed towards cutting India's dependence on imports to meet oil needs by 10% by 2022, from 77%. It may seem like an easy target but it is not. It becomes especially challenging in a country where demand for petroleum and petroleum products are rising incessantly and growth of most industries is directly or indirectly linked to crude supply.

Some of the key reforms undertaken include the diesel price deregulation, implementation of PAHAL (world's largest Direct Benefit Transfer scheme for transfer of subsidy for the domestic LPG consumers) and the Pradhan Mantri Ujjwala Yojana (which aims to provide LPG connections to over 50 million women members of below poverty line households in three years).