Oil & Gas market stability and change: Investment in a New Era

Stable continued investment is fundamentally all about creating and maintaining unit oil and gas finding & development costs at a level that is robust to lower oil prices, and thus resilient to cycles, and competitive versus new emerging sources.

Based on our recent client work, we believe that six measures can help ensure market stability and drive the new investment needed to compensate for declining assets and for the lack of investment in recent years. Each group of stakeholders (Operators, Governments and Oilfield Service companies) in the industry has a role to play in this.

Operators need to focus in three areas. The first one is to *Maintain and "lock in" the cost discipline* that has been established since 2014, and in some cases even before the oil prices crisis, as cost were escalating. Many firms have cut operating costs aggressively. As an example, BP cut North Sea lifting costs from $30/bbl in 2015 to $15 last year, and expects to be at $12/bbl by 2020. But inflation is now starting to return to the market – especially in the US and therefore it will be essential to maintain the discipline that has been established during the last years. However, this is something the industry has typically not been good at during previous inflation cycles.

The second one is to *Continue to Kill the Complexity Monster.* In our 2014 article "Killing the Complexity Monster", we highlighted the need for aggressive simplification and standardisation in E&P. Since then many operators have launched aggressive programs that have not only cut costs, but also created simpler ways of working, but we believe that there is still much further to go in this fundamental simplification – and this is where the next wave of 20%+ unit cost reductions will emerge. It also will require oil companies to go beyond their individual initiatives and team to have common standards, pool demand for assets and services and, in places, co-ordinate operations to drive efficiency.

The third one is to *Digitise to drive efficiency.* Digitisation has emerged recently as a key source of value in E&P, but we are very early in this journey. Digitisation can be applied all across the value chain, from exploration to well delivery and production operations, reducing costs and improving efficiency. This will require also the need to attract talent and new skills into the industry and the competition for talent with other more glamorous sectors.

Governments have two major areas of impact. First they need to *Ensure competitive fiscal terms.* As oil prices rose through the 2000s, we saw continuous tightening of fiscal terms in many countries to capture the "rent" of historically high prices. Since 2014 we have seen some relaxations to support continued investment – for example in the UK, with reductions in corporate tax. But all countries need to review if they have the right balance of a fair government take with terms that are competitive given the quality and costs of their resources.

Secondly Governments need to *Improve certainty around decommissioning.* In many countries, uncertainty around decommissioning costs and terms has, at times, been a deterrent to new investment and asset transactions. The Gulf of Mexico and the North Sea now have relatively stable regimes in place, but a new BCG report has identified new hot spots where decommissioning will emerge in the coming years: West Africa, Latin America, South East Asia and, over time, the Middle East. In some of the countries, there is a great risk that the burden of decommissioning costs dramatically reduces the available funds for new investments and that will make even worse the situation. Governments and the industry must work together to address this important risk for the security of supply. A good example is the 2017 setup of Nexstep, the Netherlands' National Platform for Decommissioning, which was supported by BCG.

Finally Oilfield Service Companies need to *Develop technology and services to reduce unit costs – not to drive premium margins.* This should be done in partnership with the oil and gas operators as the objective is to reduce the overall cost of the supply chain rather than reducing them at the expense of other players in the supply chain. For much of the 2000s, new Oil Field Services and Equipment (OFSE) offerings were all about the ability to do "more", in more difficult places, e.g. deeper water, deeper wells, more remote environments or higher-pressure reservoirs. These developments often required high technology that came at a high price – driving development costs for some projects to $100/bbl and above, and service company staff were incentivised to promote these high complexity solutions. For this new era, we need a different type of innovation – which is about efficiency, unit cost reduction and improved reliability.

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