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COLUMNS

Executive viewpoint

Don't turn off the lights; the party ain't over!

Pradeep Anand, Seeta Resources

Back in 1967, Willie Nelson wrote and sang, "Turn out the lights, the party's over. They say that, 'All good things must end.' Let's call it a night, the party's over. And tomorrow starts the same old thing again." Despite being influenced by Willie Nelson's Country & Western music, the E&P industry is anything but conventional, and the industry will prove it again in the way it responds to the recent drop in oil prices.

Market disruptions, driven by oil price fluctuations, are not uncommon in the E&P industry. Oil prices produce cash flow for the operators, who then invest a portion in finding and producing hydrocarbons. When oil price falls, cash flow declines, and spending budgets drop.

When there is a significant change in the direction of oil prices, uncertainty creates ultra-cautious behavior and budgets get slashed, which flows through the industry value chain, affecting all players. Thanks to the Bull Whip effect—small fluctuations in the wrist/arm can produce wide fluctuations at the end of the whip—suppliers farthest from operators will suffer from the greatest instabilities.

However, the "party ain't over." Energy is vital in our everyday lives, and the global economy stills needs a substantial amount of oil and gas to fuel economic growth. Exxon Mobil's 2015 *Outlook for Energy* forecasts that energy consumption will increase 35% by 2040. In the interim, to thrive in today's disrupted environment, all firms in the E&P industry will benefit from five swift actions that can deliver immediate, intermediate-term and long–term results:

1. Focus on attractive markets for core businesses
2. Protect margins in attractive markets
3. Pursue dominant share in attractive markets
4. Improve operational efficiencies in attractive markets

5. Build the future with new technologies.

Focus on attractive markets for core businesses. These are markets where customers have a need for a supplier's offering, have budgets to fulfill their needs and intend to spend their budgets, and where that supplier's offering is a necessity or nice to have (but not a postponable decision). For a tighter focus, the supplier has to honestly answer the question: What do we do better than the competition in this market? A quick focus on profitable, sustainable core markets sets the first stage of recovery.

Protect margins in an attractive market. Declining markets create panic in operating units, who then respond to revenue pressures in shrinking markets by indiscriminately reducing prices. This accelerates the reduction and destruction of company and industry profitability. To stem this deterioration, it is important to reinforce the front line by training them to discover the Ideal Competitive Selling Price (ICSP) for their products/services in their market-specific environments. The ICSP helps the front line realize how high their price ceiling actually is, causing them (and the management) to pause and reflect before making detrimental pricing decisions.

Pursue dominant share in attractive markets. Once attractive markets have been identified, the first task is to focus on protecting and increasing market share and margin share, globally. Then, after developing a deep understanding of current competitive positions (What do we do better than rivals and upstarts?), revisit and refine the firm's business model/design for these markets.

Typically, a lead business model would be one of three options: innovative supplier, a full-service supplier or low-cost supplier. After picking one, fill minimum expectations on the other two fronts. The oil field is a technology business. Firms must spur new technologies to market, to stave off competitive thrusts.

Improve operational efficiencies in attractive markets.

Acquire diagnostic services. Due to their recent focus on growth initiatives, E&P firms lack the right resources to answer the three "shocked market" related questions: Where are we? Where can/should we go? And how do we get there? The affected companies need experienced commando teams that can swiftly perform "Diagnostic Services" on these identified initiatives and speedily deliver recommendations for easy, timely execution.

Focus on triple economies of scale, scope and knowledge: Firms can benefit significantly when they strive for all three benefits. Economies of scale are obtained, because available knowledge is shared over a number of uses as time passes by, thereby reducing average costs per use. Economies of scope are realized, because explicit knowledge can be reused in activities and processes across different uses or users. For both economies of scale and scope, the higher the number of uses or users where codified knowledge can be reused, the higher the benefits potentially obtained. Economies of knowledge are obtained, because sharing of explicit knowledge leads to knowledge combination, not mere replication.

Target cost cuts to find equilibrium in the current environment.

Build the future with new technologies. In current economic conditions, more compelling technology solutions and processes will be needed to continue finding and producing oil and gas, especially in unconventional segments. During the oilfield recession of the 1980s, logging-while-**drilling** and 3D seismic, two of the most significant E&P technologies, were born and commercialized. Both survived, because they were independent business units. Core businesses will fight for limited resources, but it would be folly to stop investing in new technologies that can substantially change economies of finding and producing oil and gas. WO

THE AUTHORS ///

Pradeep Anand helps global engineering and technology companies accelerate their revenue and margin growth. Mr. Anand was the first marketing manager for logging-while-drilling at Sperry-Sun Drilling Services and Vice President, Marketing, at Landmark Graphics. He is an adjunct faculty member at Rice University’s Jones Graduate School of Business, where he teaches “Marketing in the Energy Industry” in the MBA program.

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