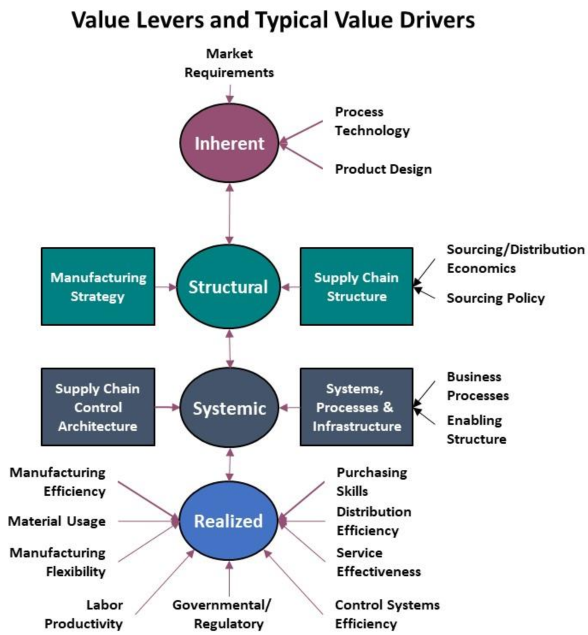
Systemic Solutions are the Path Forward for the Oil Industry

"Leverage successful tools from other industries to create opportunities in Oil and Gas."

One of the most powerful strategic frameworks for competitive cost analysis is ISSR (see Figure 1).

Figure 1: ISSR Competitive Cost Framework



ISSR or Inherent Structural Systemic and Realized, describes four main components of a cost-driven framework. ISSR helps organizations to clearly categorize both their competitive strengths and challenges. Inherent and Structural value levers are strategic, involving one-off decisions and often are highly defensible while Systemic and Realized levers tend to indicate how well an organization is at executing its strategy and operating its business.

Oil and Gas Industry Application

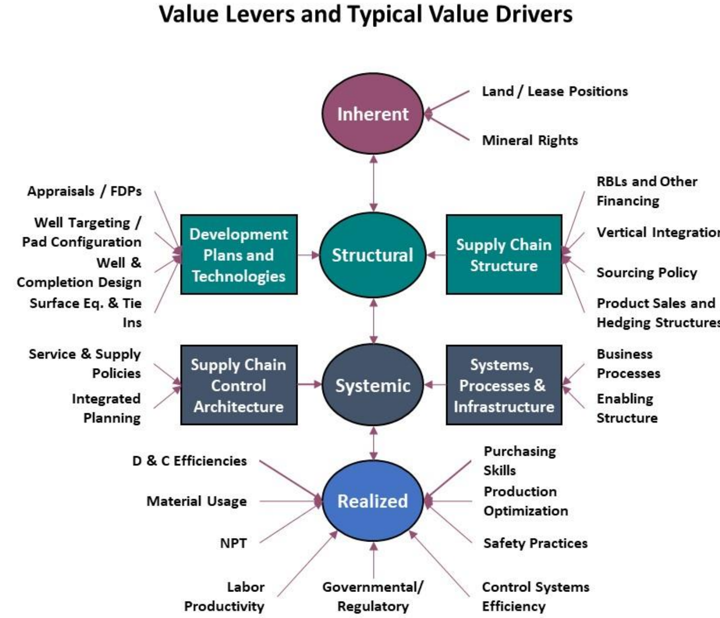
In Figure 2, we provide an equivalent ISSR model for the oil and gas industry. Traditionally, operators and service companies have focused on the Inherent and Structural levers as they acquired lease positions, tested different completion designs, pursued in-basin sand and the like. While there is still room for further technological advances, the incremental gains are getting smaller and now, Systemic and Realized levers are becoming more important in lowering well breakeven costs. To date, procurement has been the largest engine of Systemic value. However, operators and service companies now must fine tune their business models, processes, organizational structures, talent and practices to achieve leading performance.

Examples of Systemic Opportunities

Integrated Planning: We are increasingly hearing operator's concerns about the cost of drilling, completion and production silos. They realize that poor coordination and planning across the well delivery process are creating significant costs and are looking for new business models to get the entire organization working as a single team without sacrificing the gains functional structures have historically delivered.

Supply Chain Layers: Over the years, the oil industry has come to rely on local supply of materials and equipment. Unfortunately, the layers in the supply chain—manufacturer, wholesaler and distributor—come at great cost with everyone expecting a healthy margin. We call this "margin stacking." In our personal lives we are bypassing retail stores and ordering online direct. Some operators are starting to go direct as well.

Figure 2: ISSR for Oil & Gas



Lean: Aera, Hess, Halliburton, and many others are pursuing Lean with great results. Yet, many companies have yet to embrace the concepts and many processes have yet to be subject to Lean assessments. We worked with one manufacturer who believed they were capacity constrained and now are doubling production with the same manufacturing space.

Last Mile Logistics: Much effort is being applied to last mile logistics for proppant and chemicals. But, most of the solutions are technology based. Enhanced processes, stronger governance and simpler tools are the next step in improving logistics.

Human Automation: Frequently, companies hire people to resolve a problem; invoicing and financial reporting are two examples. The oil industry also has fallen for human automation. Many processes need to be revisited and the processes streamlined so that humans aren't doing costly busy work.

The Solution:
Two parallel initiatives are required to capture the full value of Systemic improvements.

First, companies need to take a hard look at key processes that drive value to make sure they are as efficient as possible. If opportunities for improvement are identified, changes will need to be implemented effectively to achieve real efficiencies.

Then, the business model driving individual behaviors needs to be addressed to ensure alignment while sustaining the gains. What worked years ago with $100 oil won't work today. The business model elements include KPIs, decision rights, organizational structure, coordination mechanisms, roles, information and incentives.

Self-Test: Performance Red Flags?

- Can your business plan only work with outrageous assumptions?
- Are competitors investing in what seems to be marginal or negative businesses? (Remember competitors have different economics.)
- Are executives starting to blame poor performance on a weak bench?

Competitors' ability to perform and achieve higher returns can often be explained by differences in business models.

The Result:
Identifying these Systemic Opportunities have resulted in cost and cycle time performance improvements of 5 to 10%. In today's environment, lowering breakeven costs $2 to 4 per BBL are significant and an opportunity to stay ahead of peers.

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This is a great opportunity for the aggressive oil and gas players who want to seize the lead in their respective sectors of operations, whether E&Ps or OFS companies.

Helping oil and gas companies to accelerate performance improvement.

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