

# Oil price volatility

## Getting your priorities right

In just a few months, the rules of engagement for the oil industry have changed beyond recognition. Between June 2007 and July 2008 crude oil prices soared from about \$55 a barrel to a record \$145, before collapsing to less than \$40 by the end of 2008 and then creeping back up a few dollars. Oil companies continue to face a level of volatility that few could have anticipated a couple of years ago.

It is extremely difficult to formulate strategy under such uncertainty, yet companies must do so and do it well. While a price of \$60 might have looked like a healthy price a few months back, escalating costs now make it difficult to achieve a respectable profit at this price level.

The situation has already been good for some companies and bad for others. Sound strategy can make the difference between fortune and oblivion, yet without extensive knowledge of the market, and of competitors' activity and status, it is easy for companies to be overtaken by events. Such knowledge is not always available to oil companies, particularly smaller ones

So how can companies acquire the information and knowhow that they need to take advantage of market volatility rather than falling victim to it?



**Just as doing the wrong exercises at the gym can worsen your physical condition instead of improving it, so targeting corporate energy at the wrong areas can draw attention, effort and resources away from the areas that you really need to focus on.**

### **Capgemini's framework for competitive health**

In order to help companies out of this quandary, we have undertaken comprehensive analysis of the market and its prospects based on published reports and our own research. This analysis has enabled us to formulate a method for rapidly diagnosing a company's competitive health with respect to both its immediate short term liquidity and its longer term operational profitability.

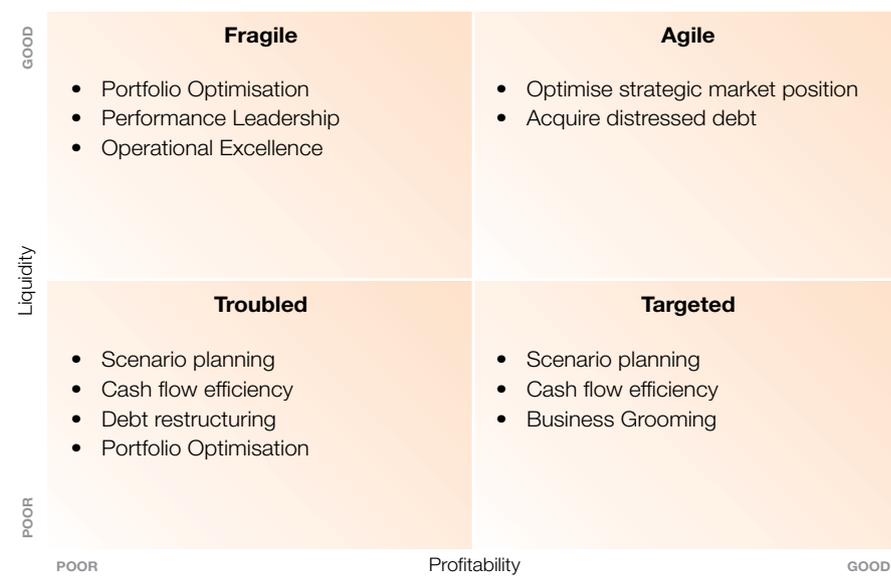
The Capgemini framework shown in Figure 1 embodies our systematic analysis of the characteristics that determine real companies' success or failure in today's market. This framework allows you to identify your main issues effectively and prioritise actions for survival in the short term and growth in the long term.

assessing the time element of revenue streams, you can optimise your portfolio, bringing real, sustainable value to your business.

In the 'Troubled' quadrant, measures to improve the profitability of operations are essential, but even more urgently, your cash flow position needs attention. Possible ways forward might include scenario planning, providing a reality check for project timelines and allowing you to re-prioritise your initiatives. Focusing on short-term liquidity benefits, you might also want to look at cash flow efficiency or debt restructuring.

In the 'Targeted' quadrant, your operations are profitable and poor liquidity can make you an easy acquisition target by a competitor. Again focusing on short term liquidity benefits, you need to look at cash flow efficiency, or even at grooming the business to attract further financing.

**Figure 1. Capgemini's framework for competitive health.**



Depending on where in the Figure 1 framework your company sits, different business solutions and approaches are appropriate.

In the 'Fragile' quadrant, improving the profitability of operations is key. By allocating true project costs and

If you are in the 'Agile' quadrant, you are healthy relative to your peers and need to prepare for the upturn by optimising your strategic market position; there could for example be opportunities to acquire distressed debt.

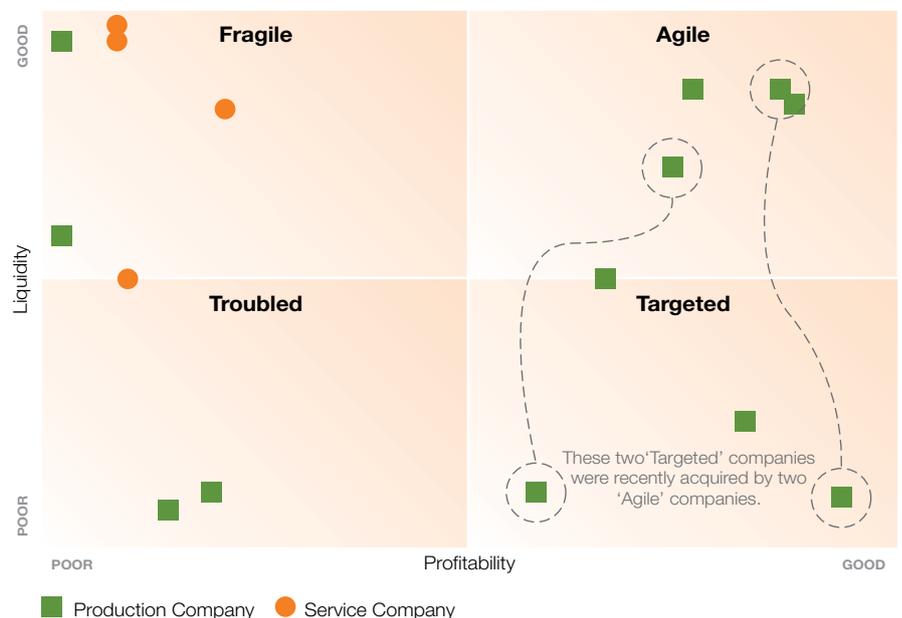
### Focusing on the North Sea oil industry

Applying the framework to a selection of North Sea oil companies, one can quickly assess their relative competitive health, identifying an acquisitive growth strategy for those with advantageous market positions and a more defensive strategy for those without: see Figure 2.

### How Capgemini can help you

Just looking at Figure 2, you may think you recognise your own company, but with our detailed model we can quickly confirm your positioning and help you prioritise your actions with the aim of moving you towards the 'Agile' quadrant if you are not already there.

**Figure 2. Capgemini's framework for competitive health applied to North Sea oil companies.**



As indicated by the dashed lines in Figure 2, two companies in the 'Targeted' quadrant were recently acquired by two much healthier 'Agile' companies. Financial strength and profitable operations, assuring revenue in the medium and long term, allowed these companies to acquire their main competitors at distressed prices.

Note also that virtually all service companies are found in the 'Fragile' quadrant. Because of the market downturn and volatile oil prices, production companies are cutting back on maintenance and trying to secure big reductions in service costs. Service providers hence tend to be the first to suffer the consequences of the tougher market conditions.

Whether you are a 'Targeted' production company struggling with medium term financing or a 'Fragile' service organisation with declining profitability, we tailor our approach to your unique circumstances, capabilities and strategic intent.

It's important to consider the full range of options and make sure that you leave no stone unturned by drawing on multiple disciplines including strategy, finance and employee transformation specialists.



**Finding the right 'exercise' to promote corporate health:**

An oil production company has recently initiated a cash flow improvement programme with the aim of collecting its outstanding receivables more quickly. Although these efforts are having a positive impact on cash conversion, the company has nonetheless hit profitability problems.

Application of our framework immediately tells this company to focus its efforts on project rationalisation, which will have had an immediate impact on profit. The company discovers that it currently lies in the 'Fragile' quadrant, where improving profitability is all-important, and portfolio optimisation must be a top priority.

**Conclusion**

Just as doing the wrong exercises at the gym can worsen your physical condition instead of improving it, so targeting corporate energy at the wrong areas can draw attention, effort and resources away from the areas that you really need to focus on (see panel).

Correct prioritisation of improvement projects is vital for the typical medium-sized company operating in the North Sea: they do not usually have the capacity to tackle multiple major projects simultaneously.

Yet when you're faced with an overwhelming mass of information, combined with a lightning rate of change in the industry, it's only too easy to focus on the wrong exercises. Our research-based framework accelerates the process of establishing your current position; we can then help you focus on the right priorities for change, and make the decisions that will translate into competitive advantage.



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