

## Cost Sustainability Information Paper

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17/05/2018

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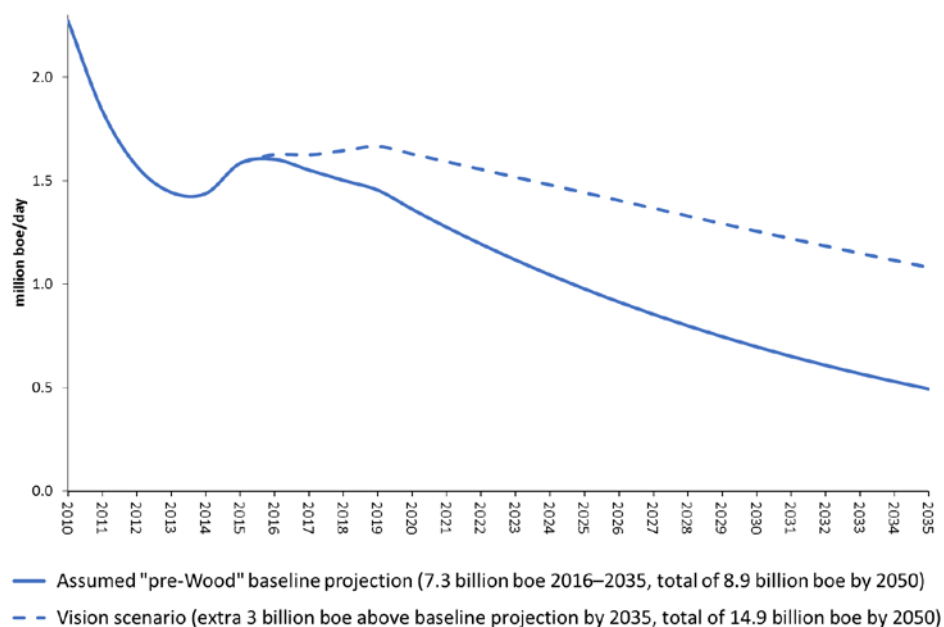
# 1 Introduction

The Oil & Gas industry has a history of peaks and troughs. The supply chain cost base has, in the past, fluctuated broadly in line with the oil price, however this relationship is tenuous and somewhat artificial. The market flourishes during peaks, but many companies struggle to survive the troughs. Although it is unlikely to ever completely change, or possible to totally delink supply chain costs from the oil price, this “boom and bust” cycle is fast becoming unsustainable as UKCS reserves become scarcer and other regions become more attractive to investment.

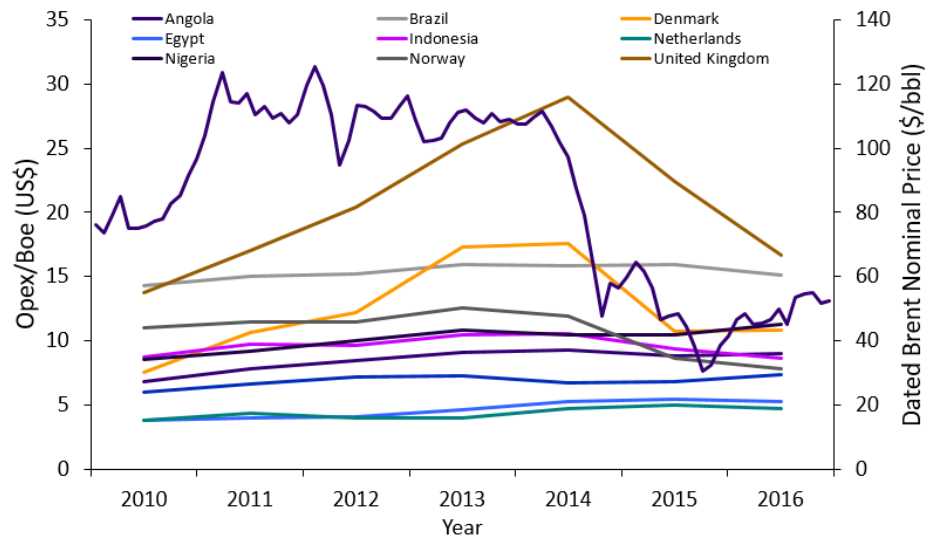
In the current environment, securing investment in new projects and developments, which ultimately extend the life of the basin, is more challenging than ever. If costs cannot be sustained at consistent levels and continue to rise in line with oil price during the “booms” potential projects will not be economical, and investment will move elsewhere.

Equally, steep and fast declines in the cost base are just as damaging as the peaks. As oil price declines, Operators are forced to make choices and spend more wisely. The supply chain often struggles to survive such rapid declines in demand. Many companies are either forced out of business completely, or are forced to operate at a loss and, as a result, the supply chain becomes less competitive while valuable knowledge and skills are lost.

The current downturn is deep and should serve as a wakeup call – the local industry may not survive another. If the cycle cannot be eliminated, action must be taken to soften the peaks and troughs. The uncertainty is highlighted by Oil & Gas UK’s Vision 2035 scenarios, which illustrate the potential difference between action and inaction.



Other regions have been more effective at this in the past. During the last upturn, costs (measured by UOC) rose faster than the oil price, and fell steeply when the price subsequently dropped. Over this period, other regions' costs remained relatively stable. If action is not taken to improve cost sustainability, the existence of the local industry is under threat.



A Task Finish Group, comprised of representatives from the supply chain community, was established to explore cost sustainability in more detail.

A series of themes, underpinning cost sustainability, were first identified:

- **Collaboration** – How can the industry work more closely together, across the Operator community and local supply chain, to become more efficient, share costs, reduce duplication, generate new ideas, pool resources and share risk and investment opportunities?
- **Standardisation** – For a relatively small and insular industry, there is a notable lack of common standards and alignment across the supply chain. Although there is long-standing recognition that standardisation increases efficiency, there has been limited success in this area. Possibly, the perception of protecting a competitive advantage, has bred a complicated supply chain, and many different technical standards and procedures.
- **Education, Awareness & Understanding** – Are individual's roles in the cost cycle understood? Is the link between cost sustainability and the life of the UKCS O&G industry known? What opportunities are there to make a difference? How does the industry address the potential knowledge, competence and experience gap emerging within the local skill pool?
- **Behaviours** – Why are learnings from the past not implemented? Many cost sustainability solutions and opportunities are widely recognised, but less successful when adopted and implemented. How does the industry change its collective behaviour to improve performance?
- **Contracting** – Effective contracting strategies are potentially a way to promote open, honest and transparent relationships between Operators and suppliers, ensuring a fair

distribution of risk and reward through contract performance management. Are the right contractual models being used? Are contract parties incentivised to work together and collaborate? Are contracting and tender processes as efficient as they could be?

Having identified these key areas affecting cost sustainability, the group carried out the following actions:

- Conducted a program of interviews across the regional industry, to further explore these themes and identify associated potential improvement opportunities and current barriers;
- An extensive number of qualitative conversations held, with representatives from Super Majors to niche operators, Tier 1 contractors to SMEs;
- Spoke with a representative cross-section of the supply chain, including vice presidents, business managers, supply chain managers, business improvement experts, engineers and technical specialists, sales and account managers.

The research completed by the group has been consolidated into a series of key highlights and recommendations, which Operators and the supply chain are now encouraged to adopt, in a bid to achieve better cost sustainability, and prolong the life of the local industry.

## 2 Collaboration

- In this context, collaboration has been taken to mean a willingness to work together to share ideas, best practices, costs and risks
- Collaboration can be:
  - Between Owner/Operators to share information
  - Between Owner/Operators and Tier 1 contractors in the execution of contracts
  - Across the rest of the supply chain
  - Internally between disciplines inside an organisation
- There is a general perception that collaboration is an essential ingredient of cost sustainability and that more is needed.
- Despite this, many companies still act independently, duplicating effort, and spending unnecessary amount of money.
- Significant cost will be taken out of the supply chain, without impacting margins, through better pooling of resources and sharing of ideas and best practices
- Other industries successfully share and re-use generic information, equipment and parts to the benefit of all
- Cost efficiencies will be more effectively achieved through sharing of risk and incentivisation of partnerships



### 3 Standardisation

- Standardisation is the use of common language, standards and processes or the avoidance of duplication of effort
- Despite as an industry having similar objectives, using the same technology and following the same processes organisations operate differently, to different standards, using different equipment and names.
- This adds unnecessary time and cost, for example:
  - HSE Standards – contractors providing the same service for multiple different clients with different HSE standards may need to slightly change the time, process and people involved in a job, tailoring their service for each
  - Lack of common language – people and contractors are less able to move seamlessly through the industry, needing to relearn names and terminology, adding time and increasing the chance of error
  - Lack of common processes – both operators and contractors execute many of the same basic processes, in different ways, which require different equipment, tools and people
  - Lack of standardisation of equipment and inventory –organisations buy slightly different equipment, to slightly different specifications, resulting in the need to carry more stock than needed, little of which is transferrable between facilities or organisations

## 4 Education, Awareness & Understanding

- It is proposed that supply chain education for the industry looks like:
  - Increasing understanding of costs, value and supply chain mechanics
  - Publicising the threat faced by the UKCS O&G industry, without change, and how to include the whole industry
  - Understanding the objectives, values and drivers of the industry
  - Training, development and competence of local skill pool
- Although traditionally a highly technical industry, there still appears to be a surprising lack of commerciality and understanding of industry costs and value drivers, throughout the various layers of organisations and the supply chain
- People responsible for spending (calling off equipment and services on a daily basis) are not always adequately trained in supply chain mechanics and how their decisions impact the cost base
- General lack of employee awareness of the part they play in cost sustainability and the local industry's longevity
- The cost sustainability challenge faced by the industry, the case for change, the vision and ambition have not been well articulated
- Unsustainable cost levels have meant that significant skill and experience has been lost during this and previous downturns

## 5 Behaviours

- The way people act and think are behaviours, which are not necessarily the same way as people talk
- Despite years of attempts to collaborate better, increase standardisation and passionate agreement in the case for change, there has been little success
- Despite the “boom and bust” cycle having repeated itself time and again within the last four decades, there has been little to mitigate the height and depths of the peaks and troughs in the cost base
- The industry does not think and act together in the way that many others do successfully. Companies often act individualistically, in their own interests rather than in those of the whole industry.
- The local industry has a strong cultural identity, which is decades in the making which can make change slow and hard. This culture is underpinned by a general aversion to change, a low appetite for risk, and a fear of challenging the status quo
- These behaviours become more apparent during downturns, when business can become adversarial, for fear of sharing competitive advantage at the risk of ignoring greater benefits

## 6 Contracting

- Contracting, for the purpose of this paper, is:
  - The commercial agreements and partnerships that underpin the industry
  - The formalisation of the relationships that govern the way organisations work together
- Contracts are a powerful tool that can be used to achieve greater cost sustainability, representing the potential foundation for improved collaboration and standardisation
- Contracts have not been effectively used or used to their full potential
- When oil price began to fall, the focus was contract rates and prices, rather than the value and cost drivers of the contract parties, collectively forcing the industry's cost base down quickly to potentially unsustainable levels
- In what is becoming a more marginal industry, the focus should be on performance and quality, and so value, rather than cost alone
- It is important to use contracts to share risks, drive better partnership and incentivise all contract parties to work together
- It must be ensured that contracts are fit for purpose and context. That is, contracting for the right durations, using the correct commercial models, with appropriate escalation mechanisms, sharing risk more equitably and more effectively incentivising

## 7 Barriers

- It is human behaviour to think and act primarily in the individuals best interests – collaboration and sharing does not always come naturally
- There is a strong cultural identity of the local industry, which is decades in the making and slow to change
- A lack of urgency for change and so a significant part of the industry waits for another boom instead of changing now
- The industry vision for change has been inconsistent and not well articulated. A convincing concept of a successful and healthy industry must be widespread
- Understanding of the challenge that the local industry currently faces is missing, and the role that each person within the industry plays in combatting that challenge
- A Misalignment of objectives – whether at a personal or corporate level
- De-skilling of the industry through loss of expertise
- Lack of trust, transparency and openness, across the industry
- Artificial and tenuous relationship between supply chain cost base and oil price
- Competition – protection of competitive advantages inhibits collaboration
- Fear and risk appetite – fear to challenge the status quo, at a personal or corporate level
- Many key industry players have grown too big to be able to respond quickly and effectively to the case for change

## 8 Recommendations

### 8.1 Vision

The vision of a healthy industry with a world class UK supply chain and growing worldwide exports that enables increased revenues from UK production has been produced and shared by the OGA and Oil & Gas UK. But all parts of the industry must help to craft this combined vision and articulate it to demonstrate that it has been widely bought into. By publicising this and demonstrating the success of the industry, every member can be part of positive change.

The alternative, is a return to an unsustainable boom and bust culture, that damages many companies, the jobs that they maintain and the wider industry

### 8.2 Publicity

The case for change can be better publicised by improving the visibility of success stories and maintaining links between Oil & Gas UK and a large network of supply chain champions. Oil & Gas UK's Supply Chain Hub should be used as a focal point for these activities and to broadcast progress towards the industry's vision. The case for change can be demonstrated better through:

- More effective visibility of MER throughout the industry. Organisations can actively publicise and communicate progress through posters and company events, more effectively leveraging media and resources.
- Organisations to partner more closely with industry bodies sharing success stories that can be delivered to the wider industry. Increasing the distribution of these improvements will encourage greater collaboration and efficiencies in the industry.
- Support and recognition of outstanding projects and performance that demonstrate cost sustainability
- Industry bodies to better collaborate and communicate with one another, and align on key industry initiatives, avoiding additional costs, duplication of effort and delivering wider improvements.

To enable better communication throughout the industry, each organisation should identify a supply chain focal point who can act as:

- A link between organisations and Oil & Gas UK, as well as other industry bodies, which enables better information sharing through the Supply Chain Hub.
- A conduit of related information, into and out of their organisations;
- A sharer of best practices;
- A champion of collaboration, standardisation and sustainability.

### 8.3 Workforce engagement

It must be ensured that industry alignment around common goals and strategy penetrates down through every level of organisations. This can be improved by:

- Internal engagement within organisations geared specifically towards regional industry objectives, performance and strategy as well as corporate goals
- Oil & Gas UK to be visible through entire organisations by communicating available resources, activities and events. This to include engagement within companies to reach all members of the organisation.
- Companies to ensure that cost sustainability is part of daily conversation. This can be done by internal campaigns, team meetings and employee inductions which demonstrate the benefit to the company and the wider industry.

### 8.4 Training

There is an opportunity for development of training courses or improvement forums, covering key 'change' themes and topics relating to cost sustainability:

- Leadership forums bringing together representatives from several different tiers across the industry for targeted sessions on change opportunities.
- Oil & Gas UK can publicise 'cost awareness' programs through the Supply Chain Hub to a wider audience and help organisations to better leverage Oil & Gas UK resources.
- Organisations to ensure that cost awareness is part of general employee induction process;
- Organisations to ensure that all employees adequately and appropriately trained in cost and value discussion, and basic supply chain mechanics.

### 8.5 Supply Chain

A review of industry guidance and tools to ensure that they remain fit for purpose and match the vision for the supply chain. This would enable the Oil & Gas UK tools to aid improvements in industry:

- Allow organisations to find an effective balance between own interests and sustaining competition within the regional industry supply chain, for example through the Supply Chain Code of Practice and industry wide supplier registration and verification tools.
- Simplify information and best practice sharing;
- Standardise where appropriate, to remove unnecessary duplication of efforts.

### 8.6 External partnership

Collaboration could be enhanced by the better leveraging of institutions and resources, both outside and within the industry:

- Local industry to more effectively partner with academia, and bodies such as Oil & Gas Technology Centre and Oil & Gas Innovation Centre, to optimise innovation.

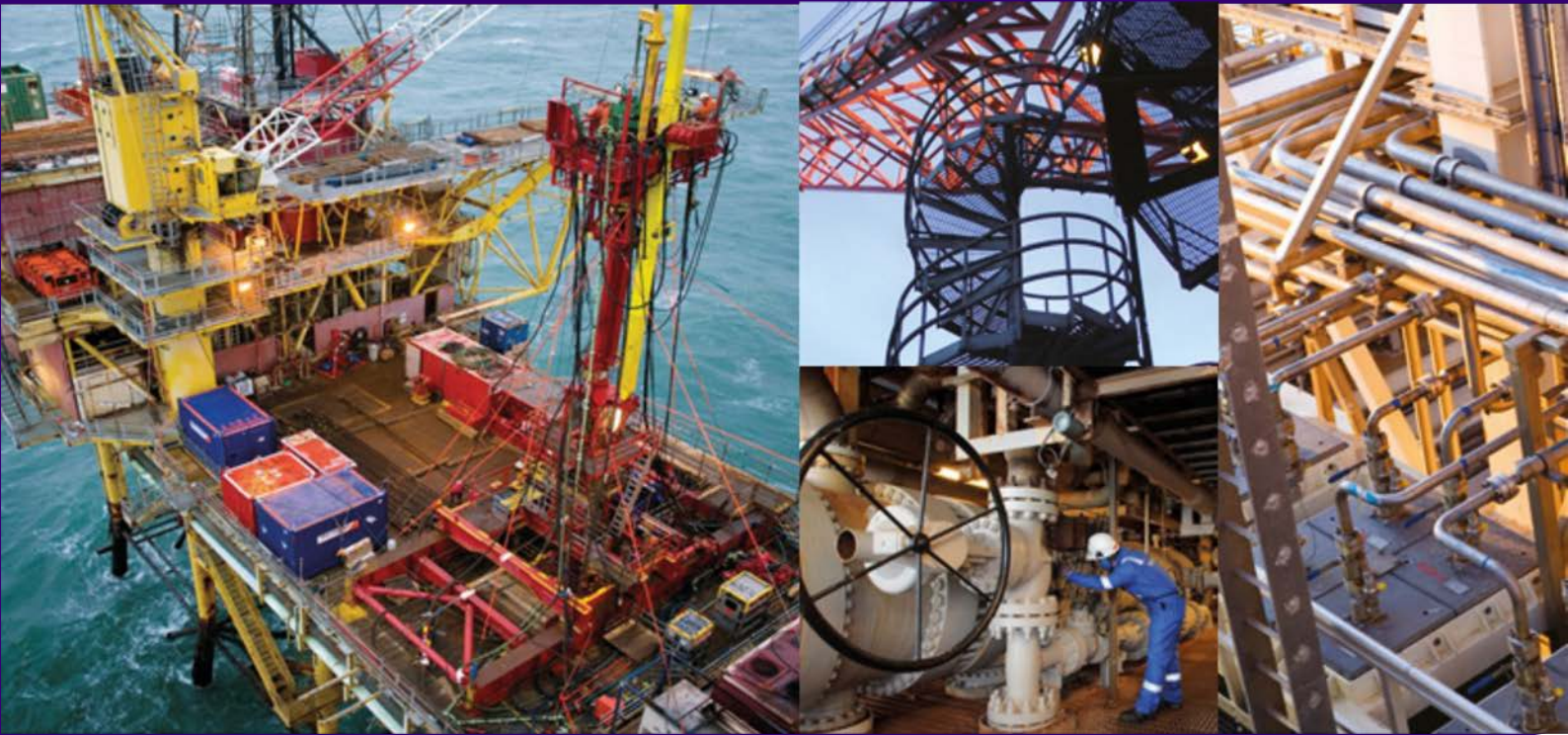
## 8.7 Contracting process

Organisations can challenge contracting models and processes, with a view to remove unnecessary duplication of effort and better reflect current local industry conditions. For example:

- Review contracting strategies and challenge their internal status quo (e.g. contract durations, tender requirements, processes and documentation etc);
- Review contracting models (e.g. escalation mechanisms, work scopes, commercial models, risk sharing, incentivisation etc);
- Actively promote effective contracting principles, via internal contract guidebooks and presentations.
- Leverage the benefits outlined in Oil & Gas UK's Tendering Efficiency Framework.



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