The Davos Energy Brief

$40/bbl	30	-20%	-10%	5 mmbd
Planning Pressure	Top 300 Firms Exit	Industry Spending	Activity & Employment	Production Decline

Industry Outlook 2009: Energy

Picture this: a volatile year for pricing with crude selling for $40 a barrel on average; a seismic shift in the oil industry with 30 key players acquired or consolidated; and a painful contraction in the oil industry with a 20 percent cut in spend, a 10 percent decline in activity and a 10 percent reduction in employment. All of this adding up to a decline in global production capacity by 5 million barrels a day, compared to 2008.

It's not hard to imagine this scenario for 2009. As the global economy changes gears, the oil sector is now feeling the grind. It will be a testing time for industry players. The resilient will survive and perhaps even gain competitive ground; the weak will flounder or perish. Business leaders will need sound judgment to strike a fine balance between action and patience. The former, timely action, will be needed to set a strategic direction through turbulence, steer major projects forward, manage costs and sustain dialogue with stakeholders. The latter will be necessary to ride out price volatility, survive a tight capital market, and overcome supply uncertainty.

Despite the scale of turbulence, Energy, Oil and Gas remain attractive sectors. In 2009, performance across these sectors will vary. But large segments of the industry will remain strong in the face of adversity and continue to deliver returns to investors, governments and suppliers.

Managing Uncertainty

The global oil industry faces three big unknowns this year: oil prices, production capacity and sector consolidation. As the industry comes to terms with the reality of oil priced at $40 per barrel, it must recalibrate its 2009 plans with $30-50 per barrel estimates. For most, this radically changes the strategy landscape in the short term. For producers it offers new portfolio priorities; for consumers, it throws up new supply and storage needs.

The long-term perspective is no less challenging. A dramatic energy industry contraction seems inevitable: demand and capacity reductions are already visible; the unconventional oil boom is switching to contraction; infrastructure expansion will be slowed down by rebids; marginal capacity is shutting in and new exploration, new market and technology developments are all under threat in the current economic situation. With industry capacity and resources strapped, 2010's potential global oil production capacity is likely to be off by as much as 5 million barrels a day.

Winning in Turbulence

Out of chaos can come competitive advantage. In 2009, executive leaders—CEOs, Chairmen, board members—will be tested not just for their mettle to ride out turbulence but also for their talent to build stronger, more resilient organizations that are well poised to make the best of the current situation and to take advantage of the upturn when it arrives. Timing will be critical as leaders scan the commercial landscape and make decisions between short-term gains and long-term strengths. Some key challenges:

− Consolidation in the energy sector is imminent and will impact the full spectrum of players: producers, suppliers, service providers and consumers. Of the top 300 players in the industry, upwards of 10 percent will be caught in the consolidation maelstrom. As many as 30 to 40 industry players will be merged or acquired or cease to exist. For leaders in the energy sector it will be critical to be prepared with scenarios on alliances, joint-ventures, mergers and acquisitions for their company—and be able to react fast and with full preparedness when offers and opportunities present themselves.

− With a 10 percent contraction in global oil industry activity projected by year-end, 2009 will see substantial lay-offs. Already, Conoco Philips and Schlumberger have announced substantial cuts in their workforce. While for most companies cutting jobs will be the first instinct to offset the steep decline in oil prices, the winners will be those who recognize that under-investing in human capital brings long-term risk. A more refined approach will be for companies to adopt resilient human capital strategies, that don't compromise the organization's need for operational and technical excellence through turbulence—and beyond.

− Managing procurement and supply chains will be a critical skill that will distinguish winners from also-rans. In 2009, average spend is projected to contract by 20 percent while prices are expected to be down by 15 percent, compared to 2008. While most organizations will focus on cost reductions, winners will develop strategies that clearly establish accountability, increase efficiency and effectiveness, eradicate fragmented activity and maximize the impact of every dollar spent.

While most companies will face similar threats—consolidation, uncertainty, volatility—those that gain ground will be companies that use turbulence to set their house in order. With relative competitive strengths rapidly changing due to external forces, companies most likely to withstand adversity will be those that have strong internal fundamentals. Reducing complexity, managing cash-flow, and focusing on performance improvement will help companies emerge leaner and meaner for the future.

Bain and the Energy Sector

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