

OIL AND GAS ASSETS REQUIRE

Unique Financial Management System

Oil and gas asset financial management is unique in nature. It is not like other businesses, as in this business producers must work by following the exploration and licensing policy of host governments. Because oil and gas are considered national resources, operator produces and shares the profit with the host government. Identifying potential investment risks and working to mitigate risks is highly essential in this business. This business involves many uncertain factors and it is important that the investing company (operator) should conduct its due diligence, study available technical reports, and use strategic financial management decisions for success.

Exploration Policy

An operating company has to compete with global oil and gas companies including national oil companies, for oil and gas blocks, which are generally auctioned. The operative company submits a bid based on the available technical data from the relevant ministry responsible for hydrocarbon resources and any of its technical arms. The operating company has to invest money with approval from host government and explore the field for oil and gas. This involves several stages, including exploration drilling, appraisal drilling and development drilling. Moving on to subsequent stages is dependent on the economic and technical feasibility of a project. Sometimes huge sums of money are invested to find a successful production well. The success of operations depends on a company's asset management skills also.

Uniqueness

Oil and gas operations are not like other businesses. In this sector each and every stage involves high-risk investments and approvals from a host government. The oil and gas operating company should produce the resource quantity committed to the host government, irrespective of reservoir complexity or uncertainty. All the committed production is to be taken out by operating company to recover its investments, and the profits are to be shared with host government. The price of selling and distribution of oil and gas is also fixed by the host government only, irrespective of the supply vs demand equation. Prices vary based on market dynamics. These oil and gas resources serve as either a fuel or feedstock for many downstream industries, perhaps both. This production will have a very strong influence on the economy of host country. Operating the company with all the variable factors, and acclimatising the operations to the entire global variable is only possible for a strategic asset manager.

Economic Factors

The operating company should carry out an investment risk analysis at the time of submission of Field Development Project(FDP) to technical arm of the host government, or relevant ministry. Operator

should have completed a thorough analysis of the expected Internal Rate of Return, and payback period from the proposed project as well as the Capex and Opex required for the years until getting financial returns from the asset (via production and sale of hydrocarbons). Too much infrastructure cost more capex to operator, similarly, not having proper infrastructure can hamper operations to take out hydrocarbons. Operator should carry out techno-commercial analysis thoroughly. The operator should plan financial sustainability for the company during the investment phase, because the return on investment takes some years.

Human Resource Cost

In oil and gas business every stage of operations require specialized skills and specialists are required to perform the work. This aspect involves huge costs and is subject to increase every year. Even though special operations are outsourced like FDP design, drilling, commission, overall operations are carried out by operating company only.

Specialized Services Cost

In oil and gas exploration many services are costly such as drilling, well logging, well cementing, offshore construction, pipeline laying, commissioning services, corrosion monitoring services, asset integrity services, OEM services for equipment etc. It is incumbent upon the operator to invest in all these services for oil and gas exploration.

Statutory

Oil and gas exploration involves many statutory regulations by the host country and compliance is a must. There are many bodies the operator may be required to report to such as the relevant ministry, technical arms, safety directorate, pollution control overseer, regional and local administrators for clearances, approvals and permissions.

Uncertainty Factors

Even though technology has reduced the quantity of uncertainty, it still persists in oil and gas exploration and production. Even though petroleum engineering technology has developed significantly and uses

sophisticated models, the quantity of oil and gas existing in the reservoir remains uncertain until the operating company starts production. The oil and gas operator should earn their investments and profits only from sales of oil and gas produced, by crossing all the uncertainty factors.

Financial Freedom

Oil and gas reserves are considered national resources and the host country has all rights to its reserves. This oil and gas exploration business is not like other businesses where the company can get a fixed price on raw materials or fix the price of the oil or gas produced. The operating company should get approval from the host country's relevant ministry and technical arms for all investments, because only approved expenditures can be recovered from sales of oil and gas. The risk factors are always inclined towards the operating company. So the operating company should take the utmost care in assessing the reserves carefully, before investing money into exploration. In addition, oil and gas prices and distribution are also fixed by the host government only; operating company has no voice in the decision on prices.

Strategic Management

The operating company should be strong in taking strategic financial decisions. It is involved with many external factors, which are not under its control, exclusively in dealing with all statutory compliances of host government and overcoming technical uncertainties. Making the operating company sustainable in the international market, with fluctuating oil and gas prices is also a challenge for the operating company financial management.

Capex for Infrastructure


Production of oil and gas requires huge infrastructure like offshore platforms, subsea pipelines, wellhead platforms, offshore processing plants, multi support vessels for offshore support, gas dehydration units, gas sweetening units, sulphur recovery units, water separation separator for crude oil, liquid hydrocarbon storage tanks etc.

In addition to the above, other associated infrastructures like water plants, effluent water treatment, buildings, control rooms, and power stations may be required. Establishment of the entire infrastructure chain requires huge amounts of money, operating company should invest its own money initially with approval from government.

Opex for Operations

Oil and gas exploration requires huge operating expenditures. These expenditures require hiring personnel with experience and specialized skills, purchases from original equipment manufacturer (OEM), purchasing spares from OEM, purchasing of consumables, outsourcing short-term specialized services for running the operations, etc. In addition, some more special expenditures like CSR (corporate social responsibility), hiring of associated supporting services, and transportation are required.

Conclusion

By carrying out investment risk analysis, techno-commercial analysis and taking strategic financial decisions, the operator can earn huge profits with satisfaction of serving the nation. 

References

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Required reading for the African Oil & Gas industry since 2003

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