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Navigating the Energy Transition Across the Oil and Gas Industry

By Rob Bell and Shawn Winkler

Figuring out what transformation will be necessary to sustain leadership in the oil and gas (O&G) industry is a moving target right now. The global focus on the energy transition, a transformation of the energy sector from its sole dependence on fossil fuels to more renewable energy sources, is manifesting as sharply increasing regulatory, public relations, and financial risks for companies, rooted in the still-essential jobs within the legacy value chains for carbon-based energy.

For oil and gas leaders, the question that's top of mind is: what is the right balance between enhancing the capabilities of the core business and preparing for a world in which those legacy core competencies need to be expanded?

Even the most risk-averse need to start making bets that take the energy transition into account without losing sight of the efficiency of their core operations. But the types of strategic bets that will have the biggest positive impact for your organization depend on where you sit in the value chain, the extensibility of the capabilities you have built into your core business, and the runway available to bring a viable new business model to scale.

Key Takeaways

- Even the most risk averse oil and gas companies need to start incorporating the energy transition into their future business models without losing sight of the efficiency of their core operations.
- The types of strategic moves that are most optimal for individual O&G companies will depend on where they fall in the value chain.
- Independent upstream companies should focus on enhancing their competitive edge via consolidations ensuring the proper inventory and cost structure to be competitive as demand for oil and gas shifts over time.
- Oil and gas services companies are well positioned to innovate their business models to incorporate valuable data insights gained through their work with clients.
- Midstream companies can capture near-term and longer-term markets by delivering on solutions for strategic investments in key green technology trends like carbon capture.
- Convenience store fuel distributors should be looking to provide a differentiated customer experience to continue to draw people in as traditional fuel demand diminishes over time.

Each cog in the oil and gas ecosystem has a unique role to play in the industry now and in the future. But the challenges each type of company is facing are inherently different. That's why the appropriate response for each is so incredibly nuanced, depending on a myriad of factors.

According to a recent Bloomberg report, global investment in the energy transition in 2022 was equal to fossil fuels investment for the first time in history. China leads investment in the energy transition, followed by the United States, Germany, France, and the United Kingdom, respectively. Individual governments' commitments to decarbonization vary greatly, but one thing's for certain — there's clear momentum toward a cleaner, greener future for energy production, transmission, and storage that shouldn't be ignored. Even by established O&G players.

Upstream Players: Focus on Honing Your Competitive Edge with M&A

This category of oil and gas companies are committed to their business models by default. However, the technical expertise embedded within these organizations could allow for swift adaptation of new technology once others have developed it. Combined with the continuing global need for fossil fuels, upstream players will see the most benefit from tweaking their business models to accommodate investor demands rather than making sweeping, wholesale changes. For these companies, the task becomes positioning for future demand while also adjusting for current investor expectations of return of capital rather than high growth.

Upstream companies may also consider mergers, acquisitions, and consolidation to expand efficiencies to hone their competitive positioning in market. Reducing per-unit production costs allows these companies to be competitive while maintaining proper inventory.

In this arena, there's a declining risk tolerance and a collective "hunkering down" because access to capital is getting harder to come by. This is creating a robust backlog among the remaining, consolidated entities. While upstream consolidation opportunities are easier contemplated than in execution given the need to agree on valuation and go forward governance , it reamains a viable option for many.

This theme supports changing the the ways companies plan for future and acces capitalto be more competitive in a lower-growth future.

Oil and Gas Services: Business Model Innovation Is the Name of the Game

Many existing oil and gas services companies provide a large catalog of capabilities developed over time, either due to customer demand or consolidation with other companies, which often come about in pursuit of a business model transition from exclusively offering physical services and equipment to a focus on more data- and expertise-based solutions.

If services companies can make this shift and master this approach, they could deliver valuable insights to EMP companies around efficiency, safety, and other critical factors. Productizing this expertise could open new doors in terms of the sustainable evolution of their businesses. While this is not necessarily directly related to the energy transition, it's a way of trying address the variability of their business model and layer in some other sources of income to increase their margins and customer loyalty during an uncertain, unstable time.

The energy transition provides a robust opportunity for these companies to capitalize upon core competencies developed around data analytics that can be applied in the growing energy transition sector. Efficiency in oilfield operations is mission critical for the upstream industry and could easily transfer to emerging operations in hydrogen, carbon capture, energy storage, geothermal, and natural gas as these sectors grow in importance over time.

Midstream Players: Get Ahead of Green Trends

Carbon capture and green hydrogen are two areas ripe for innovation in the midstream space. The key is to innovate while also paying attention to and responding to customer needs. Companies with the best technology and the most efficient processes will be the preferred project developers and are natural expansion and utilization of the core competencies of these organizations. Project finance capital can support the shift in focus from traditional oil and gas to these new green projects based upon volume commitments from presumably high grade counterparties.

Convenience Store Fuel Distributors: Respond to Evolving Customer Needs

The reason that people stop in to convenience stores or gas stations (getting gas) is, in theory, going to reduce at some point in the future. People who have electric vehicles (EVs) don't need to stop for gas.

So what happens to this real estate? Should they put in charging stations? Do you expand to convenience store offerings to position the business as standalone without gasoline? How do you attract people to your stores to sell your higher-margin products and services (convenience store products, car washes, etc.)?

While future technology developments for car batteries and charging infrastructure are encouraging, how they fit with current gas station real estate remains to be seen. While actual gasoline sales aren't reducing to zero anytime soon, the carrot to bring customers in to sell higher-margin products certainly needs to be considered now as a potential challenge in the medium to long term.

Questions for Leaders

Regardless of where your company currently resides in the oil and gas ecosystem, there are a few questions you should be asking yourself to ensure you make the best decision for your unique organization.

- What are customers asking for?
- How do potential new investments fit within your current business model/scope?
- What are the potential returns (with and without subsidies)?
- What is your org's risk tolerance?
- Do you have a BD team that is fresh on new technologies/transaction structures?
- What is your best guess about what the future holds?
- Are there available joint ventures/partnerships that could spread out the risk?

Despite the best intentions of global governments and clean energy innovators, we're likely going to have oil and gas needs for the next several decades. So, it's critical that oil and gas companies have a clear plan and roadmap to keep their operations functioning in the interim.

Taking a 100-year view, these companies have time to transition their business models. It's about balancing the maintenance of your core O&G operations and keeping an eye toward **the future of the energy transition** all while in a challenged capital availability environment.

In other words, how can you optimize your business today while fostering existing competencies and employee skill sets to capitalize on energy transition opportunities as developments warrant expansion and diversification?

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