Impacts of Drop in Investments in New Assets in Oil & Gas and Associated Sectors

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Though the global graph of COVID-19 is generally flattened and is trending to slope down in most parts of the world, it is still impacting everyday life. This has caused a severe economic disruption globally and the future is unpredictable though the real impact has slowly started to unfold. With the significant macroeconomic turbulence it has caused, there are convincing reasons to worry about a post-COVID world on the brink of global recession; probably the only question is, 'when'. Quite obviously, most of the variables are directly or indirectly connected to unavoidable containment measures and their potential economic consequences. There is a brutal meltdown in the global financial markets. It is hard for any government to stop the economy from stalling and some may struggle to stop even falling. There is a big risk of breakdown in the credit line which in turn will lead to severe liquidity crisis and bankruptcies and finally employment losses. The article attempts to look at the impact of the drop in investments in new assets in the Oil & Gas and associated sectors on various levels.

Industry in General

Apart from severe damage on the business ecosystem, it is extremely important to see if there would be lasting structural impacts on the industry and business from the current crisis. The answer is Yes and No. Industry needs to seriously and quickly explore the possible scenarios for recovery. Projections and indices will not answer this question precisely. Though every business entity should be optimistic about it, they should also be fully prepared with their own strategies for a worst-case scenario. The impact will not be uniform across countries and industries. It will be unique for each country, each sector, each industryand even each entity. The scale of economic vulnerability will be very heterogeneous.

Oil & Gas and Associated Sectors

The Oil & Gas sector, its downstream petrochemical and even the chemical sectors are facing compounded stress from the unprecedented drop in the oil price which synchronised with the COVID pandemic. Even before the emergence of the current challenges, many companies and businesses inthe Oil & Gas sector were feeling financially fragile for the negative impact due to increased emphasis on climate change. Currently, with reduced air travel and many other lower economic activities caused by COVID, crude oil demand is projected to be unmanageably low, calling for curbing of additionalproduction capabilities. With the demand side falling to unprecedented levels, oil prices are under severepressureas the sector is navigating through uncharted territories in the past, in terms of demand and supply sides.

Investments in Projects & Assets

The two unprecedented situations of COVID and tumbled oil price are poised to wreak havoc on new project development plans for this year. All upstream players will balance their cost levelsandinvestment plans with the financial shock of lower prices and demand. Many projections from leading consultingfirms indicate a slash of up to two-third of earlier envisaged project sanctioning, that too facing delays from earlier plans. Author feels that some of the projects in advanced stages of bidding may even go to a re-bid scenario, which may change the entire competition profile on these bids.

Organisations cannot afford to go bankrupt. Whatever reduction they can do in terms of financial commitments and exposures they will and have to. All these will reduce the investments innewinitiatives and enhancement of existing production capacities, which means much less projects and much smaller projects. As liquidity and cash will determine who will survive the current crisis and who will not, many companies in midstream, downstream and other associated sectors will also suspend or defer some of their projects with a slashed capex budget. Visibly a huge dip in consumer demand in many sectors from textiles, plastic and others will impact the petrochemicals sector severely. Therefore, there willbesevere cuts in investments in this sector. Many good to have project scopes and nice to do things will disappear from the portfolio.

Investment in the clean energy sector has been slowing for a few years now, after peaking in 2017. This situation is only set to worsen as the impact of COVID-19 continues to squeeze liquidityconditions.Though the renewable energy sector would be entering a new growth phase, it cannot compensate even a small percentage of damage made by the Oil & Gas sector in terms of GDP and employment.

The Infrastructure sector like power and water will also face a significant drop in Government spending and even from private sector developers. Furthermore, many projects in the Non-industrial Infrastructure sector will also be slowed down, deferred or even cancelled as annual budgets of some of the countries are directly or indirectly driven by the revenue from the Oil & Gas sector.

Financial Distress on Projects

Projects in the Oil & Gas and other associated sectors mentioned above are predominantly Construction Projects or EPC (Engineering, Procurement & Construction) though there are other contracting models practiced to less extent. These segments of the Oil & Gas value chain are largely price-sensitive and operate on low-profit margins with a heavy dependency on materials management, supply chain, workforce management and various other economic parameters. As a result, many upstream and midstream EPC projects will potentially face a multitude of challenges during this quarter and subsequent quarters. Most of the ongoing projects are prone to experience delays and cost escalation.

For the contracting companies, the key challenges in this difficult situation are supply chain, workforce management, cost overruns and increased subcontracting work timelines dependency.

The project supply chain for equipment and bulk materials has been badly impacted in the last three months and will continue for many more, driving up prices and causing delayed deliveries. All of these will further add to the overhead costs, apart from forced buying at premium prices and dependence on air-shipment rather than by road and sea.

Field construction productivity has taken a big hit with the required social distancing, personal protection requirements, new safety rules and cleaning routines. Though multiple indicators on cost escalation are predicted by leading business houses and MNCs, 12–15 per cent is agreed by most of the industry experts. Spending on personal protective equipment along with generic and specialised workplace hygiene enhancements is going to be significant. This will encompass N95 masks, disinfectants, disposable gloves, hand sanitisers, performing no touch thermometer checks on the workforce and possible need for additional onsite compliance, testing staff and many other items. Even the standard work and operating procedures may change in some areas.

Projects will take longer to complete making it dearer on overheads. Author foresees at least 10 per cent time overruns for projects which are currently at less than 50 per cent overall progress. Lenders and banks have tightened borrowing and project funding procedures which will strain the overall cash flow position, adding up to further reasons for delays.

Though some projects may have provisions for re-negotiation of full or parts of the contract in such unprecedented times, by and large these are not easy except for interventions by the respective governments through stimulus packages. In the practical contracting world, effective exercise of the force majeure clause in a contractor's favour is heavily dependent on the factual circumstances and the drafting of the specific clause.

Employment Levels

With all challenges due to lower investments, tighter cost basis and many other factors, the direct employment levels in the projects and those in many associated sectors like manufacturing, supply chain and services are already under severe strain and unfortunately going to continue till these sectors return to "business as usual" which is many months away, if not years. Global Business Data Platform 'Statista' had predicted a significant drop in employment levels in the Oil & Gas sector in 2019–2020 even before COVID and validated for COVID impact in March 2020 as follows. The data analysed are in three broad categories Off-shore, Shale and other On-shore.

Table 1. Data Forecasting Drop in Employment Levels in the Oil & Gas Sector for 2019–2020 and Impact from COVID.

Sector	Offshore	Shale	Other Onshore	Weighted Average
Pre-COVID Impact for 2019–2020	8%	24%	12%	13.5%
Added Impact from COVID (March 2020)	11%	8%	5%	7.5%

Source: Statista, Global Business Data Platform.

It is to be noted that the global scenario has terribly worsened in April and May 2020 which needs to be considered as further dip may be seen in these already alarming figures.

Expatriate Employees

Many countries around the world depend on expatriate employees, even unskilled labourers, for project execution in the Oil & Gas/associated sectors and some countries have a significant percentage of expatriates for other related sectors as well, like manufacturing, supply chain and services sectors. Major restrictions on visa regulations are envisaged to be imposed by various governments while engaging expatriate employees at any level, as the domestic unemployment levels will shoot up to an unprecedented level in the post-COVID world in most of the countries. Even before COVID, some parts of the world had started going away from globalisation and post -COVID would most likely move further away from it. Localisation and self-sufficiency will be the powerful slogans in the post-COVID world for many countries.

Indian Manufacturing & Service Sectors

There will be a shock wave to the manufacturing and service sectors for the business volumes they have been executing for the last many years for the projects in the Oil & Gas/associated sectors internationally. Off late, many Indian manufacturers have found a visibly significant place in these projects through products manufactured in India or those manufactured in their facilities in the respective countries most likely as Joint Venture with local companies. In FY19, India's engineering export stood at US$ 81.02 billion and during April 2019-January 2020 it was US$ 64.03 billion. A significant part of this will go on to industrial projects and most of them are directly or indirectly related to the Oil & Gas sector. The Service sector covers engineering design services (most of the leading multi-national EPC Companies have their high value engineering centres in India employing thousands of high-end engineers and consultants), testing & inspection services, IT services, HR related services (like payroll), training and recruitment services, visa

NRIs Employed in Oil & Gas and Associated Industries

Another important component of the impact on Indian economy is the loss of employment for a large number of Non-Resident Indians (NRIs) engaged in the Oil & Gas sector projects and associated other sectors abroad. The Oil & Gas sector projects employ hundreds of thousands of people on the project itself, and on multiple associated industries and businesses like manufacturing of equipment and bulk materials, trading, logistics and many other services. Like any other sector, these personnel can be grouped broadly into three categories:

1. Executive & Senior Management

2. Management, Middle Management and Frontline Personnel
3. Skilled and Unskilled Workers

In the MENA (Middle East & North Africa) region, a substantial percentage of expatriates in the second and third categories are from India; especially in the third category which has the weakest financial muscle and worst personal saving habits.

Another area where a large number of Indian workforces are engaged (though short term) internationally, is the Turnaround & Shutdown of major producing facilities. With the current strain on their bottomlines, many production facilities will be deferring their scheduled shutdowns by one or two quarters.

Unemployed NRIs will return in large numbers, which has already started. This obviously will impact the purchasing power of their families back home and is going to make a deep dip in the demand side for anything and everything. Furthermore, many of these returnees will find it hard, or in some cases, even impossible to find an alternate earning in the locality/State they are from. With poor to no savings and outstanding loans to be serviced for many of the returnees, the social impact will also need close attention from the respective governments, which have big limitations through widened budget deficits.

Change in the Skill-set Mix for Projects and Opportunities

Unlike all other big industries, the construction sector has not improved its efficiency much over the past decades. However, with cut-throat competition in the post-COVID era, where too many big engineering companies in the Construction and EPC sectors chasing too few projects, the industry will be forced to and will surely embrace digital transformation at an unusual pace calling for a different mix of skill sets required for employees. The industry can only afford quick learners with multi-faceted skillsets and adaptable to further changes as would be expected in the modus-operandi of the industry.

At the same time, there would be opportunities for professionals around the world, especially from India, to work on contract basis on the support side of the projects and manufacturing sectors like cost management, planning & monitoring, documentation development, etc. Even smaller companies with a group of experienced freelance specialists will find opportunities to support projects in the Middle East, Africa, Europe, Caspian area and North America.

Conclusion

Uncertainty on the trajectory of the virus outbreak, which is still unfolding, makes it impossible to have any reasonable prediction on how transformative the overall impact of COVID will be on the regional, national and global levels. The economic priorities and business dynamics in the post-COVID time would be significantly different.

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