Government-Facing Strategy for Oil and Gas Companies

Developing a Productive Relationship with Host Governments
Contact Information

Abu Dhabi
Dr. Raed Kombargi
Partner
+971-2-699-2400
raed.kombargi@booz.com

Amsterdam
Robert Oushoorn
Partner
+31-20-504-1981
robert.oushoorn@booz.com

Otto Waterlander
Partner
+31-20-504-1950
otto.waterlander@booz.com

Chicago
Eduardo Alvarez
Partner
+1-312-578-4774
eduardo.alvarez@booz.com

Dallas
Dennis Cassidy
Partner
+1-214-746-6552
dennis.cassidy@booz.com

Christopher Click
Partner
+1-214-746-6543
christopher.click@booz.com

Andrew Clyde
Partner
+1-214-746-6566
andrew.clyde@booz.com

DC
Peter Bertone
Partner
+1-703-905-4077
peter.bertone@booz.com

Delhi
Suvojoy Sengupta
Partner
+91-124-499-8700
suvojoy.sengupta@booz.com

Dubai
Sean Wheeler
Partner
+971-4-390-0260
sean.wheeler@booz.com

David Branson
Executive Advisor
+971-4-390-0260
david.branson@booz.com

Asheesh Sastry
Principal
+971-4-390-0260
asheesh.sastry@booz.com

Houston
Juan Trebino
Partner
+1-713-650-4151
juan.trebino@booz.com

Kuala Lumpur
Edward Clayton
International Director
+60-3-2095-2088
edward.clayton@booz.com

London
Andrew Clark
Partner
+44-20-7393-3418
andrew.clark@booz.com

Rose Landau
Associate
+44-20-7393-3508
rose.landau@booz.com

Milan
Giorgio Biscardi
Partner
+39-02-72-50-92-05
giorgio.biscardi@booz.com

Cristiano Rizzi
Principal
+39-02-72-50-91
cristiano.rizzi@booz.com

Moscow
Ekaterina Kozinchenko
Partner
+7-495-604-4100
ekaterina.kozinchenko@booz.com

Paris/London
Douwe Tideman
Partner
+33-1-44-34-31-27
douwe.tideman@booz.com

Rio de Janeiro
Paolo Pigorini
Partner
+55-11-5501-6229
paolo.pigorini@booz.com

Arthur Ramos
Partner
+55-11-5501-6229
arthur.ramos@booz.com

Sydney
Varya Davidson
Partner
+61-2-9321-2820
varya.davidson@booz.com
EXECUTIVE SUMMARY

Political power plays, environmental disasters, increasing competition, rising oil and gas prices, ambitious national oil companies, and increasing public scrutiny are changing the rules of engagement for international oil companies and governments around the world.

The old and tested approaches to government relations, based on high-level connections and pie-splitting, are no longer sufficient for the new challenges companies face today. The times require an integrated government-facing strategy that addresses all these challenges and positions the company for long-term success in the host country. We advocate that international oil companies change and take a more systematic approach to government relations than hitherto has been customary. This requires much deeper knowledge of the host country, a broad network of relationships, more coordination with local stakeholders to ensure coherence between a company’s intent and local expectations, and strengthened capabilities to plan, respond, and adapt to ongoing change.

An effective government-facing strategy eases the path to business objectives like access to acreage on reasonable terms and competitive (oil-field) services. Such a strategy helps position the company in the longer term as a responsible contributor to the host country’s economic and social development, and as a long-term player able to fully realize its hydrocarbon potential. This strategy will create reputational capital that can pay big dividends over the life of a project and beyond.
A NEW MODEL FOR GOVERNMENT RELATIONS

For oil and gas companies, it’s never been more important or more difficult to forge strong working relationships with governments around the globe. Events like Argentina’s nationalization of a unit of an overseas oil company, the Gulf of Mexico oil spill, and disputes among joint venture partners cooperating in complex operating models illustrate the new political, operational, and competitive challenges facing international oil companies (IOCs). To meet those challenges, and retain the “social license to operate” in countries around the world, IOCs need better strategies for dealing with host-country governments.

An effective government-facing strategy goes beyond building relationships with high-level officials and hitting the host country’s cost recovery and production targets. Such a narrow approach often overlooks key local players and misses the big domestic factors—environmental impact, economic development, resource control, and social and political trends—that can make or break an IOC’s long-term relationship with the host country. Smart strategies reflect all these issues, and connect IOCs with influential figures at all levels, from the upper echelons of government to the national oil company (NOC), grassroots groups, nongovernmental organizations (NGOs), and the political opposition.

In the broadest sense, the company needs to convince a range of constituencies that it is a responsible “corporate citizen,” economically, environmentally, and socially. An IOC must demonstrate the tangible benefits it brings to the country as a whole. Governments want more than just their share of oil revenues: They expect oil companies to boost the economy by hiring and training local workers, ordering goods and services from local suppliers, providing access to cutting-edge technology, and helping the country attract more foreign investment. Governments need to demand so much more because of pressures from the population and the need for local development. They can ask for so much more because the oil industry has gotten much more competitive and the service sector more assertive and capable.

The wish list can get expensive, but an IOC with good relationships in the country has a better chance of negotiating arrangements that satisfy the government while preserving the profitability of projects. These benefits justify the effort required on both sides to build such a relationship. Effective government relations help the IOC win and retain access to resources, foster smooth operating conditions, enhance the company’s reputation in the country and elsewhere, and bolster its standing as a preferred partner for government on future projects.
THE CHALLENGES

IOCs around the world face a widening array of political, environmental, technical, and competitive challenges. Any one of these challenges can threaten an IOC’s reputation, access to resources, and bottom line. Managing these risks requires deeper engagement with government officials and other host-country stakeholders.

Political Pressures
Political pressures are squeezing IOCs in both the developing and developed worlds. Prominent among them is “resource nationalism,” which has many countries asserting greater control over their mineral reserves. Most recently, this trend manifested itself in Argentina’s seizure of Spanish IOC Repsol’s YPF subsidiary. Elsewhere, governments are imposing resource rent taxes and demanding equity stakes in commodity companies. The United Kingdom, for example, surprised the industry in 2011 by hiking its supplementary charge on U.K. oil and gas production in the North Sea to 32 percent from 20 percent. In Iraq, reluctance to relinquish control over natural resources is slowing the issuance of new exploration and production licenses to IOCs and driving a shift to less lucrative technical services contracts from production-sharing agreements that allow IOCs to book reserves.

Meanwhile, scrutiny of oil companies in industrialized countries is intensifying as gasoline prices rise and crises such as the Gazprom–Ukraine gas dispute and the Gulf of Mexico oil spill draw public attention. Media, politicians, and others are criticizing the industry and calling for more transparency in its activities.

Environmental/Technical Demands
As the search for oil and gas reaches more remote areas, the financial, technical, and environmental stakes rise. Exploration and drilling in deep ocean waters or the Arctic face high costs, unique operating challenges, and stringent environmental and safety standards. Similarly, unconventional fracking draws public attention and opposition and requires a proactive approach. At the same time, IOCs must address concerns over climate change, biodiversity, and environmental sustainability. Technical challenges in these demanding environments range from shortages of specialized skills and equipment to unexpected delays, cost overruns, and the need for satisfactory well productivity in difficult reservoirs. All these factors add risk to every investment decision.

Changing Competitive Landscape
Competition is increasing for IOCs

Exploration and drilling in deep ocean waters or the Arctic face high costs, unique operating challenges, and stringent environmental and safety standards.
as host countries nurture homegrown NOCs. Governments increasingly require IOCs to join forces with an NOC, sharing the financial fruits of the project and valuable technical know-how with a nascent rival. Demands for technology transfer raise serious intellectual property and competitive concerns for IOCs.

Supermajors have become less dominant in some regions as NOCs and independent oil companies expand. In their home countries, NOCs are looking to rapidly improve their capabilities (see Exhibit 1). Expansionist NOCs (those that are “resource poor”) that operate abroad (such as China National Petroleum Corporation in Africa) often serve as the leading edge of their home government’s economic development program and a means to achieve and maintain security of supply. Extensive deployment of capabilities, capital, and more by an external NOC is now common in oil-rich countries like Angola and Iraq (see Exhibit 2).

As competition intensifies, a high-quality local engagement and investment plan can be the key factor that sets an IOC apart from new and old rivals.

---

**Exhibit 1**
Erosion of Supermajor Dominance in Selected Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>1990</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>52%</td>
<td>48%</td>
</tr>
<tr>
<td></td>
<td>48%</td>
<td>52%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>38%</td>
<td>62%</td>
</tr>
<tr>
<td></td>
<td>62%</td>
<td>38%</td>
</tr>
</tbody>
</table>

Source: Rystad Energy; Booz & Company analysis

**Exhibit 2**
Role of NOCs and Independents in Iraqi Licensing Rounds

<table>
<thead>
<tr>
<th>Round</th>
<th>NOCs</th>
<th>Independents</th>
<th>Supermajors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>54%</td>
<td>22%</td>
<td>24%</td>
</tr>
<tr>
<td>2</td>
<td>74%</td>
<td>7%</td>
<td>19%</td>
</tr>
<tr>
<td>3</td>
<td>70%</td>
<td>20%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Republic of Iraq (Ministry of Oil); IHS Global Insight; Petroleum Economist; Booz & Company analysis
When Government Relations Get Strained

In a joint venture of several supermajors and an NOC, tensions between partners and the host government had recently created an atmosphere of mistrust and effectively shut down communications, impacting the venture’s ability to make decisions. Instead of addressing the underlying issues and developing a unified approach to government relations, the partners tried to manage relationships with the government individually and independently. Different and sometimes conflicting messages from the various partners soon caused the government to become frustrated with the whole venture. This situation was left unaddressed for too long, leading to painful consequences for the venture.

At this critical point, a rigorous diagnostic identified several issues affecting the venture’s government relations, including the lack of a coherent strategy and communications plan, unclear processes and responsibilities within the organization, and capability gaps among both the expatriate and local staffs. These problems were rooted in deeper divisions in the venture, such as a lack of agreement among partners on the division of responsibilities and strategic priorities. The initiative defined three key areas of action for the venture: understanding the external macro-environment; defining the government-facing strategy and the key players to influence; and improving the organization, roles, and responsibilities to support the new strategy. In hindsight, a much earlier intervention would have avoided a lot of problems and helped the venture to gain and keep the initiative.
A strong working relationship between the government and the IOC delivers real benefits to each. For the IOC, it paves the way to initial drilling licenses and helps ensure smooth operating conditions. Other direct benefits include more efficient cost recovery, fewer complications regarding permits and development approvals, greater security for the staff, and a reduced risk of legal challenges. The development of a competent and competitive local workforce will be of great value to the IOC already under pressure to mobilize enough manpower for the in-country organization (as well as from a cost perspective). More broadly, a productive relationship helps establish the company as a positive, enduring presence in local communities, and burnishes its reputation as a trusted partner for government. This, in turn, gives the company an advantage in seeking new concessions in the country, and a stronger calling card with governments elsewhere in the world.

For the government, working cooperatively with IOCs helps achieve important economic and social goals. At the macro level, it helps integrate the oil industry into the national economy in a sustainable manner, avoiding the so-called resource curse (the potential negative economic impacts of rich mineral reserves, including high inflation, lack of economic diversification, and slower development). Close ties with an IOC can advance a range of government priorities, such as building a skilled workforce, cultivating local oil industry suppliers capable of competing internationally, developing the country’s NOC, building a (gas-fired) power sector, and developing further industrial activity. They also help protect local communities, society at large, and the environment against any negative impacts from energy development projects. By demonstrating the ability to create stable operating conditions and to work productively with international companies, governments also encourage further foreign investment.

Like any pair of contracting parties, IOCs and governments will experience tensions. A strong working relationship enables the parties to resolve disagreements and reconcile competing priorities before they cause permanent rifts that undermine the objectives of both sides. An effective government-facing strategy provides the foundation for such a relationship.

A strong working relationship enables the parties to resolve disagreements and reconcile competing priorities before they cause permanent rifts.
CREATING AND EXECUTING AN EFFECTIVE GOVERNMENT-FACING STRATEGY

An effective government-facing strategy starts early—as soon as exploration rights are being secured, and therefore well before a final investment decision is made. The first step is information gathering: The company analyzes the political, economic, and social landscape of the host country and identifies key players that can influence the success of the project. After deciding to invest, the operator uses this knowledge to create an overall strategic plan that will guide its actions over the course of the project and beyond. As the project moves into development, the IOC begins executing the government-facing strategy by implementing a series of detailed action plans designed to support project objectives, address specific risks, and meet the government’s expectations. The IOC should realize that the project will reach key operational milestones long before government objectives such as local supplier development are fully achieved. Therefore, supplier development programs must continue far beyond the moment of “first oil” (see Exhibit 3).

Generate Deep Local Insight
First, companies need a detailed and comprehensive understanding of the political environment (legislative and executive structure, political parties and key players, major trends and possible implications), the business climate (security, corruption, petroleum fiscal systems, employment law and practices, environmental standards), and social conditions (education, health, infrastructure, level of economic development, NGOs). In-depth knowledge of government policy and economic development goals is essential, along with an appreciation of how the project affects that agenda. For instance, the IOC can help the government make the hard trade-offs where priorities conflict. Big issues such as assessing the need for in-country refining capacity and the manner in which to develop the power sector are only a few of many examples where dialogue between an IOC and the government are beneficial to both parties. The IOC lays the groundwork by determining which aspects of the project require government involvement (permits, workforce development, cost-recovery mechanisms) and reconciling the objectives of the company and the government. Doing this well requires some modesty on the part of the IOC in recognizing the government as its...
An effective government-facing strategy connects the company with all levels of government, other important institutions, and the major segments of society. This extended web of relationships can provide the influence needed to achieve short-term goals, and the ballast to withstand long-term changes.

**Define the Government-Facing Strategy**

Once the decision to invest has been made, and ideally even earlier, the IOC, as operator, uses the information and analysis from the first phase to create a comprehensive planning document for government relations in the host country. It is crucial that the operator has the broad support of its joint venture partners in this matter. The strategic plan should include the following components:

- **Objectives and measures:** The plan should state the goals of operators and joint venture partners (such as delivering the project on time and on budget, protecting the value of a major investment, and acquiring licenses for new acreage) and those of the government (such as developing a strong, competitive local supplier base and gaining increased energy independence). Quantifiable measures of progress help the operator and the government see one, factual version of the truth.

In some cases, depending on the host-country situation and ambitions, a much broader plan may include considerations with regard to developing the local power, gas, refining, or petrochemical sector.

- **Position on key topics:** For each key topic of government engagement identified in the first phase, the plan should articulate the operator’s ideal outcome, the government’s expectations, and an acceptable compromise position.

- **Scope:** The plan should list all aspects of the project that require government engagement, and identify the IOC activities and departments that will be affected by the government-facing strategy. Taken broadly, these will range from human resources to the supply chain.

A narrower approach might seem more expedient but can undermine the coherence of the strategy. For example, if the company’s design and procurement departments aren’t involved from an early stage in establishing goals and procedures for sourcing goods and services from local suppliers, it will be difficult to ensure that the product specifications, contract requirements, and scope “packages” they define will match the capabilities of vendors in the host country.

- **Resources and capabilities:** The plan should outline a detailed organizational structure and identify the key capabilities required to implement the strategy, along with any recruiting or training needed to secure those capabilities.

- **Anticipated main risks:** For each significant government relations risk identified in the first phase, the plan should lay out a mitigation strategy.

- **Business case:** The complete set of activities, expected outcomes, and associated costs should be brought together in a business case that
ensures that, in the end, sound economic principles underlie the government-facing strategy, and against which execution of all the plans can be managed.

Execute the Government-Facing Strategy
Planning meets reality when the overarching strategic document is translated into a series of action plans and organizational adjustments focused on short-term project goals while advancing the company’s long-term objectives in the country. Action plans name the individuals responsible for achieving each goal, set deadlines, and establish mechanisms for cross-functional communications, decision making, monitoring of progress, measuring success, and responding to changes and setbacks.

At a minimum, the action plans should cover local supplier and local workforce development (recruitment and training), communications, and stakeholder management. A more integrated strategy also will encompass social/community investment, infrastructure investment (e.g., schools, hospitals, roads), and environmental sustainability.

A successful plan draws on the skills, experience, and insight of people throughout the company. Therefore, all those who will be called on to help implement the plan should have a voice in its development. The government relations department should be the company’s hub for information and expertise, and should be consulted on any government engagement activities. But the government relations or business development team alone should not be held responsible for achieving objectives that require support from other departments. Rather, the company should integrate the plan fully into its business processes and make any changes in its organizational structure that may be needed to carry out the government-facing strategy. The latter approach is more rigorous and opens the door to genuine value creation through effective strategy execution.

Finding the right people for government-facing roles is crucial. Planners should seek the best talent available, inside or outside the company. While expatriate staffers have valuable operating experience and know the company’s “ways of working,” they’re outsiders in the host country. Hiring locals for government relations jobs brings the company deeper knowledge of the country and access to a broader network of local contacts.

Executives should consider the action plans part of a dynamic process of continuously assessing, updating, and improving the company’s government relations. Flexible action plans covering the full range of goals, constraints, and contingencies propel the project toward its goals, while managing setbacks along the way.

Using a “do-learn-improve” approach, the IOC should actively monitor progress and risks through formal, quantitative tracking systems and through informal feedback from government officials and others. These conversations provide an opportunity to discuss issues and address concerns before they lead to explosive surprises.

IOC officials implementing action plans should remember that a government-facing strategy is about more than just delivering the project; it also should advance the company’s broader objectives, such as access to new resources in the host country or enhancing its relationship with the local NOC (e.g., creating a partnership to bid for new projects).

The Importance of Influence
Influence is the lifeblood of government relations, affecting every stage of an IOC’s activities in the host country. It can help the company win exploration permits, negotiate production agreements, and smooth out the inevitable bumps in its relationships with various host-country constituencies, be it at the national, regional, or local level.

Winning and retaining influence requires strong stakeholder management and effective communications. Stakeholder management means developing one-on-one relationships between IOC representatives and the key players identified in the stakeholder map created in the first phase, which should be continuously updated to reflect changes in the power structure.

Communication works at two levels: advancing the goals of the project and improving the company’s image in the host country. IOCs should develop messages on relevant topics, tailoring them to the interests of local audiences and choosing the most appropriate media channels to tell their story. It is of great importance that the operator and joint venture partners are consistent and speak with one voice.
Think Globally, Source Locally

“Local content”—the jobs and business opportunities a project creates in the host country—is a frequent flash point between IOCs and governments. Usually, the government wants to maximize opportunities for its people, while the IOC wants the best workers, suppliers, and, above all, quality and safety. The government and the IOC might disagree on the capabilities of the local workforce and industry, for example, or the government might suddenly raise its demands for local content without consulting the company. Potential clashes can be defused by addressing local content at every stage and by implementing the government-facing strategy. Done well, local content programs are a winning proposition for both government and operator—for instance, by developing a competent local workforce.

Local Content in the Information-Gathering Stage
The IOC should invite the government to participate in a detailed review of host-country suppliers, so that both get a realistic and shared understanding of local capabilities. Ideally, this first engagement with government occurs before specific terms appear in signed licenses. A broad range of local actors should also be consulted, including the local NOC, local suppliers themselves, and even other IOCs where possible. Conducting this review in the earliest stages will enable the IOC to incorporate local content into its front-end engineering and design.

Information gathered in the IOC’s broader research on the host country’s political, economic, and social climate will be relevant to the local content analysis, helping the company understand not only what the government wants, but why. It also can provide early warning of certain risks, such as political actors likely to use local content as a platform and push unrealistic targets.

Local Content in the Planning Stage
The IOC should clearly define local content objectives in its government-facing strategy. Beyond describing optimal outcomes for the IOC, the objectives outlined must reconcile company goals with what the relevant agreements stipulate and with government expectations and local operating constraints. Consultation and buy-in from the IOC’s procurement department, which will be charged with implementing the plan, is essential.
The plan also should explain how the IOC will meet the local content objectives. Effective methods include structuring work packages to maximize opportunities for local businesses; training local suppliers in the required tendering practices; giving local suppliers enough lead time to add the capacity they will need to fill orders from the project; and aligning internal processes and systems (such as IOC management bonuses) with local content objectives.

**Local Content in the Execution Stage**

The IOC needs detailed action plans for the short, medium, and long terms, clearly identifying which goods and services will be priority areas for local sourcing, as well as how the operator will help build up the local supplier base (including financial support, training programs, and/or partnerships with established international suppliers). Each plan should have specific targets and performance benchmarks developed in consultation with the government. This official imprimatur will help protect against subsequent changes in targets or calculation methodology that might disadvantage the company.

Success depends on active stakeholder management that keeps the company informed of the government’s satisfaction with the local content program and warns of impending changes to the policy or legislative framework. Equally important is a communications strategy that showcases the company’s contribution to the local economy and its commitment to the country’s development.

Throughout the process, the operator and its partners must keep working with the government to ensure that no unreasonable expectations are building up. The government must also be reminded that the local content plan has a much longer time line than a typical upstream development phase, so there is a need to provide continuity for the sake of the host country. The latter can be done through the oil industry only to the extent that there is ongoing oil and gas activity.
CONCLUSION

A robust, adaptable government-facing strategy helps an IOC navigate the increasingly complex, ever-changing local conditions and demands that can throw a project off course. This facilitates the company’s primary goal of completing the project on time and on budget. But an effective strategy of engagement in the host country pays even larger long-term dividends by casting the company as a positive force contributing to the development of the local economy. The resulting relationships and mutual understanding form the foundation for a bright future in the country. Development of such a government-facing strategy should take full benefit from an objective external perspective.
About the Authors

**Douwe Tideman** is a partner with Booz & Company based in Paris. He specializes in the upstream oil and gas sector and has prior industry experience with large and small operators. He has led several assignments in the area of host-government/country engagement and local content for clients including oil companies and governments.

**Dr. Raed Kombargi** is a partner with Booz & Company based in Abu Dhabi. He specializes in energy-related projects working primarily with NOCs, IOCs, OFS, and EPC companies on strategy development, cost-efficiency reviews, operating model designs, and transformation programs. His experience also includes the development of local content programs with a strong focus on the Middle East.

**Robert Oushoorn** is a partner with Booz & Company based in Amsterdam. He specializes in strategy development for upstream oil and gas clients, and for clients along the natural gas value chain. His experience includes developing government-facing strategies and improving governance and operating models.

**Cristiano Rizzi** is a principal with Booz & Company based in Milan. He specializes in the upstream oil and gas sector and has led several assignments with NOCs, IOCs, and oil-field service companies in Europe, Asia, Africa, and the United States. He has a deep expertise in the field of governance and operating model of oil companies.

**Rose Landau** is an associate with Booz & Company based in London. She has upstream oil and gas experience working with clients in Europe, Asia, and Australia. Her experience includes development of a government-facing strategy for a major oil and gas joint operating company, with a deep dive on local content best practice.
Booz & Company is a leading global management consulting firm focused on serving and shaping the senior agenda of the world’s leading institutions. Our founder, Edwin Booz, launched the profession when he established the first management consulting firm in Chicago in 1914. Today, we operate globally with more than 3,000 people in 58 offices around the world.

We believe passionately that essential advantage lies within and that a few differentiating capabilities drive any organization’s identity and success. We work with our clients to discover and build those capabilities that give them the right to win their chosen markets.

We are a firm of practical strategists known for our functional expertise, industry foresight, and “sleeves rolled up” approach to working with our clients. To learn more about Booz & Company or to access its thought leadership, visit booz.com. Our award-winning management magazine, strategy+business, is available at strategy-business.com.

©2012 Booz & Company Inc.