

Cairn energy strategic analysis

[Business](#), [Industries](#)



INTRODUCTION

Cairn Energy Plc (“Cairn”) is an Edinburgh based publicly traded Oil & Gas Exploratory & Production (E&P) company dealing primarily within its operated assets in India, Bangladesh, Nepal and Greenland (Cairn, 2009). Major products sold are crude oil and natural gas, produced from both offshore and onshore drilling blocks (Hoovers, 2009b).

Cairn was founded in 1984 by Sir Bill Gammell with initial operations in the US. Following its IPO in 1988, Cairn is now publicly traded on the London Stock Exchange with 2008 revenues of \$299.3 million and operating profit of \$440.9 million – due to sales of assets and financing profit (Cairn, 2009).

BUSINESS SEGMENTS

Cairn’s businesses are divided broadly into two segments namely:

Cairn Energy Plc holds a controlling interest of 62.39% in Cairn India. Since its first oil major oil discovery in the Rajasthan fields of 2004, which was the biggest exploratory discovery in India since 1985, Cairn has focused exclusively on the acquisition of oil blocks and continuing exploration in the country (Cairn Financial Report, 2009).

Capricorn Oil Group is Cairn’s exploratory division that primarily focuses on the exploration of undiscovered oil fields, and is 90% owned by Cairn.

Capricorn’s primary focus is on India and the discovery of new oil fields in the country. However Capricorn currently owns exploratory lease-agreements to

7 oil-blocks in Greenland, which are currently pending regulatory approval for oil production (Cairn Financial Report, 2009).

PESTEL

The following table is a macro economical analysis of how political, economical, socio-cultural, technological, environmental and legal factors affect the exploration and production (E&P) industry. The extent to which these factors affect the E&P industry is outlined on a cognitive rating scale from -2 to +2. -2 represents a strong negative effect, while +2 represents a strong positive effect on the E&P industry operating within those regions.

FACTORS EFFECT ON INDUSTRY LEVEL OF EFFECT

Political

Governments of oil producing nations are very involved in the exploration and production of oil and gas in their countries (Bindemann, 1999) E&P companies would have to subject themselves to government processes in order to gain access to production sharing agreements that enables them to explore and produce oil within their territory (Cairn, 2009)-1

Geopolitical developments and violence in some countries makes it unsuitable and very risky for foreign investments in exploration and production of oil and gas. The industry is subject to risky geopolitical violence, as oil installations are usually terrorist targets (Cairn, 2009). Companies have to pay high insurance premiums in order to secure their investments against such activities.-2

Economical

There is increasing competition amongst international governments seeking

foreign investments in E&P. These industries, especially foreign oil companies, enjoy tax breaks and favourable corporate conditions such as incentives when looking to enter into countries such as India, Nigeria and Bangladesh (Rigzone, 2009)+2

Oil prices are determined by market factors such as the demand and supply in international markets (Proactive Investors, 2009). Inability to determine prices, poses a severe risk especially in times of low oil prices. Higher oil prices however results in greater than normal profits in the E&P markets (Cairn, 2009). E&P companies posted record profits in 2008 due to oil prices that went as high as \$150 per barrel. However the inverse would be the case in the advent of a very low oil price (WSJ, 2009)-1

Socio-Cultural

Climate change discoveries have led to a change in lifestyle towards carbon efficient products in most developed countries (Hoovers, 2009)The change in lifestyle indirectly affects E&P companies as it may reduce dependence on oil and gas products over the long run.-1

CSR is increasingly becoming a method for large national and multinational companies to appease local communities where they operate (Cairn, 2009). E&P companies are not as effective in their CSR policies, in proportion with the level of pollution they create. They are greatly unpopular amongst locals.-

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Technological

Innovative exploratory and drilling technology, such as 3d seismic processing, modelling and sophisticated plant designs are increasingly becoming pre-requisites for successful oil drilling (Saic, 2009). These technologies make it

easier for E&P companies to discover much more oil than they would have decades ago. Thereby increasing the likelihood of oil find, and higher returns on investment in exploration activities (Marketwatch, 2009).+2

Shifting attitude towards energy efficient technologies such as hybrid vehicles, electric and wind technologies are increasingly becoming the norm amongst the global public and the energy industry (Chicago Tribune, 2009). Global oil companies would need to adapt their strategy and start investing in renewable energy resources. E&P companies face the threat of a drop in demand for oil and gas, over the coming decades.-1

Environmental

Increased exploratory activities and global warming has facilitated oil discovery in previously unexploited territories (Reuters, 2009). Foreign oil companies, investing in new technology and territories like Greenland and India, are in a better position to reap these benefits (Energy Digital, 2009).+2

E&P activities result in carbon emissions that pose a serious threat to environmental sustainability. E&P companies face embargoes from national governments and international bodies that limit the level of their exploratory activities and the level at which they can expand their activities. They are also subject to extra taxation costs from national governments due to environmental pollution (Herald Scotland, 2009)-2

Legal

Oil producing countries in which foreign oil companies operate impose legal limitations and embargoes on their activities, and also limit their business flexibilities. The limitations and embargoes imposed greatly limit the growth

potential of exploration and production companies operating globally (Economic Times, 2009).-2

Policy uncertainties and government breach of contract are increasingly becoming popular in some developing countries where foreign oil companies are seeking to build and develop their assets such as India and Bangladesh. E&P companies operating in these markets, such as Reliance Industries and Cairn Energy in India, need to engage in legal battles with the government in order to get contractual obligations fulfilled (Economic Times, 2009).-2

SUCCESS AND SURVIVAL FACTORS IN THE E&P INDUSTRY

The overall threat to the exploration and production industry, as a whole, is huge globally. Therefore any company in the industry seeking to gain competitive advantage against competitors, and survive in times of hardship – which may be caused by a drastic drop in oil prices, or severe terrorist activities – must adhere to these success and survival factors.

KEY FACTORS FOR SUCCESS

Government support through international trade agreements, tax incentives, beneficial fiscal policies, and suitable bidding processes are very essential for foreign oil companies seeking to explore and produce oil (Datamonitor, 2009). These benefits give these companies the impetus to explore for oil in recently unexplored territory, and increase the likelihood of an oil and gas find.

E&P projects are usually very capital intensive; therefore oil and gas companies need to have access to funds in order to partake in such

expenditure (The New Nation, 2009). These funds usually range from a few millions to a couple of billion dollars, therefore access and availability is thoroughly essential for bidding, drilling, production or even transportation activities.

Strategic alliances between oil and gas companies are essential globally as it enables them to transfer assets and leverage resources amongst different projects, so as to capitalize on a broader geographical location and resource base (Hoovers, 2009b). The competitive rivalry in the E&P industry is therefore minimal by the need for these strategic alliances, enabling competing companies to hedge and share risks.

Successful oil discoveries are however the main determinants of success for E&P companies (Datamonitor, 2009). Non-oil bearing blocks are highly unprofitable for exploration companies. India and Greenland, where Cairn currently has the majority of its assets are poised to be largely promising countries, as major oil discoveries and production have already been reported. Greenland is also stated to contain 20% of the world's oil reserves thereby making it a very profitable investment for Cairn and other indigenous oil companies, if that assumption holds true.

The global forces of demand and supply determine oil prices, therefore oil prices move in accordance to global need. Higher oil prices, such as was in 2008, was very beneficial for oil companies as it significantly increases their profit margins and leads to increased exploratory activities (Wall Street Journal, 2009).

The Availability of buyers is essential for E&P companies seeking to produce oil in large quantities and sell at a profitable price. Sometimes the government determines the buyers who an E&P company can sell to, such as is in India, and this reduces their chances for competitive bargaining.

Exploratory licenses are wholly dependent on E&P companies successfully bidding for leasing agreements (Bindemann, 1999). Inability to win leasing contracts would incapacitate the growth potential of the industry.

Profitability of E&P activities is dependent on the success rate of new oil wells drilled and the ability to increase production from existing wells.

Capital availability and investment decisions are based on estimates on future oil prices (Hoovers, 2009).

Large oil manufacturers usually hedge against risk of exploration failures by investment in several oil producing states with large oil reserves, so a depletion of one reserve does not seriously impact on the company's general business (Hoovers, 2009b).

SURVIVAL FACTORS

Continuous availability of oil and gas resources in the natural reserves of the country being explored.

The availability and access to large capital, though also a success factor, is a survival factor. E&P companies that are unable to form strategic alliances or gain access to large funds would be incapacitated during large capital-intensive projects that could boost their fortunes. They also need capital in

order to gain exploration licenses from the government, before they could even begin producing or shipping oil or gas.

Lack of detrimental geopolitical factors such as terrorist activities that specifically target oil and gas installations in their vicinities. An example would be of exploration companies that are usually being subject to local terrorist activities in Nigeria, Iraq and Bangladesh.

High oil prices in global markets, which would ensure that exploration and production companies, investing a huge amount of capital in their businesses, would be able to break even as the oil prices in international markets determines the profit they make as businesses.

Prolonged global dependence on oil and gas products would ensure that demand for these products are still high. A divergence towards renewable energy source such as solar, wind and biological energy would reduce global dependence on non-renewable petroleum products, thereby stalling demand for such products in coming decades.

Adopting technologies that would make exploration and production processes more environmentally efficient would go a long way in appeasing international bodies who are bent upon imposing several climate related levies and taxies on the E&P industry. These taxes and levies would severely impact profits and growth potential into new markets such as Greenland, which is bent on preserving its ecosystem.

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