

Talk of stability

OPEC argues for more investment downstream plus greater dialogue to benefit the oil market

“OPEC HAS INCREASED ITS DAILY CRUDE OIL PRODUCTION BY 4.5 MILLION BARRELS SINCE 2004”

The price of crude oil has traditionally been linked to supply and demand levels, which determine the degree of tightness in the market. However, OPEC has recently issued a series of statements making the case that the current high price of oil is not caused by a shortage of supply. So, what does lie behind it? To find out, *Impact* talked to Mohammad Alipour-Jeddi, head of petroleum market analysis at the OPEC Secretariat, in his office in Vienna.

He started by quoting some key statistics. “OPEC has increased its daily crude oil production by 4.5 million barrels since 2004, which was when the latest exceptional surge in demand began. The quota system was effectively abandoned, and spare OPEC production capacity initially fell to about 4%. It has now recovered and is at about 7 to 8%. We expect it to reach its traditional level of around 10% by the end of 2006. It is also significant that crude oil inventories in the OECD countries are currently above their five-year average and in the USA are at an eight-year high.

“The supply is definitely there. The fundamental problem is a shortage of refining capacity. People are not demanding crude oil: they want products. Refinery utilisation rates are typically running at more than 90%, and this creates risk and anxiety in the market. In addition, product specifications are rising year after year without, it seems, sufficient consideration being given to whether the complex refining capacity exists to make the volumes of cleaner products needed.



Mohammad Alipour-Jeddi, head of petroleum market analysis, OPEC Secretariat.

“Statistical analysis here at OPEC shows that product prices have had a significant effect on the crude oil price over the past two years. It was traditionally the other way round of course.

The high price of crude oil is a signal that we are not investing enough, especially in the downstream area and in the industry’s supply chain.

“Geopolitical concerns have also pushed the oil price higher. However, I think that the security threat is sometimes overstressed and the effect is exaggerated by speculative activity in the financial markets.”

Alipour-Jeddi firmly believes that investment is the key to future oil market stability and points out that several OPEC countries are pursuing downstream expansion opportunities in the Far East – in Malaysia and China particularly. He would like to see the large oil companies and the consumer countries similarly reinforcing their investment plans, although he accepts that, before this can happen, effort is required to create an environment where long-term investments can be made with confidence.

“We need to encourage openness and greater dialogue between OPEC and non-OPEC producers and also with the major consuming countries,” Alipour-Jeddi stresses. “Energy security is affected not

only by events on the supply side but also by security of demand. We need to work together to build a clearer picture of future demand – investment relies on being sure of the size of the market for crude oil in the years ahead.”

OPEC is engaged in various activities to promote greater international cooperation in the oil market. For example, the organisation is an active member of the International Energy Forum (IEF), which met for the 10th time, in Qatar, earlier this year, and is closely involved, along with the International Energy Agency (IEA), the UN and others, in the IEF Joint Oil Data Initiative.

Alipour-Jeddi himself is leading a task force set up to pursue greater cooperation between OPEC and China. As a consequence, he has a good insight into the country’s rapid economic development. “It is unfair to blame China for the current high oil price,” he asserts. “It cannot be wrong for China to strive to improve the welfare of its people, whose per capita use of energy remains among the lowest in the world.”

Alipour-Jeddi cites the collective measures taken by both consumer and producer countries in response to the devastating hurricanes in the Gulf of Mexico in 2005 as a good example of the increasingly constructive spirit that exists in the oil market today. “The IEA released products from its strategic reserves, and OPEC producers quickly made available an extra two million barrels per day of crude. As a result, the impact of the hurricanes on the oil price was hardly noticed.

“The tangible benefits of greater institutional cooperation and enhanced dialogue in cases such as this provide the best argument against any return to the confrontational approach taken during the 1970s and 1980s, when each side had a tendency to blame the other for any problem in the market. The oil market is far from fragile when all sides work together to achieve their common interests – indeed, it is remarkably resilient and astonishingly flexible.”



• Contact: Katie Baverstock
Email: katie.baverstock@shell.com

Downstream transformation

Saudi Aramco sets its sights on distribution excellence

As the world's leading and most prolific oil producer, Saudi Aramco operates on a major scale. Upstream, it has one-quarter of the world's proven crude oil reserves and a production capacity of some 10.5 million barrels per day. Downstream, the company's refineries produce more than a million barrels a day of products for domestic and international markets.

In 2004, however, with domestic demand for oil products soaring, the state-owned company had concerns about its distribution operations. Although the distribution business was successfully handling over 450 million barrels per year in refined products, Mohammed Al-Gusaier, vice president, distribution and terminal operations, Saudi Aramco, was not convinced that the organisation's business model for storing, transporting and selling fuels was sustainable.

Best-in-class performance

Al-Gusaier was determined to be proactive. He wanted to ensure that distribution would not present capacity constraints as demand increased further. Similarly, he wanted the facilities to remain fit for their purpose, and the business' costs, efficiencies and skill levels to stay competitive. If the

“OUR BENCHMARK KEY PERFORMANCE INDICATOR, THE COST PER BARREL, SHOULD IMPROVE BY OVER 20%”

distribution business was to remain a value-adding element of Saudi Aramco, he felt it was imperative to raise efficiency and modernise processes.

Al-Gusaier set about transforming the organisation's distribution operations and assigned an internal team to consider ways of improving the efficiency of the business. The result was a long list of good ideas, projects and initiatives that required a cohesive plan to address the future goals.

So, working closely with Shell Global Solutions, he created an opportunity confirmation programme. This was a 16-week review of the supply chain from the refinery gate to customer delivery for all domestic fuel products. It built on the existing initiatives and uncovered further potential improvements. The review also estimated the value of any improvements, developed implementation plans and provided a structured project framework.

“The opportunity confirmation programme was multifaceted,” says Al-Gusaier. “It addressed our plants,

processes and people, as well as issues such as capital investment, automation, supply-chain management, manning and employee development.”

For example, the working practices employed at the organisation's terminals and depots were reviewed, and the team benchmarked performance against those of other distribution operations in the industry. This highlighted performance gaps, which the team was then able to address. Meanwhile, a strategic review considered whether the organisation had the right assets in the right place; for example, could any of the depots or terminals be rationalised?

The programme also included assessing the organisational effectiveness of the distribution and terminal operations function. Operational strategies, work processes, roles and responsibilities were reviewed, and improvements were suggested. Other areas that were considered included consequence management, staff competencies across



“CHANGE MANAGEMENT WAS CRUCIAL ... BUT TODAY OUR EFFORTS ARE PAYING OFF”

the organisation, change readiness and barriers to implementation.

Effective change

Together, Saudi Aramco and Shell Global Solutions developed a business improvement and implementation plan. This showed the resource requirements, the key steps and the phasing for the individual activities and also ranked them according to their potential value. The plan included cash-flow projections and return-on-investment and benefit-tracking models.

Al-Gusaier was aware that major change efforts can fail to deliver the promised targeted results if they do not achieve the necessary buy-in from the rest of an organisation.

“Change management was crucial,” he says. “Building and implementing a communication programme to inform and gain the buy-in of employees, management and stakeholders took time. But today our efforts are paying off. The programme benefits are being achieved, any concerns have been addressed and a consensus has been reached on the way forward.”

Important benefits have been created, as Al-Gusaier explains: “We are now making

changes to our road transport contracts that will lead to far-reaching improvements. In addition, we are focusing on enhancing our customer services through using technology. Customers can now order and pay for products electronically and they will soon be able to select their own loading times online, which will significantly reduce the waiting times.”

Adding value

With the petroleum sector accounting for nearly one-third of Saudi Arabia’s gross domestic product, Saudi Aramco is the cornerstone of the Kingdom’s economy. It is also one of the largest employers in Saudi Arabia, with more than 50 000 workers.

The move to raise the performance of Saudi Aramco’s distribution network was therefore important. “Today, many of the projects under implementation will create valuable benefits,” Al-Gusaier says. “Our benchmark key performance indicator, the cost per barrel, should improve by over 20%. Significant productivity increases will be unlocked, manpower will be optimised and costs will be reduced.”

In addition, one objective was to raise the profile of Saudi Aramco’s distribution business. “The supply and distribution of

refined products in the Kingdom has had a varied history,” Al-Gusaier explains.

“Internally, the function was viewed as an unavoidable cost to the company, and the operation was looked upon simply as a retail station. Now, we are seen as a vital component of Saudi Aramco’s value chain,” concludes Al-Gusaier.

• Contact: **Robin Bromage**
Email: robin.bromage@shell.com

Global competition in the steel industry

Russian manufacturers consider new tools and techniques for staying ahead



Historically, the global metallurgical industry has been beset by challenges such as overcapacity, high cyclicality and price pressures. Although not immune to these factors, Russian metallurgical companies have thrived. They are among the most profitable in the world and benefit from the country's abundance of low-cost energy and labour, and the advantages of owning, either directly or indirectly, the requisite raw materials.

Indeed, Russia is the world's fourth largest steel manufacturer, accounting for 7% of the world's total output. Domestic economic growth and burgeoning worldwide demand for steel have driven production.

However, Russia's labour and energy costs are increasing at greater rates than those of many of its competitors, and

external factors, including the country's impending membership of the World Trade Organization and the appreciating rouble, present fresh challenges.

Meanwhile, the global metal industry is consolidating, and new plants for some metals are under construction, around the world, especially in China. Analysts are questioning whether the Russian industry's formula for competitive advantage, one of relatively low productivity accompanied by low costs, is sustainable.

To explore ways of maintaining a competitive edge in the global marketplace, leaders from Russia's metallurgical industry recently gathered at a Shell Global Solutions seminar in Moscow.

Tools and techniques that have an established track record for delivering performance improvements in the petrochemical and refining industries were discussed. Many of these were based around the implementation of risk-based maintenance and reliability techniques, which have delivered reductions in maintenance costs while improving plant availability. Crucially, these methods are transferable to other industries and have been key to the consultancy provided by Shell Global Solutions to metallurgical operations around the world.

Globally, the challenges facing the metals industry are similar to those in other process industries: asset values are high; there is an increasing focus on costs; and there is the need to meet product quality targets and comply with health, safety and environmental legislation.

The advantages of applying risk-based, rather than time-based, methodologies

to the maintenance of a site's assets were discussed during the seminar. Another theme debated was energy optimisation; energy efficiency has been improved for clients by a variety of techniques that require little or no capital expenditure. Emissions management was also of interest because Russia is a recent Kyoto signatory.

Wayne Hale, senior vice president, upstream business unit, SUAL Group, says, "Our organisation is continually looking for new ways to improve performance. Our delegates found this to be an interesting forum for discussing best-practice sharing and considering successful practices from other industries."

It was noted that many Russian metals producers are commencing substantial investment programmes, modernising their existing plants and installing additional capacity. Others are seeking to raise production standards to meet higher specifications and quality standards, and to widen their capabilities for delivering higher value end products.

There was a feeling that, if these modernisation efforts and technology advances can be accompanied by cost reductions and the adoption of successful industry practices, then the Russian metallurgical industry can remain one of the industry's most vital players for many years to come.

• Contact: [Duncan White](mailto:duncan.white@shell.com)
Email: duncan.white@shell.com
