

1982: A PRECIPITOUS DECLINE, THE SERVICE COMPANY, BIDDING AND INTEGRITY

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Abstract

From 1979 to 1982, the oil industry experienced a continual rise in the rig count. This ever expanding number of rigs caused the service company industry to undergo rapid expansion both from the standpoint of people and equipment. It was obvious that many of the companies looked at an ever increasing, upward spiral and planned expansion and requirements on that continued growth. The decline in rig count, which actually started in late 1981, was even more drastic than the upward spiral. Many service companies and suppliers for those service companies who had become highly leveraged found themselves in a very precarious position. In order to capture an ever declining market, many service companies resorted to extreme price cutting on available jobs. An examination of the profits of five representative companies during the good years is evaluated and compared to the profitability of companies during 1982 and early 1983. The response of both the service companies and the oil companies in a survival mode are evaluated. The keynote of the paper will be directed toward the free enterprise system, profit motivation, and ultimately, the survival of the oil service industry as we now know it.

Text

Over the past two and one-half years, members of the service industry have experienced the heights of euphoria from the standpoint of an exploding market and great potential for work. Over the period of just a few months this exploding market which had been characterized by an ever increasing rig count, need for more people, more equipment, and more capability, deteriorated to a plunging rig count, excess equipment, excess people, and subsequently a very soft market for all services offered. Old line service companies under anticipation of an ever growing market expanded drastically both from the standpoint of men and equipment, new stations, facilities, etc. New companies came upon the market to try to take part in what appeared to be a very profitable venture. There also were many of the service companies who delved into areas in which they had little experience trying to increase their capabilities by impinging upon specialty companies. A classic example of this sort of thing occurred, with many companies building and producing nitrogen equipment, moving into the area of which NOWSCO SERVICES was singularly leading. There were other examples of the same sort of thing with companies which had been stimulation companies moving into cementing, and dual service companies moving into tools and other areas, including coiled tubing, etc. What basically occurred was a flood of equipment and personnel that were designed to meet a need that had been projected by an upward spiral in the rig count. It appeared for some time in 1981 that there was going to be no end. There was an increasing need for making our country independent of Middle East suppliers. The price of oil was increasing. There was an increasing need for natural gas with no excess in sight.

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One must attempt to understand the tremendous potential of the American free enterprise system and the capabilities of American technology to be able to perceive what has occurred in the oil field service industry over the past two years. The rapid expansion of existing companies plus the intrusion of new companies into the oil field service market in a very short period of time certainly boggles the mind. In looking back over those years we now know that we were wrong if we stated that our country could not become independent or self-sufficient in hydrocarbons. If the supply of oil from the importing countries had been cut off for whatever reason, the great snowballing effect of the American free enterprise system would without a doubt have enabled our country to become totally independent of outside sources of hydrocarbons for many years. There were, of course, other factors involved. The 1973 Middle East War and the subsequent shut-off of Middle East crude started a large push toward the use of coal or non-hydrocarbon type energy. The large gas bubble that exists today from excess natural gas would be greatly lessened if many of our plants had not been converted to coal burning.

The American consumer's ability to conserve energy was certainly something that was unexpected to many of us in the industry. The decline in the use of electrical power combined with fuel-saving automobiles has also dramatically impacted the need for hydrocarbons in our country.

The American utilizing the free enterprise system appears to have a bottomless pit of energy and capability particularly when that energy is used toward making a reasonable profit. The forces that were assembled were brought to bear in a time when there seemed to be an unquenchable need for hydrocarbon-based energy.

What we see today and look upon with sadness for many of us are large fields of excess pumping equipment. We see vast numbers of our friends and associates who are without jobs and futures in our industry. We see manufacturing plants shut down and with little hope of opening in the foreseeable future. This sadness is further strengthened when we consider that had the incentives been there we could have virtually become, at least for the short-term, independent of foreign hydrocarbon sources.

We, of course, in our land live under the free enterprise system. We live and die through competition. What has occurred in the last three years has proven the integrity of all of our service companies. We have all lived through an extremely soft market with intense competition. To the best of my knowledge, there has been no evidence whatsoever of collusion on the part of any service companies. There has been a tremendous effort put forth to perform for the various oil companies and to obtain greater market share. This has been extremely difficult for new companies who have come into the market without proper technology and without experienced personnel. It has been a time when large size has in many cases worked to a disadvantage because of high overhead and because the wheels that had been put into motion were extremely hard to be slowed down and stopped. The evidence for this is marked by the large amounts of equipment stacked in cities across our land. It is marked by silent factories or manufacturing centers that work only one-third of the time. It is marked by rigs stacked as far as the eye can see through South and East Texas. It is illustrated by the silent frustrated stare of the laid-off roughneck.

With a rapidly softening and deteriorating market, service companies were forced into fatal price cutting. From the period of the early part of 1982 to mid-1983, bidding wars have escalated to the point that both the service industry and the oil companies will suffer. Computer programs were developed to try and calculate men, equipment, and chemicals on each and every job in order to bid down to the last dollar maintaining cash flow. It is logical that investors and stock holders are interested in profitable operations which continue to expand and it is the profit motive that has driven America's industry through the free enterprise system to legendary heights and strengths. The years 1982 and 1983 have been years of survival for our industry. We have witnessed smaller, less technically competent, or poorly managed companies fall by the wayside. Some operators within the industry have interpreted discounts approaching 50% off 1981 prices as meaning that the service companies were taking extraordinary profits. They are wrong! Vast sums of money were pumped back into the expansion and development of research, expansion of facilities, and hiring and training of new people. Certainly the profits exhibited during these years by the companies shown are not extraordinary and do not approach the often mentioned obscene level. Our company like most reputable companies believes in quality control. It perhaps goes without saying that more emphasis is needed from the oil companies concerning quality control of oil service company work. This also goes for the oil service companies concerning their own suppliers on whom they have placed considerable pressure concerning pricing. There have been examples of suppliers diluting and cheapening surfactants, foamers, etc. There have been cases where the quality of proppant has deteriorated which was directly the result of competitive forces. A great deal of quality control by the service companies is a tremendously costly thing but one that had to be taken in these times as a matter of necessity.

One can see within the industry so-called innovative marketing approaches whereby "cheaper" or "thrifty" fracturing fluids have been offered to the industry. There is certainly nothing wrong with supplying lower quality products to the industry as long as these products are advertised and delivered for the proper applications. Those knowledgeable in the industry know that a blend, for example, of 75% hydroxypropyl guar and 25% guar gum will exhibit viscosity and temperature stability almost identical to 100% hydroxypropyl guar. The only difference, of course, relates to the residue. If residue is not a problem in treating a particular well, then perhaps the customer may need to look toward straight guar type fluids. Perhaps the most troublesome thing to the service company salesman is instructing and informing the oil company representative from the standpoint of his being knowledgeable about the various codings, etc. It would perhaps be instrumental in these times that an up-to-date chemical cross-reference for these companies be completed.

Let us compare the profit and loss statements of five major service companies for 1981, 1982, and the first quarter of 1983. As you can see by comparing the values shown on Fig. I, none of the companies exhibited showed what has been termed to be obscene profits. Most of the dollars that were generated were put back into expansion of facilities, the building of new research facilities, hiring of new engineers, training, etc. As you can see, in 1982 a deterioration of these profits ensued. Many companies, some of those shown in our table and others have experienced heavy losses. Some companies are in fact experiencing severe problems in relationship to survival. Some service organizations are heavily leveraged, and unless a rapid turnaround of the rig count occurs in the very near future, truthfully there is an excellent chance the number of service companies will decrease. If we make a comparison of the performance of the above mentioned companies in relationship to Figure 2, which is a run down of the active rig count

research, no work will be done. I do believe that these times have the potential to set back research several years because of the lack of emphasis upon development of new and unique research rather than emphasis on development of cheaper commodity type products. We must try to avoid research groups decreased back to the point that they function as a field service facility and spend a majority of their time working on cost effectiveness rather than pure long-term research.

As stated earlier there are definitely positive results from the precipitous decline of 1982. Those of us who have worked many years in the oil field service industry and never truly felt the pinch of vicious competitiveness and cost cutting will be better for it. Many of us have come to a better understanding of what truly is necessary to complete a job for a customer and what is not necessary. I believe the oil companies have perhaps, in light of the bidding, come to a better understanding of what measures they should take to assist the service companies in performing better service. We in the oil field service industry are always appreciative of another person's caring, interpreting and understanding our operation. We have two problems in our industry. We have electric and mechanical equipment that can fail and we have human beings involved. With the assistance and observation of oil company representatives better and more profitable treatments can be performed in the field. There has been no doubt that treatments need to be optimized to get rid of waste. We the service company, need to control our inventories, reduce fat from the standpoint of personnel, and reduce waste from the standpoint of maintenance of equipment. The negative things that have occurred because of the demise, of course, relate to the great number of people who have suffered. Honest individuals who started careers in the oil field service industries, dedicated their lives to it, for one reason or another were terminated. Obviously mistakes were made and a great deal of talent was probably wasted. Negative things will obviously occur from the standpoint of needed research being put on the back burner. Products and equipment that would have been available sooner will be delayed.

It is my contention, however, that those of us who have survived will be better and will be stronger. From the pangs of adversity comes strength. Statements that I have heard from oil company management basically relate to the fact that those that live will be lean and mean. Mean from the standpoint of being able to survive in a time when there were little or no profits. Waste and mismanagement is something that just could not be abided. The companies that survive will be those that have good managers. The companies that will survive will be those that develop cost effective products and were able to compete. The companies that survive will be those who were able to adjust; who did not live on tradition but made objective decisions on people and equipment based upon profit and loss and not on emotion.

As has always been the case, the softening will firm up. There will be a gradual increase in the rig count. There will be some major companies fall out to the dismay and sadness of the employees of those companies and truthfully to some of their competitors. What we are talking about is the American way, the free enterprise system. If we want examples of other systems we need but look across waters to other lands and see systems that deal in collusion, in friendly dealings. These systems are doomed to failure. With all the pain and sadness that we faced in our companies, we indeed have gone through a learning experience. Those of us who have faced it will deal with aggressive young men who want to build for an exploding future with a tinge of conservativeness. We should learn and understand that there is a limit. We have learned and I hope understood by

in this period of time, you can see what in effect actually happened. The success of the companies that have been with us so long is in direct proportion to the amount of work available.

Most of the better managed companies immediately reacted to the very rapid drop in rig count by cutting forces, stopping orders, and reducing inventories. Companies were forced to look for and trim excess fat and answer hard questions about how much was too much and how much was enough. If these companies have indeed trimmed the excess, then they will indeed be stronger. Many feel that too many inexperienced personnel had entered our industry and a cleaning-out period was needed. These statements are perhaps correct, but must be balanced by the case of the hard working young man who having spent four years in obtaining a petroleum engineering degree is now employed at a fast food supplier.

Immediately as the bidding pressures increased, a great deal of pressure was applied to the major suppliers of the service companies. Suppliers of polymer, fluid loss additives, and proppant were pressured to reduce prices and assist their major customers in times of need. Suppliers of expensive chemicals such as cross-linkers, surfactants, clay stabilizers, etc., found themselves being pressured on a day-to-day basis and decisions were being made on products with the emphasis on price rather than quality.

The pressures of bidding ultimately do create more pressure on the oil companies from the standpoint of quality control. It is not the intent of this paper nor the writer to intimate that inferior products have been marketed in field operations due to the bidding. All of us do have human beings working for us and oil field service company operations are judged upon profit and loss on a district and regional basis. It has never been the policy of our company nor to my knowledge the policy of any other reputable company that customers be shorted or inferior products be placed before the customer. There is, however, a great need, I believe, for oil companies to be more aware of products and equipment being supplied to them by service companies. This is absolutely necessary if the oil companies insist on bidding out each and every job and asking for specific generic items to be supplied on each job. There are many techniques which can be used to quickly and accurately control quality of fracturing and acidizing fluids in field operations. Excellent papers have been written concerning this and various guidelines can be supplied to the oil companies who do not have their quality control procedures set forth.

As mentioned earlier, during the good times for the oil field service industry, most of the service companies either built new or expanded existing research facilities and personnel. Many of these companies have pulled back and laid off research people or certainly cut back on the budget for these research groups. The major emphasis for most of the work has been related to cost effectiveness and the pressures applied can have a positive approach. At NOWSCO SERVICES the keynote of research has been upon cost effectiveness. A new product or process cannot succeed in today's market unless it is not only better but more cost effective. These goals in the vast majority of circumstances have been met. I believe that another positive thing that has occurred in relationship to research personnel is a better understanding of these people toward the basis of profit and loss and profitability of products developed for the oil service industry. Ultimately, however, as the bidding continues and profits continue to decline, the very first people to go in these cases are in research. As is the case in many instances, more expensive products come forth and there is no market for same, then there is no need for research. If there is no budget for

now that there is a limit to the buildup and expansion of all things. We perhaps would have learned how to operate more efficiently and perhaps we'll be more careful in hiring vast numbers of people with the understanding of the emotional trauma that we put these people through when we have to call them back into our offices and send them away. We'll be stronger and we'll be better because we are Americans. What we've dealt with here in all its trauma, in all of its hard times, is an example of nothing more than the free enterprise system on which our land and our system is based. We in the oil field service industry will survive and we'll be stronger for it. We do need understanding from the oil company that we, too, must have a profit. We all must have it if we are to survive.