India designs DSF rounds to attract entrepreneurs

The government is hoping that the low-risk nature of the Discovered Small Field (DSF) model will foster innovation within the sector, writes Andrew Kemp

COMMENTARY

WHAT:
India launched the DSF rounds as a way to offer state-owned but neglected marginal fields to private investors.

WHY:
New Delhi wants to create a more diverse mix of domestic developers to help turn around declining oil and gas production.

WHAT NEXT:
A second DSF bid round is to be held this year and may see many of the same faces from the first auction.

INDIA has made strides in the last couple of years to kick-start its stagnant upstream, introducing more investor-friendly policies geared towards changing perceptions around doing business in the country.

New Delhi introduced the Hydrocarbon Exploration Licensing Policy (HELP) in 2016, which included reforms such as unified licences for conventional and unconventional resource development, marketing and pricing freedom and an end to the controversial cost-recovery based production-sharing contracts (PSCs) in favour of a revenue-sharing model.

New Delhi later introduced the Discovered Small Field (DSF) rounds, which aim to redistribute smaller, less attractive acreages from the country's state-owned enterprises (SOEs) to private investors.

In March 2017, the government awarded 31 contracts under the first DSF round to 22 companies, with 15 being new entrants to the oil and gas sector. The government now plans to hold a second round later this year for 75 contract areas – 60 new areas plus the 15 contracts that were not awarded in the first round.

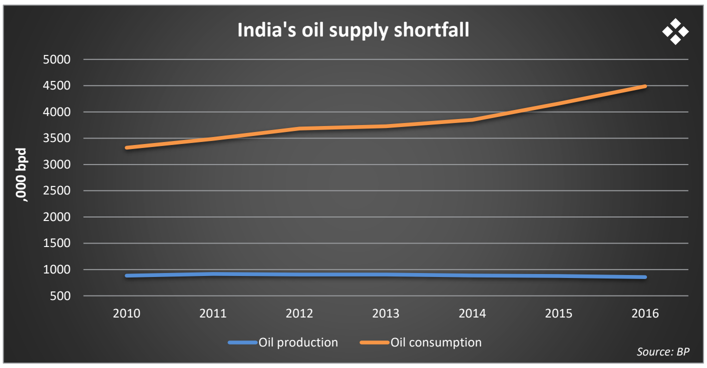
Speaking to *NewsBase Intelligence (NBI)*, one of the authors of a new report examining the changes taking place with the Indian upstream described the DSF model as an "experiment" designed to attract entrepreneurs to the sector. These new players bring more than just capital to bear on existing sectoral challenges; they also bring a spirit of innovation.

In the mix

Clareo and the Kellogg Innovation Network (KIN) interviewed more than 25 executives across the Indian oil and gas value chain for their report – Indian Oil & Gas Exploration and Production: Catalyzing Growth through Business Model Innovation.

From those interviews, Clareo partner Satish Rao told *NBI*, it was clear that the government's interest lay in creating a more diverse set of Indian exploration and production companies.

The country's upstream is dominated by national oil companies (NOCs), with only two privately owned Indian producers of note – Cairn India and Reliance Industries Ltd (RIL).



Source: BP

At the same time, among the super-majors only BP has shown any interest in the Indian upstream.

New Delhi has created two rounds with separate investment ambitions – HELP and DSF. The first is geared towards changing perceptions around traditional bid rounds, while the second is aimed at creating a new generation of oil and gas developers.

Noting that the government wanted more private company participation, Rao said: "We spoke to a lot of companies [and] there's an understanding that [DSF] is still widely considered an experiment. It's going to take some time to play out."

He added that while it was still too early to tell whether many of the 15 new entrants would still be present in the oil and gas sector within the next five years, if even a relatively small portion were still present the government would consider it a success.

As it stands, the relatively low-risk nature of small-field exploration makes a strong case for entrepreneurs to take the plunge.

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Two-fold payoff

Rao said: "My understanding is there's not a significant penalty if some decide not to implement field development plans [FDPs]."

As such, some of those companies may exit the sector after they draw up FDPs and gain a greater sense of the project economics. The government has adopted this approach because it wants to encourage nimble players to work on the blocks the NOCs pushed to the back burner.

On the one hand, New Delhi wants to see faster development of discovered oil and gas potential at a time when production of both is in decline. Oil production slid from 916,000 bpd in 2011 to 856,000 bpd in 2016, according to BP's Statistical Review of World Energy, while gas output shrank from 44.5 bcm to 27.6 bcm in the same period.

The awarded contracts are believed to hold 40 million tonnes (293 million barrels) of oil in place (OIP) and 22 bcm of gas in place (GIP), with the blocks to be monetised over 15 years. The reserves may be marginal, but they offer new players the opportunity to cut their teeth in a low-risk environment.

Rao said: "The Ministry [of Petroleum and Natural Gas] wants to see accelerated development of the blocks. They probably don't see the NOCs doing all of that in the future, so they want private companies who can act faster."

On the other hand, New Delhi is also eager to help create home-grown juniors that understand the local operating environment – its challenges as well as its opportunities.

"Indian Prime Minister Narendra Modi is using his Make in India initiative to encourage Indian entrepreneurs. The government really wants to encourage [them] to do more and to acquire more capabilities," Rao said.

While India is keen to create its own junior exploration and production sector, some of that desire is also driven by the difficulties it faces in attracting smaller overseas operators, which tend to be very small and focused on regions they understand.

Rao said: "There are still a lot of challenges to doing business in India, so a junior that has no experience operating [there] will find it very challenging to move in and make the economic justification to expand."

Strength in numbers

The Clareo-KIN report listed some of those challenges as the lack of market scale, low oil and gas prices making imports competitive, relatively poor midstream infrastructure that is dominated by the NOCs as well as a lack of adequate local technical talent.

Rao told *NBI* that the 15 new entrants lacked economies of scale, which could prove to be a stumbling block when trying to secure good deals on drilling equipment and related services.

He said: "It's going to be really hard to make a lot of the economic justification work."

But the report also points out that this challenge also presents an opportunity for many of these first-time developers to collaborate and share their experiences.

Rao noted that the interviews had revealed that DSF developers had talked about creating an operators' association, though what this would ultimately look like still remains unclear.

What next

With the second DSF round lined up for later this year there is an opportunity for the first round's winners to work together on project economics and to secure better deals from service providers.

There might even be an opportunity for such an operators' group to collaborate with Oil and Natural Gas Corp. (ONGC), tapping into its equipment and experience.

While challenges remain for DSF developers, Rao argued that an entrepreneurial spirit was one of the country's biggest advantages. He pointed to this mindset in such first round winners as Sun Pharmaceutical Industries and Adani, which would "try to figure out a way to succeed".

Moreover, the general consensus from the interviews Clareo and KIN conducted was that the availability of private capital in India was not a problem. Rao added: "If you combine entrepreneurs and capital, I think you have one half of the equation."

Most companies will have already started building out their operational and technical capabilities, many having been hard at work since they won their licences. For those that are confident that they can make ends meet the second round will present a tempting opportunity to expand their upstream positions.

By providing a relatively low-risk environment in which to play, New Delhi is laying the foundation for a thriving ecosystem of entrepreneurs. While challenges remain, the government is banking on innovation to win through.❖

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