

CAIRN ENERGY PLC EXTERNAL ANALYSIS

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1 Overview of Cairn Energy Plc.

Cairn Energy Plc. is one of Europe's leading independent oil and gas exploration companies that has its main offices located in Edinburgh, United Kingdom. The company was incepted in 1981 by Sir Bill Gamell together with other three colleagues. Initially, the company operations were based in the United States of America with the company expanding into the United Kingdom in 1988 after it was listed in the London Stock Exchange. Thereafter the company expanded into other international markets that included Australia, China, Vietnam and Papua Ne Guinea. In the 1988, after the company had been listed in the London Stock exchange, the company bought Conoco's UK onshore acreage a move that made Cairn Energy Plc. One of UK's largest onshore oil operators. Currently, the company has operations in various countries that include Tunisia, India, Nepal, Albania, Bangladesh and Greenland. The company's currently produces approximately 33,000 barrels of crude oil a day with the company's largest operations being in India where the company has made more than 20 discoveries (Cairn, 2012).

1.1 Business Segment

Currently, Cairn Energy Plc. operations are segmented into two different segments that consist of Cairn Energy Group and Cairn India group. While Cairn Energy Group is made up of the company's operations in Greenland as well as the Mediterranean region, Cairn India Group consists of operations in India, Nepal and Sri Lanka (Cairn, 2012).

Cairn Energy Plc owns 62.39% of the Cairn India business segment. After the company's discovery of oil wells in the Rajasthan fields in the year 2004, the company now concentrates on acquiring oil wells as well as continued exploration in India.

1.2 Featured competitors

A competitor as discussed by Proctor (2000) is a business entity that offers identical products or services with another organization. In the perspective of the case study company, the company's competitors are organizations that provide oil and gas exploration services that the company provides to its customers.

The two main competitors that Cairn Energy Plc. has to compete with include Afren Plc and Gulf Keystone Petroleum Limited.

1.2.1 Afren Plc.

Afren Plc. is an independent oil and gas exploration company that is based in London United Kingdom. Afren Plc. was founded in the year 2004 as an oil and exploration organization that mainly focuses on Africa. In the year 2005, the company was listed in London Stock Exchange a move that facilitated the company's expansion to various countries that includes Nigeria, Iraqi, Ghana, Ivory Coast, Gabon, Democratic Republic of Congo and Sao Tome & Principe JDZ. Currently, the company produces an approximate of 22,000 barrels of crude oil every day from seven different wells (Afren, 2012).

1.2.2 Gulf Keystone Petroleum Ltd.

Gulf Keystone Petroleum Ltd. is oil and gas exploration company that was founded private equity from United Arab Emirates, Kuwait and the United States of America in year 2001 and registered in Bermuda. The company was later on in year 2004 listed in the London Stock Exchange. Currently, Gulf Keystone Petroleum Ltd has offices in Algeria, London and Arbil (Gulf Keystone, 2012).

1.2.3 Tullow Oil Plc.

Tullow Oil Plc. is an independent oil and gas exploration company that is headquartered in London. Tullow Oil Plc. was established in 1985 by Aidan Heavey in a small town in Ireland called Tullow. Unlike the other two organizations that are concentrating in one or two continents, Tullow Oil Plc. operations are global as the company has explorations in Africa, Europe, South America and South East Asia. At the moment, the company produces an approximate of 85,000 barrels of crude oil every day (Tullow oil, 2012).

2 Analysis of external factors impacting industry & structure, which Cairn operates

2.1 Industry Overview

The oil and gas sector is categorized into two categories that are upstream and downstream. The upstream category is involved with the exploration and production while the downstream category is involved with the refining, processing, distribution and marketing of the crude oil and gas products. The exploration and production process consists of the following steps; desk study that identifies the area that has favorable geological conditions, aerial survey, seismic survey, exploratory drilling, appraisal and finally the development and production (Unknown, n.d.). The figure below shows the typical crude oil processing process.

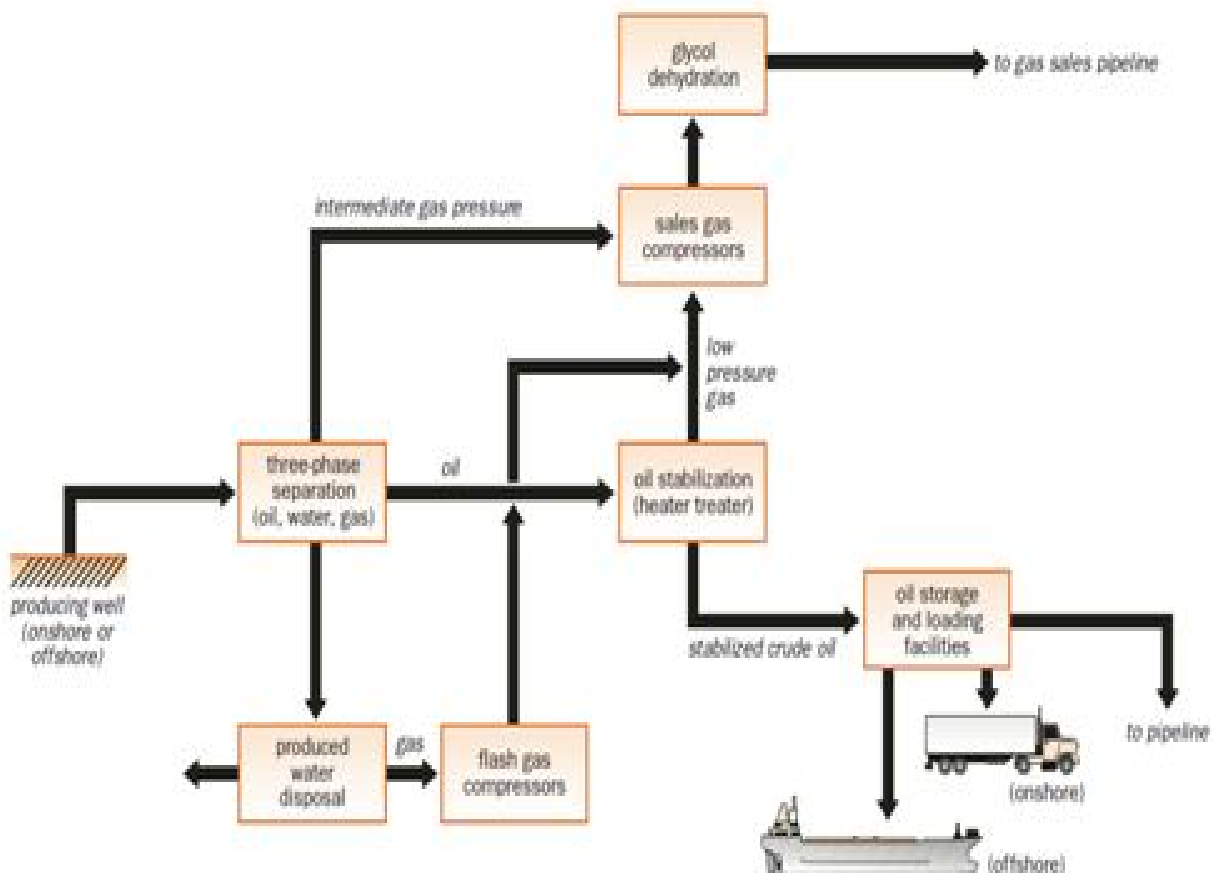


Figure 1: Typical crude oil processing system (Source, Unknown, n.d.)

All the companies that serve in this sector are involved in development of fields where crude oil and gasses can be extracted. According to a research conducted by First Research (2012), the industry produces an approximate if 75 million barrels of crude oil per day and more than 100,000 billion cubic feet of natural gas annually. The industry is made up of both large and small multinationals. The success of organizations operating in the sector is determined by the rate at which the organizations serving the sector find new wells as well as their ability to increase production from existing wells (First Research, 2012).

As far as the oil and exploration value chain is concerned, the main value chain activities includes exploration, production, transportation, refining and marketing as shown in figure 2. In the exploration stage, the organizations serving the sector implements new technologies to find new oil resources. Once the resources have been established, the organizations then undertake to bring the oil to the surface by adopting of both natural and artificial methods. After the crude oil has been brought to the surface, it is then transported to refineries through various means that mainly includes tankers, pipelines and trucks. The crude oil then undergoes refining with the refined oil then being marketed to the customers (Petro Strategies, 2012).

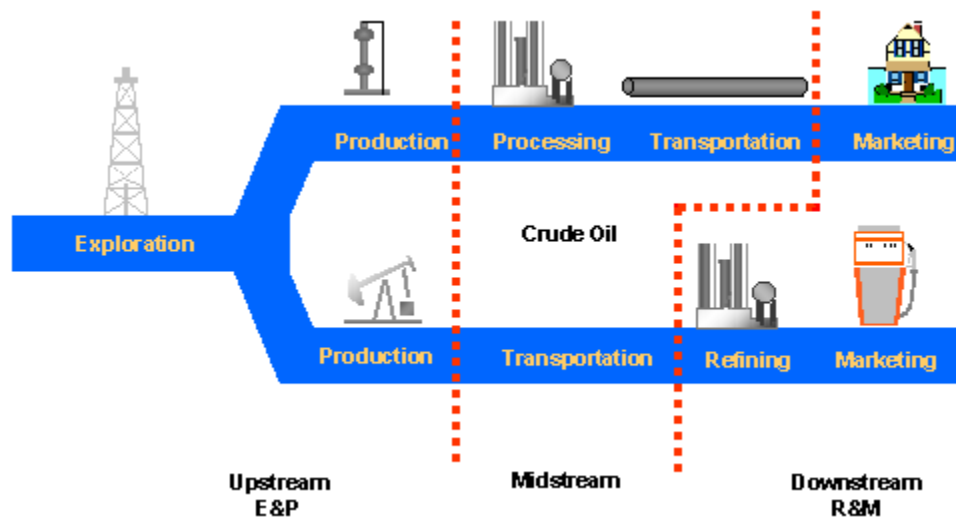


Figure 2: Oil and gas Value Chain (Source, Petro Strategies, 2012)

2.2 Market Overview

According to First Research (2012), the demand for services offered by oil and gas explorers is determined by various factors that includes population growth, economic activity, and transportation uses of both gas and oil.

2.3 PESTEL Analysis

PESTLE analysis is a situational analysis technique that is used to analyze the political, economical, social, technological, environmental and legal factors that might have an impact on the way a specific organization operates (Kotler and Keller, 2011). It is thus important to conduct Cairn Energy Plc.

PESTLE analysis as the analysis will help establish macro-environmental factors that could affect the company in the future.

2.3.1 Political unrest

As an oil and gas explorer that has operations in different countries, the political climate of the countries that the company operates in will have a big impact in the company's operations. In particular, if there happens to be political unrest in India, the output of Cairn India will most likely be affected. Some of the approaches that the company can adopt in order to ensure that its operation is not affected by political unrest would be to insure against such incidents.

2.3.2 Government Involvement

According to Bindemann (1999), most of the governments that have oil in their territory tend to be involved in the exploration as well as extraction of the oil. From that perspective, the role of government in various countries where Cairn Energy Plc has operations in will influence the way the company operates.

2.3.3 Bribery and corruption

Since Cairn Energy Plc. operates mainly in developing countries like India that have high rates of corruption, it is important that the company ensures that it is not involved in any corruption scandals as it could negatively affect the company's operations.

2.3.4 Ownership requirements

It is important that the company understands the oil wells ownership requirements in some countries as some countries have a requirement that the government owns a certain percentage of the company that is producing the oil.

2.3.5 Government Policies

According to Rigzone (2009), various governments adopt specific policies that are aimed at attracting oil exploration companies into their countries.

2.3.6 Fluctuating oil prices

According to Proactive investors (2009), the prices of oil are always fluctuating implying that organizations cannot be able to make accurate projection. Nevertheless, when the prices are high, the companies make higher profits while low prices imply that the profits are drastically reduced.

2.3.7 Economic growth

As already outlined, the demand for Cairn Energy Plc. will mainly be determined by the global economic growth. In that perspective, in the event that the global economy is struggling it is expected that the demand for the company's services might reduce. In addition, the fact that the company operates in different countries implies that the company is subjected to currency fluctuations.

2.3.8 Environmentalists critics

The constant claims by environmentalists as argued by Hoovers (2009) that the oil and gas are the highest contributors of carbon emissions that contribute to climate change may in the near future affect Cairn

Energy Plc. as demand for oil and gas might go down as people seek sources of energy that are environmental friendly.

2.3.9 Technological advancement

The shifting focus towards development of efficient technologies that include hybrid automobiles as well as other types of energy for fuelling engines could have an impact to the demand of energy generated from the oil.

2.3.10 Sustainable forms of energy

For the last few years, there has been more emphasis on energy producing companies to establish more sustainable forms of energy that are less harmful to the environment. From that perspective, it is important that Cairn Energy Plc. is involved in research and development process that would aim at establishing more sources of sustainable energy as demand for sustainable energy is going to be high in the future.

2.3.11 Legal policies

In every country that Cairn Energy Plc. operates in, there are different rules and regulations that have been set by the respective governments. It is important that Cairn Energy Plc adheres to the set rules in order to ensure that the company does not incur any fines or is banned operating in the country.

2.4 Michael Porter Five Forces Analysis

Porter's five forces analysis is an analysis technique that examines the five main forces that shape any industry. The five different forces are made up of threat of new entrants, competitor rivalry, bargaining power of buyers, bargaining power of suppliers and threat of substitute products (Stonehouse et al. 2004).

2.4.1 Potential entrants

According to Proctor (2000), the threat posed by new entrants in any industry is determined by the entry barriers in the specific industry. In situations where is easy for investors to establish presence in a given sector, then the threat posed by new entrants can be said to be high. From that perspective, the threat

posed by new entrants to Cairn Energy Plc. can be said to be too low since any new investor is required to invest a lot of money in order to operate as an independent oil and gas exploder. In addition, apart from the huge capital amount required, any potential investor is required to have knowledgeable manpower which might be hard to come by in the gas and oil exploration sector.

2.4.2 Buyer bargaining power

The bargaining power of a buyer is normally high in situations where the buyers are few in number and they normally buy the products or services offered by a given organization in large quantities (Kotler and Keller, 2011). From that perspective, buyers are said to have a high bargaining power in situations where they can dictate the sales terms to the seller. In case of Cairn Energy Plc. the buyers can be said to have a low bargaining power as oil and gas are very valuable commodities that are usually on high demand on almost all times.

2.4.3 Supplier bargaining power

A supplier as explained by Proctor (2000) is an individual or a business entity that provides a specific organization with raw materials and in some cases equipments that are used in the processing or manufacturing of the final product that the given organization sells in the market place. According to Stonehouse et al. (2004), suppliers normally have high bargaining power in situations where they are few in numbers. In case of Cairn Energy Plc. the suppliers consists of countries where the oil wells are located as well as other organizations that develop various machinery that are used by the company in oil and gas explorations. The bargaining power of suppliers in Cairn Energy Plc. case can be said to b every high since oil and gas is only available in selected country. In addition, the bidding system that is usually adopted by most of countries that have oil and gas reserves is a good indicator of the high bargaining power that the suppliers have as the countries have the power to decide which company to award the exploration tender to.

2.4.4 Threat of substitute product

A substitute product can be described as a product that is unique while compared to a given product but can actually meet the needs met by the product that it is different with. According to Abraham (2006), the threat of substitute product is normally high in situations where a substitute product is easily accessible to the buyer and the buyer is not required to necessarily pay more for the substitute product. In case of the products sold by Cairn Energy Plc. the substitute products can be said to be other forms of energy that includes wind energy, bio fuel, nuclear energy as well as solar energy among other forms of energy. The threat posed by the substitute products to Cairn Energy Plc. can be said to be low since the various forms of energy that can be used as substitutes to oil and gas cannot be said to be quite effective and reliable as is the case with oil and gas. Nevertheless, it is important to note that the threat posed by substitute products might be high in the near future as efficient ways of harnessing solar and wind energy are discovered as various governments have invested a lot of money in pursuit of sustainable sources of energy.

2.4.5 Competitor rivalry

A competitor as earlier defined is a business entity that provides similar products or services to the ones provided by a given organization. In case of Cairn Energy Plc. some of the main competitors as discussed earlier include Tullow Oil Plc., Afren Plc, and Gulf Keystone Petroleum limited. According to Stonehouse et al. (2004), competitor rivalry is usually high in situations where there are a lot of organizations offering similar products or services in specific market place. From that perspective, the competitor rivalry of Cairn Energy Plc. can be said to be medium as most of the organizations that the company competes with operates in different markets.

3 Key Success Factors

As is evident from the analysis, success within the sector that Cairn Energy Plc. operates in is determined by various factors. The succeeding paragraphs discuss the key success factors.

3.1 Hedging

According to Hoovers (2009), oil producers have to hedge their operations in order to ensure that 'drying up' of existing well does not affect the company in any way.

3.2 Discovery of new wells

As already outlined, the success and profitability of companies operating in the E & P sector is determined by how successful the companies discover new wells while at the same time increasing the output of existing wells.

3.3 Economic growth

For there to be a constant and at times an increasing demand for oil, the global economy has to be experiencing growth since economic growth will result to high demand which will then lead to high prices.

3.4 Government policies

It is vital that governments in countries that have oil and gas adopt policies that encourage the explorations without a lot of interference from the government since in situations where the government interferes with explorations, the company's are likely to find it hard to operate efficiently.

3.5 Strategic Alliances

According to Hoovers (2009), it is important that oil and gas companies establish strategic alliances with one another in order to ensure that they are able to share various recourses among the companies. Such an approach would ensure that the organizations are able to fully utilize their resources.

3.6 Using latest technologies

It is paramount that organizations adopt the latest technology in their operations in order to ensure that they achieve efficiency in their operations as latest technology are most likely to be more efficient.

3.7 Issuing of licenses

It is important that various governments in regions that have oil and gas continue issuing exploration licenses in order to ensure that the companies are given the opportunities to find new oil wells.

4 Survival Factors

4.1 Access to large capital

It is important that any company operating in the sector has access to large capital as that will ensure that the company can be able to bid to be awarded exploration license.

4.2 High oil prices

High global prices will ensure that the companies are able to make high profit margins as they would be able to sell the oil at higher prices.

4.3 Stable environment

It is vital that regions that have oil wells are stable with no incidents of terrorists or political unrest in order to ensure that companies operating in the region are not disrupted in any way.

4.4 Sustained dependence on oil and gas

It is important that the world maintains its dependence on oil and gas since any deviation from the two sources of energy would result to decreased demand of the oil and gas leaving the companies with no options apart from shutting down or diversifying to other sectors.

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Appendix

Appendix A: Porters Five Forces Analysis

