Goodbye big oil – welcome big energy

COVID-19 looks likely to accelerate the transition away from fossil fuels for big oil companies

According to **Aon's COVID-19 Risk Management and Insurance Survey** of respondents in the energy and utilities sector experienced an impact on their business from the pandemic, with 12% believing the effect was severe and will take significant time to recover from. For oil and gas businesses – all the way from upstream exploration through to downstream refining and distribution of fuel products – the most prevalent theme has been the dramatic fall in the demand for transportation fuels, such as aviation, diesel and gasoline.

Consequently, a remarkable transformation is underway that will see the big oil companies accelerate their transition to greener, renewable energy sources, while many other oil and gas businesses such as refineries will need to pivot and diversify to exploit opportunities in areas like petrochemicals.

Aviation fuel dumped

One of the key factors behind the reduction in fuel demand over the last year has been the reduction in aviation. The US Energy Information Association estimates that the consumption of jet fuel for commercial passenger flights fell by 2.4 million barrels per day between March and April in 2020. The knock-on effect of the demand slump has seen a reduction in offshore drilling for example, and projects either shelved or postponed.

In the oil refining sector, many refineries realised that some of the investments they had planned for would no longer be economically viable so they have been abandoned or pushed back. Given the rock bottom oil price in recent years, margins were already poor for refineries and the pandemic has simply exacerbated the problem. There is a chance that a number of refineries will close, especially under invested assets. We've already noted closures in Finland and Portugal in the last six months, as well as in the US.

Cash constraints hit 'reshape' activities

Given the bleak outlook for many businesses in the oil and gas sector, is it a surprise that only 12% in **Aon's survey** reported being in the more strategic 'reshape' phase of their pandemic response? The ability to reshape – where the emphasis moves from crisis management to pivoting products and services towards a changed post-COVID-19 world – will usually depend on the availability of cash. To reshape a traditional fossil fuel refining or exploration and production company, businesses will need to invest heavily in assets such as carbon capture, the ability to produce more renewable fuels as well as solar or wind. The smaller independent refineries may not have the cash flow to enable them to pivot.

The oil majors, on the other hand, do have the strength on their balance sheet to transform their operating models and many of them are moving even faster as a direct consequence of the pandemic. In the next decade, we may well stop talking about oil majors; it'll be all about energy majors as companies divert their future capital towards greening their energy portfolios in response to pressure from investors, governments, customers, and environmental activists.

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A refined business model

For the larger refineries, if they're well invested in modern technology and can produce more environmentally friendly transportation fuel with an increased renewable element, then there is likely to be a good market. There's also an interesting comparison to make between refineries producing transportation fuel and the petrochemical industry making plastics. The petrochemical business has suffered a lot less during the pandemic and some plants and companies have even thrived. As with the oil companies, there is every possibility of refineries broadening their portfolio but this time by investing in petrochemical extensions of their existing plant to develop a more integrated approach. While we're seeing the beginning of the end for the burning of fossil fuels for power, their use in the manufacture of plastic products shows no sign of decline.

Wellbeing a priority

Of course, changing business models to adapt to changing demand and pressures from stakeholders isn't the only part of the story. **Aon's survey** indicates that energy and utility companies have the protection of people and assets as their number one priority with employee wellbeing top of the list.

The good news is, energy businesses have managed the pandemic well with no obvious refinery shutdowns, for example, due to COVID-19 outbreaks. The industry has taken pandemic related health and safety seriously; hardly surprising given these businesses are generally very risk aware in comparison to a normal manufacturing plant. Oil and gas risks like fire and explosion are potentially catastrophic and this heightened risk awareness has been an asset when it comes to managing and mitigating the effects of COVID-19.

Energy and power consolidation?

Looking ahead beyond the pandemic, climate change is an area of future risk that energy companies believe is a bigger threat for this industry than for the combined sector benchmark in **Aon's survey**. The sector is making headway with the big European oil companies already committed to a carbon neutral future. But it will be an expensive problem and neither will it be a quick fix, which is why marginal assets in areas like refining, for example, might have to be shutdown eventually, if not being upgraded and invested in. Expect to see consolidation in the industry. And don't be surprised either to see a convergence between the energy and power generation industries as big oil continues that journey towards big energy, given the inevitable increase in demand for electricity as transport electrifies and the world's population continues to grow and demand more power.

To find out more about the impact of the pandemic on the energy sector, **explore the full results from Aon's COVID-19 Risk Management and Insurance Survey**.

If you'd like to discuss any of the issues raised in this article, please contact **Henric Gard**.