How Aker BP Uses Strategic Supplier Alliances to Tap Business Value

Published 10 September 2020 - ID G00717304 - 18 min read

By Analysts Geraint John

Initiatives: Direct Material Sourcing and Supply Chain Services

With supplier collaboration, CPOs can generate step-change business value and competitive advantage. Long-term strategic alliances are still rather uncommon, but this case study shows how Norwegian oil and gas company Aker BP uses alliances to boost productivity in its drilling and wells operations.

Overview

Key Challenges

- Supplier relationships are typically viewed from a transactional, rather than collaborative, perspective, with selection based primarily on pricing and cost rather than on opportunities to create broader business value.

- Attempts at collaboration often fail because joint strategies, decision-making processes and financial incentives are poorly defined and implemented.

- Strategic alliances involving multiple companies are more complex to operate successfully than one-to-one supplier collaborations because different ways of working, conflicting motivations and a tendency not to share information openly are magnified.

Recommendations

Chief procurement officers responsible for direct material sourcing should:

- Select suppliers based on a detailed upfront assessment of their culture, behaviors, leadership style and willingness to collaborate over the long term, as well as their strategic and operational capabilities.

- Use governance and other mechanisms to foster transparency, open communication and accountability for joint decision making, alongside a commercial model that incentivizes all partners to create shared value and drive continuous improvements in productivity.

- Promote open communication and joint problem solving by developing a “one team” mindset and a collaborative way of working among employees at all levels of each alliance partner organization, from frontline staff to senior executives.
Introduction

Aker BP, an independent European oil and gas exploration and production company, is listed on the Oslo Stock Exchange. Formed in 2016 as a joint venture owned by Aker Capital, BP and other shareholders, it operates five offshore hubs on the Norwegian continental shelf (NCS). While currently a relatively small player in global industry terms, with revenue of $3.3 billion in 2019 and 1,700 employees, Aker BP is fast-growing and ambitious: its vision is to be “the leading independent offshore exploration and production company.”

The company’s strategy is predicated on the assumption that oil reserves are plentiful globally and, therefore, the challenge is to be highly efficient and productive in extracting oil and bringing it to market. Traditionally high margins in the oil industry have allowed producers to not be as cost- or process-conscious as many manufacturing firms, leading to significant waste in the value chain. However, a number of factors have changed the operating landscape for both Aker BP and its larger rivals:

- Lower oil prices in recent years
- Environmental pressure from governments, activist groups and investors
- Growth of alternative energy sources like wind and solar
- Market disruption stemming from the COVID-19 pandemic

A decade ago, and prior to the sharp oil price decrease in 2014, new projects on the NCS were sanctioned at a level as high as $60 per barrel for full life cycle development costs. Since 2016, Aker BP’s investment hurdle has been set at just $35 per barrel, and this break-even rate has been further reduced in 2020. So additional efficiency and productivity improvements will be required to maintain profit margins going forward.

Achieving these, in the company’s view, requires both a new way of thinking and a different operating model — especially for its supply chain. It means digitalizing processes and using advanced technologies and analytics; adopting lean practices to ensure flow efficiency and continuous improvement; and having a flexible, agile approach to changing market dynamics and opportunities.

For these reasons, Aker BP has undertaken a radical departure from traditional procurement and contracting methods in an effort to harness its suppliers’ capabilities more effectively. To align interests between Aker BP, as the operator, and its service partners, the company has formed seven strategic alliances. These cover key areas such as drilling, subsea production systems, facility construction and engineering services. Together, these represent 40% of Aker BP’s annual third-party expenditure.
This case study looks at how two of these alliances operate. These two alliances cover the core activities of drilling and wells and account for 70% of external spend in this category. It outlines the lessons for other companies seeking to develop more collaborative relationships with their suppliers. Gartner research done in 2019 found that this was the most important priority for sourcing and procurement functions, with cost and quality improvements as the most highly prized benefits. However, few organizations have attempted genuine win-win supplier collaboration on the scale that Aker BP has over the past three years.

Analysis

The Business Case for Alliance-Based Supplier Collaboration

For an oil and gas exploration and production (E&P) company, business requirements don’t come much more critical than tapping new reserves. They are the main source of organic revenue growth. In November 2017, Aker BP announced that it had formed two strategic alliances with rig and well construction contractors. The first alliance was with Halliburton and Maersk Drilling for “jack-ups” (mobile offshore drilling rigs with legs that attach to the seabed). The second was with Odfjell Drilling and Halliburton for “semisubmersibles” (mobile offshore drilling rigs that float and are used in deeper water). Figure 1 summarizes the parties involved in these two alliances and their respective roles.

![Figure 1: Partners Involved in the Two Drilling and Wells Alliances](source: Adapted From Aker BP 717304_C)

Each alliance is run using a collaborative model in which the three parties, including Aker BP, align around common goals, drive continuous improvement and create shared value. Aker BP sees strategic alliances as the way to deliver superior business outcomes such as:

Gartner, Inc. | 717304
- **Waste removal.** Reducing bureaucracy in processes and documentation is one source of improvement; understanding suppliers’ cost drivers (and sometimes the full cost of Aker BP’s requirements) and working jointly with them to reduce total costs is another.

- **Flow efficiency.** The time between an exploration license being awarded and the first oil being produced is typically seven to 15 years, during which no revenue is generated. Using lean methods to shorten this timeline promises significant benefits.

- **Productivity increases.** Removing barriers to engineering collaboration, exploiting a bigger proportion of oil reserves in a given reservoir and moving away from a time and materials payment formula for contractors are among the methods for raising productivity.

- **Quality and innovation.** Data, analytics and digital technologies are key enablers of faster, more efficient and more productive operations. But they need to be harnessed to boost value for all parties, not just uptime and profitability for one supplier.

- **Greater flexibility.** Having partners that are willing to take on extra activities, work jointly to solve problems quickly and scale production up or down in response to market conditions is more important than simply lowest pricing or unit costs.

From Aker BP’s perspective, successfully executing on these value levers and investing in the lean practices and digitalization necessary to support them are priorities. To achieve these goals, Aker BP uses long-term partnerships with a small number of suppliers, rather than the typical “three bids and a buy” procurement model. This approach also recognizes that the suppliers need to make money and see strong financial returns from their investments in technology and continuous improvement. The differences between alliances and traditional relationships are summarized in Table 1.

<table>
<thead>
<tr>
<th>Table 1: How Alliances Differ From Traditional Relationships</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Alliance Partnership</strong></td>
</tr>
<tr>
<td><strong>Time Horizon</strong></td>
</tr>
<tr>
<td>Long term</td>
</tr>
<tr>
<td><strong>Number of Suppliers</strong></td>
</tr>
<tr>
<td>Minimum sufficient</td>
</tr>
<tr>
<td><strong>Risk Sharing and Incentives</strong></td>
</tr>
<tr>
<td>Aligned incentives and shared upside and downside risk</td>
</tr>
<tr>
<td><strong>Team Organization</strong></td>
</tr>
<tr>
<td>Integrated, empowered team; “best person for the job”</td>
</tr>
</tbody>
</table>
From an overall strategy perspective, “supplier relationships” is one of six key enablers for the company’s drilling and wells organization. It seeks to deliver not only world-class dollar per barrel costs, but also to be the “most attractive wells team” for suppliers and potential employees to work with and for. In many companies, efforts to build collaborative relationships with suppliers are driven by procurement and supply chain leaders who seek to convince upper management that this will deliver superior business benefits. But at Aker BP, the decision to move to a strategic alliance model was made at the board and CEO level. Its supply chain management team, headed by Rolf Nystein, has since played a key role in framing and developing the model to support the company’s objectives.

How the Alliances Operate From a Commercial and Governance Perspective

Halliburton, Maersk Drilling and Odfjell Drilling were selected based on a broad range of criteria, in particular their top management’s commitment to working in an alliance model. The key building blocks of each alliance consist of the alliance agreement, scope, organization and incentives designed to optimize the working of the entire value chain:

- **Alliance agreement.** Contracts are based on competitive tender processes, with frame agreements supplemented by an alliance agreement. The alliance itself is not a legal entity.

- **Scope.** Mutually dependent work scopes are integrated to enable optimization of the total scope. The typical operator scope is included within this to the appropriate extent.

- **Organization.** Each delivery team is tailored to the total scope of work, with the right capacity and the right level of competence. The “best person for the job” principle applies, with Aker BP and partner resources mobilized into “one team.”
These building blocks are supported by the principles of trust and transparency, empowerment, and collaboration, as illustrated in Figure 2.

**Figure 2: The Alliance Model at Aker BP — Key Building Blocks**

- **Incentives.** Interests are aligned around the common goals of health and safety, cost, schedule, productivity, and quality. A shared financial risk-reward model drives performance improvement.

Each alliance operates under a five-year frame agreement, with the option to renew for a further five years. (This is an unusually long-term commitment in the volatile oil industry, and it’s up from the three-year deals Aker BP previously used.) These frame agreements give the company “soft exclusivity” to its partners’ rigs and resources in exchange for predictability of business. They are supplemented by “most likely cost” (MLC) agreements that specify the commercial terms, cost and profit models, and how bonuses and losses are shared between the alliance partners. To motivate Halliburton, Maersk Drilling and Odfjell Drilling to invest in continuous productivity improvement, Aker BP caps their downside risk at a lower share of any well cost overruns than the company itself bears. At the same time, it awards them a disproportionately higher share of any savings achieved against the MLC model.

The alliance agreement sets out the operating principles, key objectives, behaviors expected of all parties and governance arrangements. Figure 3 summarizes this structure and the main selection criteria used for each type of contractor. The most notable absence from this list is pricing — Aker
BP looked for capabilities and strategic alignment for the long term, rather than the cheapest providers in the market.

**Figure 3: Selection Criteria and Alliance Agreement Structure**

**Selection Criteria and Alliance Agreement Structure**

<table>
<thead>
<tr>
<th>Main Criteria for Selection</th>
<th>Agreement Structure in Semi-Sub and Jack-Up Alliances</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Operating discipline</td>
<td>• Frame Agreement</td>
</tr>
<tr>
<td>• Alliance skills</td>
<td>• Call-Off Contract(s)</td>
</tr>
<tr>
<td>• Digitalization strategy</td>
<td>• MLC Agreement</td>
</tr>
<tr>
<td>• Rig supply capability</td>
<td>• Alliance Agreement</td>
</tr>
<tr>
<td>• Commercial alliance proposal</td>
<td>• Rig Contractor</td>
</tr>
<tr>
<td>• Leadership and behaviors</td>
<td>• Well Construction Contractor</td>
</tr>
<tr>
<td>• Alliance skills</td>
<td>• Aker BP</td>
</tr>
<tr>
<td>• Digitalization strategy</td>
<td>• Overburden and reservoir data acquisition</td>
</tr>
<tr>
<td>• Overburden and reservoir data acquisition</td>
<td>• Technical capability</td>
</tr>
<tr>
<td>• Technical capability</td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted From Aker BP

*MLC = Most likely cost. This includes operator base cost plus contractor base costs, project and corporate overheads, contingency, risk and profit.

Each alliance has five shared objectives:

- **Shorten the lead time from discovery to first oil.** Apply lean methods for quicker delivery, ensure continuity and early engagement and create predictability for alliance partners.

- **Reduce the cost per barrel.** Build a culture of continuous improvement (including improvement on safety performance) and reduce the time per well and cash-flow cycle.

- **Optimize well concept and placement to maximize reserves.** Adopt a one-team approach within reservoir development, ensure continuity in planning and operations and maximize the value of data acquisition to generate and optimize future targets.

- **Reduce waste in the entire value chain.** Avoid doubling up on risk allocation/contingencies, use a “standardize and repeat” approach and reduce risk and waste resulting from changes.

- **Create a win-win outcome for all parties.** Drive transparency around plans and problems to enable more optimal joint decisions to be taken; these reduce the time spent on each well, delivering a lower total cost for the operator and greater profitability for service partners.
The governance structure created to pursue these objectives consists of three elements:

- **Alliance project management team.** Jack-ups and semisubmersibles each have their own alliance project management team, a cross-company group made up of one representative from each partner company. This is led by an operationally focused project manager who is accountable for the scope of work, meeting target costs, execution schedule, and quality and safety standards. The management team also develops the MLC agreement and joint work processes, and manages change orders.

- **Alliance-specific steering committee.** Progress, issues and opportunities are reported on a monthly basis to an alliance-specific steering committee made up of two executives from each of the three companies involved. One of Aker BP’s representatives acts as the chair and has the deciding vote in case of a stalemate. The steering committee meets quarterly and acts as a supervisory board, monitoring and auditing alliance performance and signing off on financial results. It also works to resolve any issues escalated to it by the alliance project management team.

- **Joint discussion forum.** The joint discussion forum also convenes on a quarterly basis. Its members include category and key account managers who review the application of alliance principles, discuss common topics of interest and consider potential improvements to the model.

Table 2 summarizes the business benefits and value to Aker BP and its alliance partners from this way of working.

<table>
<thead>
<tr>
<th>Alliance Principle</th>
<th>Alliance Benefits</th>
<th>Value to Aker BP</th>
<th>Value to Supplier</th>
</tr>
</thead>
</table>
| **Long-Term, “One Team”** | ■ Loyalty and trust  
■ Mutual understanding  
■ Stability and predictability | ■ Capacity security  
■ Higher performance and improvement rate  
■ Reduced waste in supply chain | ■ Contract security  
■ Transparency of forward plans  
■ Reduced waste in business development |
Strong Operational Performance, but With Two Specific Challenges to Resolve

Although Aker BP’s two drilling and wells alliances were formed in late 2017, and only became fully operational from mid-2019, they have already demonstrated positive results. Benchmark data from the IHS Markit Rushmore oil and gas industry platform shows that in 2019 Aker BP drilled faster than other operators on the Norwegian continental shelf in terms of the number of meters per day. It also had lower costs per meter drilled and the lowest nonproductive time per 1,000 meters. In one operation, a series of wells were delivered 13 days faster than before, said Eamon Condon, vice president of drilling and wells at Aker BP — in a record-breaking 23 days per well. The time taken to get rigs into position and working has also been reduced from around one day to just a few hours.

Nevertheless, there have been growing pains. Two challenges, in particular, stand out. The first involves persistent service quality issues with some wells, resulting in data not being obtained and operations having to be rerun at an additional cost. Under its previous contracting model, such failure might have resulted in Aker BP switching to a different supplier. But Ole-Johan Molvig, the company’s senior vice president of reservoir development, is confident that these issues can be resolved by the alliance partners working together to analyze the root causes and find joint solutions. In some instances, these include hiring subcontractors to perform certain tasks.

The second challenge concerns the MLC model. Calibrating this so that it balances Aker BP’s desire for predictable costs and sustainable bonus payments with the suppliers’ need to mitigate unforeseeable risks outside their control has proved difficult and time-consuming. Although three-quarters of projects so far have typically come in ahead of target — and therefore pay Halliburton,
Maersk Drilling and Odfjell Drilling bonuses — delays on others have triggered malus (penalty) payments that put a significant dent in their revenue expectations.

It is incumbent on the four alliance members to fine-tune the model so that it provides fair incentives and returns over time. This will be especially important as the time and cost savings from initial collaborative planning and execution are realized and new sources of productivity improvement need to be found. Value levers such as digitalization — especially the application of advanced analytics — rig automation and lean practices will be required if the alliances are to deliver lower per-barrel development costs over the next few years.

Six Key Success Factors for Alliance-Based Supplier Collaboration

Strategic supply alliances are not a new phenomenon in the oil and gas industry. Previous examples include Shell and FMC for deepwater subsea systems in the Gulf of Mexico in the 1990s and 2000s, and BP with its major IT outsourcing partners in the late 2000s and early 2010s. However, such collaborative arrangements are rare compared with traditional procurement and contracting methods. Aker BP's approach is pioneering in both its ambition and its scope. Says Shannon Slocum, a senior vice president at Halliburton: "It's a unique operating model. Aker BP is truly trying to create 'one team.'"

In developing this model, Aker BP studied these earlier industry examples, as well as the company's own experience of working with engineering services company Subsea 7 in its inaugural alliance, established in 2016. Key success factors identified by executives involved in the two drilling and wells alliances include the following:

- **Select the right partners — and people.** Aker BP spent a lot of time upfront assessing the culture, behaviors and executive leadership of potential partners, explains Tommy Sigmundstad, its senior vice president of drilling and wells and chairman of the alliance steering committee. It also scrutinized their digitalization strategies, tools, technologies and innovation capabilities. With the three partners chosen and field operations underway, the focus has switched to accountability in ensuring that the right people, with the right competencies, are chosen by each company to work on Aker BP projects.

- **Drive transparency as a fundamental enabler.** A sustainable alliance model built around a culture of continuous improvement depends on transparency. Without this, it will surely fail. Transparency includes being open about cost and value drivers, sharing key operational data and not hiding performance failures and other issues that are detrimental to the interests of one or more partners. Putting these things on the table is an essential first step to finding workable solutions and resolving differences.

- **Foster a collaborative mindset at all levels.** Open communication and joint problem solving must be actively practiced by offshore operators, onshore engineers and top executives alike. Around 2,500 employees are involved in these two alliances, each with affiliations and loyalties to their respective companies. Building a collaborative "one team" culture is far from easy. It
requires a willingness among all partners to share sensitive information, verify or challenge rumors, talk with each other frequently in both formal and informal settings, and consistently “walk the talk” when it comes to alliance principles and behaviors.

- **Create a platform for collective decision making.** In addition to defining interfaces, roles and responsibilities, the governance model must ensure that key decisions — bringing in subcontractors, changing tools, and so on — are made collectively by the alliance, not by Aker BP alone. This requires open conversations that, in some cases, may slow down the decision-making process. So each company needs to be clear about who owns decision rights to ensure that any inefficiency here does not adversely impact the need for nimble execution.

- **Design a fair compensation and incentive model.** Through its MLC model, Aker BP sought to incentivize continuous improvement and provide an approach to risk and reward that was superior to using time and materials or other traditional commercial arrangements. But, as described above, achieving this in practice is far from straightforward. Resolving tensions and finding an acceptable formula require a clear understanding of costs and risks, persistence and a genuine desire to balance the needs and interests of all alliance partners.

- **Stay faithful to alliance values and principles.** With the oil and gas industry battered by growing regulation, alternative energy competitors, falling prices, and a slump in demand or glut in supply as a result of the COVID-19 pandemic, operators are under significant pressure. The real test for Aker BP’s drilling and wells alliances is whether they can navigate through this turbulence and emerge stronger on the other side. “Everyone loves winning,” notes Morten Kelstrup, chief operating officer at Maersk Drilling. “It’s when you’re losing that you see how strong a team you really are.”

### Evidence

1. **Gartner Procurement’s Value Contribution in Supply Chain Survey, 2019** (n = 264). This primary research study was designed to understand the business outcomes of procurement. It is mostly focused on supporting the primary levers procurement is using to achieve these business outcomes and the technology enablers required to operate these levers effectively. It was conducted online during July and August 2019 among 264 respondents in the North America, Latin America, Western Europe and Asia/Pacific regions. Respondents at manager level with primary involvement and responsibility for the sourcing and procurement function were surveyed in companies from the retail, manufacturing, healthcare and natural resources sectors with annual revenue of at least $1 billion. The study was developed collaboratively by Gartner analysts and the Primary Research Team supporting supply operations.


Recommended by the Author

Business Ecosystems: A New Partnership Paradigm
Key Success Factors to Assess Your Supplier Relationship Management Program
Tapping Supplier Innovation for Competitive Advantage

Recommended For You

Improve Key Account Management Results Through Targeted Compensation Plan Design
Deliver Strategic Business Value With Your Seat at the Table
Increase IT Value: Shift Your Seat at the Table
Survey Analysis: Healthcare Providers Seek Results With Financial Performance Optimization Systems
Aligned Assurance: Coordinating Your Crisis Response Plan