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OIL AND GAS

MANAGING HUMAN CAPITAL ASSETS DURING A MARKET DISRUPTION

MARSH & McLENNAN COMPANIES

"With the continued drop in oil prices, there are daily headlines around the world about the effect on economies, companies, communities, and individuals. It would be an understatement to characterize the oil and gas market as dynamic – we are clearly experiencing a market disruption. Disruption, however, can be managed, and we believe no matter the impact on a particular business, there are ways to manage through this downturn that mitigate risks and enhance organizational strength and performance over time."

– Philip Tenenbaum, Global Leader, Mercer Energy Vertical

The precipitous drop in oil prices may prove to be dangerously disruptive for certain companies within the industry. On the other hand, this disruption creates significant opportunities for some to seek and gain competitive advantage. This underlies our view that while short-term actions must and will be taken, those actions must consider the long-term and strengthen the enterprise to compete in an ever-increasing volatile marketplace.

MANAGING THROUGH DISRUPTION – A HUMAN RESOURCE PERSPECTIVE

Within days of OPEC's decision not to cut production in November 2014 and as the slide in oil prices began, Mercer released a spot survey, "2015 Changing Energy Industry Dynamics", to understand what HR professionals were considering or planning in response to the disruption. The Survey looked for insight into 2015 actions as well as 2016 and beyond.

Results over the six-week survey period showed a significant shift from "wait and see" to "definitive" action - not surprising given the swift and dramatic change in market fundamentals. Outlined below are HR's highest-ranked responses to the changes in business strategy and direction. These new results represent a drastic change from the previously reported challenge of keeping up with growth, as recently as mid-2014.

Impact on 2015 business strategy	HR's 2015 response as a result
• 44% will cut back Capital Expenditures as a result of the decline in oil prices. • 38% will reduce selling, general, and administrative (SG&A), and 23% will reduce core (non-SG&A) operating expenses. • 7% will explore potential divestures of assets, business units, products ,or geographies.	• Top 3 priorities are: – Decrease in "buying" talent. – Freeze or cut compensation. – Consider how to enhance cost effectiveness of HR delivery. • 16% may reduce staff (restructuring).

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Perhaps most telling of how swiftly a market disruption can alter the strategies and course of action is to consider talent acquisition. In Mercer's Oil and Gas Talent Outlook and Workforce Practices Survey (released in 2014), employers focused almost exclusively on "buying" talent as the core of their talent strategy – with 66% of employers indicating a preference to "buy" talent over "build" talent. As the headlines now reveal on almost a daily basis, "buying" talent has taken a distant back seat to restructuring and layoffs. In the 2015 Changing Energy Industry Dynamics Survey, respondents indicate a dramatic cut in hiring plans. We point out that hiring versus reductions is largely dictated by where the enterprise plays in the value chain and its unique situation (geographic presence, operating model, and debt levels).

Looking at strategies and plans for the longer-term (2016 and beyond), respondents were primarily focused on "building" internal strength and capability (45%); coupled with enhancing supervisory, management, and leadership skills (45%); and understanding and optimizing employee engagement (41%). These priorities were followed by seeking to reshape HR service delivery (23%); optimizing the organization at large (22%); and assessing and reshaping their employment value proposition (20%).

While we are aware that sudden drastic actions, such as reductions in pay, may be necessary, they may be seriously detrimental to the enterprise over the long-term. We support longer-term thinking to create internal capability to deal with volatility and change in the coming years.

THE RIGHT MINDSET — A LONG-TERM VIEW TO ADDRESS SHORT-TERM CONDITIONS

Although there is a need for HR to address current market realities, the forward-thinking HR leader will put forth a balanced strategy – taking necessary short-term actions while building capability and enhancing organizational performance for the long haul. This view is essential because oil price is fundamentally based on supply and demand. As production cuts take their toll, demand will eventually outpace supply and organizations will be in growth mode again.

According to Mercer's Global Talent Forecast (released in 2014), today we have a global shortage of petroleum engineers with a world-wide shortage of roughly 22,000 forecasted for 2017. Furthermore, Mercer research indicates time-to-proficiency for a petroleum engineer can take between 20 and 30 years. Time, in fact, does not heal all wounds. When markets rebound, the industry will still be faced with a shortage of critical skill jobs.

DECISION MANAGEMENT FOR HUMAN CAPITAL

It is with this mindset that we encourage HR and business leaders to follow a decision process meant to help set a course of the best actions to meet near- and long-term requirements of their business, its customers, employees, and stakeholders.

Consider the organization that needs to produce immediate cost savings – in the end, manpower reductions may be required. However, there are a number of alternatives and actions that may produce at least a portion of the needed savings and not impede that organization's ability to compete once the market rebounds. Whatever the decision, having a framework to push thinking outside the proverbial box enables HR leadership to outline and assess alternatives, understand the ramifications of each, prepare risk mitigation plans, and make more informed choices. At the same time, HR can create shared ownership among the leadership team to execute those decisions flawlessly.

Recognizing that one process can never fit all conditions and must be adjusted based on the needs of the business, we offer the following process to aid HR and business leadership in dealing with the current disruption and volatility yet to come.

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MANAGEMENT DECISIONS

Challenge or opportunity, the decision process is common to both scenarios

Evaluate	Determine the extent and severity of market conditions. Develop planning scenarios and assess the impact of each on existing human capital strategy and the organization. Identify critical and high performance talent. Engage the organization at large with targeted outreach to critical and high-potential talent.
Options Development	Outline options over several time horizons from immediate to long-term and assess the impact and implications of each. Leverage analytics to conduct workforce planning and predictive modeling.
Strategic Choice	Leverage analytics to down-select to best choice decisions while ensuring that those choices address **short-term needs** without jeopardizing the **long-term strategic position.**
Strategy Clarification	Stress-test the human capital strategy and tactics, considering strategic choices and alternative combinations. Reclarify this strategy for a one-to-three year horizon. Establish a workforce planning and analytics center-of-excellence to enhance future performance.
Optimization	Execute human capital strategy to ensure full leverage and alignment across all HR programs. Drive for operational excellence in HR delivery.
Governance	Ensure HR is embedded with ongoing business and executive leadership. Establish HR control and management protocols, including analytics dashboarding, monitoring, and reporting. Create a culture of high engagement, communication, and transparency.

STRATEGIC CHOICES – OPTIONS BEYOND THE OBVIOUS

Of the six steps, strategic choice is a point of differentiation for the various scenarios an organization faces - for some a significant challenge to address and for others an opportunity to seize competitive advantage. A view into the ends of this spectrum follows:

Challenge to Address:

Actions likely include contraction, investment hold, cost reduction, expense deferral, consolidation, outsourcing, offshoring, and asset divestiture.

Opportunities to Seize:

Actions likely include expansion, investment acceleration, talent recruiting/up-skilling, talent development, branding, and asset acquisition/formal partnerships.

Based on our long history of working with oil and gas clients across all facets of HR management, we offer the following 10 options to consider in lieu of, or in combination with, other workforce actions that may meet immediate needs without detriment to the go-forward enterprise.

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PRIORITY ACTIONS TO DELIVER FINANCIAL PERFORMANCE IMPROVEMENT

- **Financial re-engineering (P&L and Balance Sheet)**
  - Seek alternative debt, tax and insurance structures/options of HR programs to eliminate or minimize P&L, and/or balance sheet impacts
- **Program suspension**
  - Consider alternatives to full cessation for applicable HR plans or programs
- **Increase employee accountability/empowerment**
  - Move to more direct employee accountability and ownership in benefit plans
- **Rewards reconfiguration**
  - Examine alternative delivery mechanisms, timelines of delivery, and mix configuration of total compensation
- **Plan governance**
  - Seek to enhance overall fiduciary, compliance, and claims exposure risk management through delegated partnerships
- **Optimize HR service delivery**
  - Determine priority HR services and maximize the cost effectiveness of delivery of those services
- **Workforce planning and analytics**
  - Establish a fact-based definition of future talent needs, and develop plans to achieve those needs, taking into account internal and external supply and demand for critical skills and resources
- **Alternative workforce configurations**
  - Seek to optimize workforce staffing during periods of disruption without resorting to layoffs
- **Global plan leverage**
  - Seek to optimize cost and risk management effectiveness by considering the global (versus only the local or regional) workforce
- **Employee productivity acceleration**
  - Focus on critical employee engagement, performance, and alignment actions that maximize individual and collective efforts, resources, and outcomes

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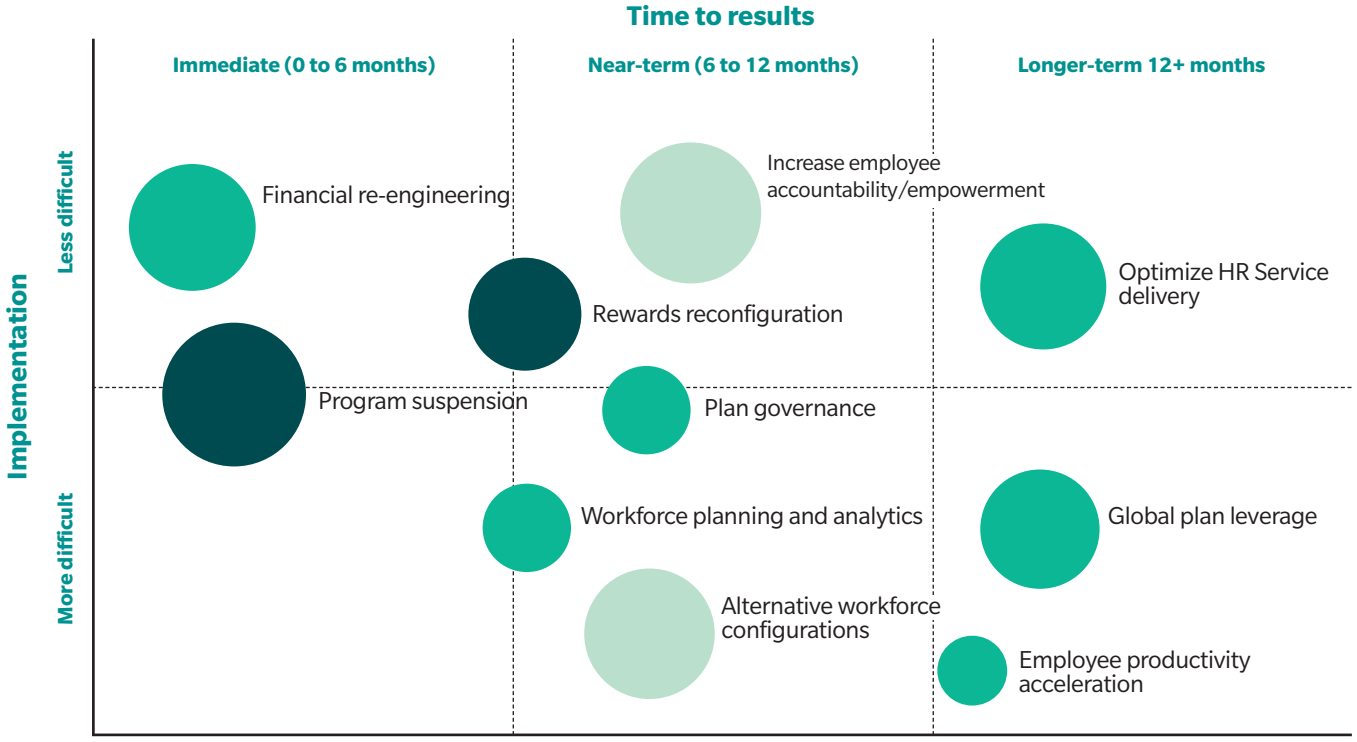
MERCER POINT OF VIEW

Priority actions to deliver financial performance improvement*



Financial impact: size of bubble

Risk to employees or enterprise, in order of magnitude from minimal to significant: mid-green, light-green, dark-green

*Actual results for any specific organization will vary

EXAMPLES OF IMPACT

Within the 10 broad categories outlined above, there are over 50 specific tactics that have a material impact on the P&L and/or Balance Sheet of an organization. Examples of specific considerations and results are noted below. Results will vary for an organization based on a number of factors.

- An integrated energy company with over 18,000 employees was looking at an estimated annual employee turnover cost for the next five years of between $7 and $11 million USD. After full consideration of possible actions in **WORKFORCE PLANNING AND ANALYTICS**, a suite of interventions (focused hiring effectiveness, onboarding, and proactive staff replacement) provided a 30% savings, resulting in lower annual costs of $2 to $3 million.
- An oil field services firm, recognizing opportunity under **ALTERNATIVE WORKFORCE CONFIGURATIONS**, is considering switching from an Expatriate Index to an Efficient Purchaser Index. This alternative would result in total cost savings, for approximately 200 expatriates, of over $1.2 million USD per year.
- An upstream company examined opportunities under **OPTIMIZE HR SERVICE DELIVERY** and renegotiated healthcare vendor service fees, resulting in annual savings in excess of $2 million USD without reducing the actual benefit employees received.
- Faced with an immediate need to reduce cost while minimizing employee disruption, a global petrochemicals company examined options to deliver healthcare differently. It made the strategic choice under **PLAN GOVERNANCE** options to implement unique, high-intensity care management service with projected savings of $1 million USD per year (2% of annual medical spend).
- A downstream company with 10,000 employees considered options under **FINANCIAL RE-ENGINEERING** and implemented a Vested Termination cashout of pension plan liabilities which will produce annual savings of between $3 and $5 million USD over the life of the plan.

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YOUR BEST FUNDAMENTAL ACTIONS…NOW

Regardless of whether this market disruption presents a challenge or opportunity, our experience with prior oil and gas cycles and learnings from clients across the entire value chain lead us to seven fundamental actions all organizations should consider:

1. **Defend your best assets — guard against critically important employees unexpectedly leaving the organization.**

   Reevaluate and modify the employee value proposition and retention plans to ensure that key talent groups in short supply are inoculated from firms poaching and "buying off" talent.

2. **Clarify roles, work, and key performance requirements — develop a clear line of sight on what is expected to succeed in the role and the skills needed to execute effectively.**

   Create clarity of critical role requirements/accountabilities, key performance indicators, and the technical and behavioral competencies needed for high performance today and tomorrow.

3. **Build sustainable internal capability and transfer knowledge — invest in critical roles that create and preserve value.**

   Invest in targeted high-impact training and develop leveragable action-learning that benefits both the employee and enterprise (especially during periods of rapid change). Codify and transfer tacit knowledge of senior experts to developing staff.

4. **Engage to retain — reduce attrition while improving performance and creating a thriving culture.**

   Engage employees with superior communication and transparency to build loyalty and seek their active involvement to bring about the new strategy. Have the courage to adjust plans to evolving market conditions accordingly.

5. **Sustain operational excellence — continually seek to improve and be adaptive to change.**

   Establish a cross-functional project management office (PMO) to oversee the implementation of significant plans, prepare for M&A activity, and manage the go-forward business.

6. **HR governance matters — set strategy, implement, control, and manage.**

   Simply stated – do what you said you would do, how you said you would do it. Apply change management principles to support implementation. Always stay true to your stated values.

7. **Segment to survive then thrive – preserve roles that create and sustain value.**

   While business conditions may force workforce actions that no leader ever truly wants to take, if such action is required, the interests of the enterprise and its stakeholders is first and foremost. This must be so to enable the enterprise to maintain a market competitive position and rebound to growth – creating more opportunities, jobs, and careers in the future. Knowing what roles affect business strategy, both creating and sustaining performance, is vital to ensure the changes today will not impede growth and performance tomorrow.

HR AS CHANGE ARCHITECT

This is a time – perhaps like never before – where HR leadership must be woven into the fabric of business strategy and operating model adjustments so that the implications of today's decisions are taken with full consideration and appreciation of long-term human capital effectiveness. Strategic choice decisions and their implementation must be a shared business leadership issue. These actions should be guided by the HR leader, owned by the entire executive team, and managed with the same rigor and intensity as any other business decision. The case for this is simple – caps can be placed and removed on wells, valves can be opened or closed, units can be shut down or ramped up. Employees cannot. Tangible assets also don't have what employees have – memory, emotion, and the ability to make decisions to stay or leave an organization.

The actions we take today will have lasting effect over the months and years to come.

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Authors Lavon Washington, John Koob, and Philip Tenenbaum are core members of Mercer's Global Energy Vertical team. Lavon is a Business Analyst who has over 7 years of experience at Mercer, while John serves as the North American Energy Leader, with over 25 years of experience in HR & workforce strategies, and mergers & acquisitions. Philip is the Global Energy Leader, with over 30 years of human resource consulting experience and a focus on business and HR strategy alignment.

MERCER'S ENERGY VERTICAL

Mercer helps organizations in the oil and gas industry outpace the competition through a combination of expert global, regional and local resources; deep project experience across the value chain; unequalled global oil and gas workforce data and insights; and cross-industry adaptive innovation. To learn more, please visit www.mercer.com/services/solutions/energy.html.

To schedule your private human capital strategy session or for further dialog with Mercer's Energy Vertical leadership and functional experts, contact:

Philip Tenenbaum, Senior Partner
Global Energy Vertical Leader
Philip.Tenenbaum@Mercer.com
+1 713 276 2253

John Koob, Partner
Americas Energy Vertical Leader
John.Koob@Mercer.com
+1 713 276 2137

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