



# THE OIL & GAS YEAR

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## Jimmy SPENCER Obstacle overgrowth

Jimmy Spencer is the chief financial officer and director of the **Chemtex Global Engineers** in India. He has been associated with industry for the past 34 years, working in sections such as strategic business management, finance, legal, taxation and purchase activities.

India's growing potential has never been in doubt. However, the nation's growth potential can be hindered if the country's global outlook becomes either uncompetitive or unattractive. This line of business is facing the negative results of not having a fully de-controlled oil pricing mechanism. The problems of government-controlled pricing and regulations, the strong bureaucratic presence, lack of transparency and a constant shift in policy decisions all need to be addressed by the Indian government in order to create a more attractive future for business.

**CONTROL ISSUES:** Public sector undertakings (PSUs) are unable to work under market-determined prices and instead are controlled directly and indirectly by the government. Political motivations force the government to regulate prices and this interference can only send negative signals to the rest of the world, thereby discouraging foreign companies from participating in or investing in the Indian market. The administered pricing mechanism should be reviewed, as it is a hindrance to a free market economy. Oil companies sell at subsidised rates, resulting in losses from the price differences. The difference is then covered by the government by way of subsidies, and this puts a burden on its finances and more often than not ends up delaying payment for subsidy. As a result of this delay, PSUs become hard pressed for cash. This leads to the government issuing oil bonds, which the PSUs pledge with banks to enhance their working capital limits. The banking system subsequently comes under stress as banks end up indirectly funding this money to the government. It is a dangerous and vicious cycle that needs immediate correction.

Engineering, procurement and construction companies working with PSUs face challenges in terms of achieving desired results, especially multinationals working to certain international standards. Contractors face increasing bureaucracy and the decision-making process can become extremely slow. They also face constant adjustments in policies and a lack of interest from PSUs that are not particular about timelines for completing projects. This is evident in the fact that most projects have a minimum delay of 8-12 months. PSUs are immune from liabilities resulting from delays that they have caused, which leaves the contractors

vulnerable and usually not able to receive any compensation as a result. It is a one-way street scenario.

While the majority of top PSU employees are able to gain experience by working for decades in the same organisation, these employees may not follow a merit-based appointment system and run their establishments through a quid pro quo arrangement. This usually means that transparency is not part of their business culture.

**THE PRICE IS RIGHT:** Transparency is key to the success of any growing economy. While the open bidding system used by the government is acceptable, it still needs to look at alternative options that will achieve transparency with minimal effort. The current lowest-bidder-wins tender system finds PSUs awarding contracts to companies that may not have the required capabilities to achieve the desired target or efficiencies for the projects. While this lowest-bidder-wins system looks at both the technical and commercial qualifications of the bidders, it focuses more on squeezing prices out of them and relies more on the lowest quote provided rather than the technical capabilities of the contractor being awarded the job.

The growing risk in this case is companies being forced to lower their prices to a bare minimum in order to win a contract. This results in contractors struggling to recover margins or to break even and can thus compromise operations, which subsequently ends up being more expensive as a result of delays. Companies can also damage their reputations in the process. Introducing an online reverse auction process could be a solution to this. The tendering process and scrutiny of bids should be handled by an independent professional body that has the ability to create transparent reports detailing reasons for awarding contracts and whether or not they believe the company will be able to complete the project in an effective manner.

Without addressing the growing need for a much stronger infrastructure base, more foreign direct investment, greater transparency and stronger public-private partnerships, conditions are sure to become very difficult for India's businesses. Although some small steps have already been taken, this is not enough. Drastic measures are required in order to realise India's full economic potential. ■

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