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ADAM WATEROUS: There's opportunity in the death of the oil industry's business model

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Canada's oil industry is going through a transformational and difficult restructuring. Over the past three months, foreign companies have sold more than $24-billion in Canadian oil assets. According to a Reuters article in May, the sales are "due to depressed global crude prices, high operating costs and limited pipeline access to market."

While these factors have played a role in the realignment of the Canadian oil sector, the primary driver has been the death of the dominant oil business model of the past 100 years – globalization – originally pioneered by a Canadian: Donald Smith, Lord Strathcona.

Among Lord Strathcona's many accomplishments – which include co-founding the Canadian Pacific Railway and driving the ceremonial last spike of Canada's first transcontinental railway in 1885 – he is the most successful oilman in Canadian history.

In 1908, at the age of 88, he was chairman of Burmah Oil Co. when it discovered in Iran one of the largest oil fields in the world, which would go on to produce more than one billion barrels.

The discovery, the first successful oil well in the Middle East, formed the basis of a new company, Anglo-Persian Oil Co., which later became British Petroleum.

The discovery created a supermajor oil company, realigned economic power toward the Middle East and continues to shape geopolitics to this day. Lord Strathcona also helped give birth to the model of using transferable technology to explore in underdeveloped regions, and diversifying reservoir and political risk by investing in multiple countries.

Over the past century, this globalization business model was great for Canada.

When our basins were immature and Canadian companies were relatively small, foreign companies brought both expertise and capital. Even when the specialized nature of Canada's oil sands did not quite fit the model, foreign oil companies invested because the size of the resource was too good to pass up. Without international investment, our oil industry would have developed at a much slower pace.

Unfortunately, Lord Strathcona's business model started to get sick about six years ago and officially died on Jan. 17, 2017. That day, Exxon bought the Bass brothers out of the Permian for $6.6-billion (U.S.). Exxon, the largest investor-owned oil company in the world and the best positioned to take advantage of globalization, decided the best place to invest was a few hours' drive from its headquarters in Texas.

There are three reasons the globalization business model for the oil industry died. First, oil companies can now achieve better growth in relatively mature reservoirs in North America than by exploring for new reservoirs in less-mature regions overseas.

The application of horizontal multistage fracking technology, which began on a mass scale around 2011, has transformed the North American oil industry, leading to production growth not seen for decades.

Second, the technology required to develop these unconventional reservoirs is less transferable than before. Most large oil companies have highly centralized decision-making processes, which make sense for allocating capital overseas to mega-projects, but are ill-suited to the rapidly changing fracking industry, where techniques are being improved on almost a monthly basis. Consequently, it has been the focused, nimble companies, which have best capitalized on this new technology.

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Third, in an era of ever-increasing environment regulation, navigating the local political landscape has become a minefield for foreign companies.

In major oil and gas regions such as British Columbia, Alberta, California and Colorado, governments are increasingly focused on maximizing not only revenues but environmental outcomes. Local companies can often better understand local stakeholders and be more comfortable in assessing the investment risks.

The same forces that led to the death of globalization – unconventional reservoir development, non-transferable technology, environmental regulations – have led to the birth of the new dominant business model: specialization.

The specialization business model dictates that oil companies should limit themselves to a small number of core fields win which they can add value by applying specialized technology. So far, the stock market has rewarded companies that have done so, such as Seven Generations Energy in Canada and Diamondback Energy in the United States.

Specialization is causing a huge restructuring of the global oil industry, which is impacting Canada. Emerging regions, non-operated positions and diversification are out – large, operated positions requiring specialized technology are in. Contrary to the Reuters article, it is this new specialization model, not low prices or high operating costs, that primarily led Conoco to sell to Cenovus and Shell to sell to Canadian Natural. Conoco was able to sell a non-operated oil sands position and plow the proceeds back into its core-operated Permian acreage. For Shell, selling its oil sands assets to Canadian Natural allows it to focus on its industry-leading LNG and deepwater business.

While Canada needs to continue to welcome foreign investment, it already has most of the capital and expertise it needs to develop its oil resources.

Consequently, while the replacement of globalization with specialization is causing a difficult restructuring, it is also giving rise to a golden age of Canadian ownership of the oil patch.

Local Canadian companies, both big and small, have the opportunity now to dance on the grave of globalization.