

The Oil Curtain and the Evolution of National Oil Companies

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Sketch out the global landscape of reserves and production and its most salient features would be the growing appetite for oil and gas and the drive for reserves replacement from frontiers and mature fields. In the background lie the cycles of “feast or famine” and the long lead times that govern investment and returns. Tantalizingly hidden away is the essence of the industry—petroleum reserves.

The Oil Curtain neatly symbolizes resource sovereignty and separates the hydrocarbon “haves” from the “have nots.” It has led to the major part of proved global oil reserves being booked by national or state oil companies (NOCs). To illustrate the change of ownership, in 1971 NOCs held 30% of total global reserves while international oil companies (IOCs) held 70%. Today

NOCs have increased their share to 93% while IOCs hold 7%. What caused such a dramatic reversal in fortune?

Since the early 1900s the importance of oil in financial, political, and strategic matters has been bubbling up to the surface. Eventually, this led to a pressing need for producing states to control oil. Mexico was first to “shut” the oil curtain by nationalizing its oil assets and forming the wholly state-owned Pemex (Petróleos Mexicanos) in 1938. By 1960, resource sovereignty had fully matured into a global force and the Central Bank of Oil—the Organization of the Petroleum Exporting Countries (OPEC)—was created.

OPEC’s central message was clear: oil was too important to leave in the hands of foreigners. It would seek to regulate “oil rents” and end arbitrary payments

from foreign oil companies. OPEC’s thinking was shaped threefold. First, deals favored foreign oil companies and foreign governments, not producing states. Foreign oil companies also controlled an outward flow of profits, which were often the greater part of producing countries’ gross domestic product. Generally, beneficiaries were foreign governments either directly through shareholder dividends or indirectly through taxes. Secondly, foreigners took vital political decisions affecting the sovereignty of producing countries. Oil production, foreign exchange earnings through oil sales, and ultimately, national debt were being dictated by foreign oil companies. Lastly, the military and naval campaigns of the Second World War combined with the utility of oil in general transportation

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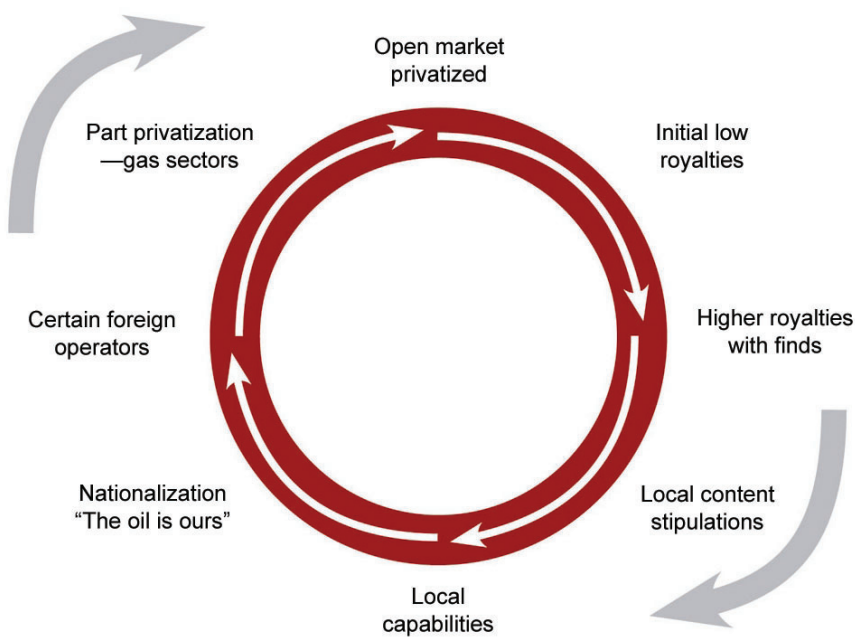


Fig. 1—Oil and gas nationalization has come full circle from seeking higher royalties to partial privatization.



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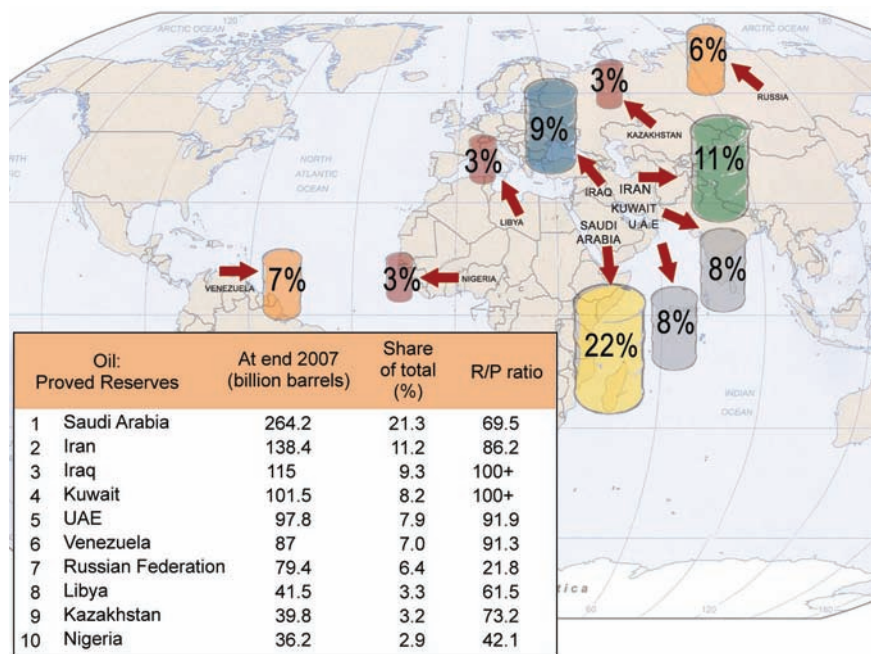


Fig. 2—Top ten global oil reserves 2007.

SOURCE: EPRasheed & BP Statistical Review.

left no doubt that oil was a primary strategic asset.

Producing countries were united; the old deals had to be undone. New deals would treat territorial owners of resources and the IOCs as equals. Modern national oil policy has come full circle (Fig. 1). It has evolved from seeking equal treatment to maximizing royalties to stipulating local content to full nationalization and now to partial privatization for some gas developments.

New Seven Sisters

Nowadays, OPEC decisions get as much ink as those of major central banks. Yet beyond the paparazzi flashes and newswire headlines, how important will OPEC and NOCs be for future oil supply? Realistically, the production of OPEC and certain NOCs will be vital for several generations to come. To understand that reality, simply look at the top 10 reserve holders worldwide (Fig. 2): Saudi Arabia, Iran, Iraq, Kuwait, UAE, Venezuela, Russia, Libya, Kazhktan, and Nigeria. Seven of these countries—the first six and Libya—are all OPEC members. To see how important these new Seven Sisters are to future oil supplies, consider the reserves-to-production (R/P) column in Fig. 2 to see how many of today’s top 10 global reserve holders are likely to be producers in the US Energy Information Administration’s Energy Reference Case year of 2030.

Of today’s top 10 reserve holders, Russia would have dropped off the list while the new seven sisters and other OPEC countries would still be producing away. Of the other current major producers, Canada has 22.9 years, the US has 11.7 years, and Mexico has 9.6 years of oil reserves left at current production rates. The upshot: OPEC and the new Seven Sisters will grow both home and abroad. NOCs may not become global household brands but they have set the trend that restricts IOC access to oil, and lately, the dividing line between the two is not so clear.

Fuzzy Logic

The fuzziness between private and state oil companies stems from the NOCs that have “gone global.” For certain companies, the logic and returns of going global are compelling: add new production and export home-grown technology. Yet, on the other hand, there is the risk of sudden nationalization. Once wellheads, fields, pipelines, and refineries are built, they cannot be dismantled and sent back home. In the event of political change or a major dispute, the oil company’s bargaining power is effectively reduced. Any share it may have of production can only be sold off to the state concerned, which becomes a question of expedient valuations rather than ownership.

What actually constitutes an NOC, and what distinguishes the NOC from the IOC? Is it 100% state ownership? Or just a state majority? What if the company floats on the world’s stock markets and has private shareholders yet retains a state majority? Yes to all.

The distinction depends on whoever holds 51% or more of voting shares and controls overall decision-making power. If the majority shareholder is a government or state, the company must answer to them, therefore such a company is defined an NOC. The opposite applies also. If the company’s 51% voting majority is privately held or listed it would be defined as an IOC.

Shareholder distinctions shed light on the responsibilities of each company too. NOCs have a strong responsibility to steward oil wealth to meet the needs of a given nation and its population in a sustainable way. IOCs focus primarily on maximizing returns. Social responsibility is important also but not to the same degree as to NOCs. Most people in the industry accept that profits must be balanced with social responsibility. Private shareholders generally accept this too. Corporate social responsibility programs within IOCs are abundant. Partly privatized NOCs fall into this category also. Just how much social responsibility is deemed healthy depends on the shareholders.

Notable NOCs such as Brazil’s Petrobras and China’s CNPC operate well beyond their home territories. Both companies not only retain majority government stakes but also raise capital using a canny combination of state finance and international financial markets to develop domestic and foreign reserves. But where they really excel is by *competing internationally* for capital and upstream acreage and applying their unique technologies and know-how. Accessing reserves or holding on to them is the producer’s top challenge. Consumption is a given. Subsequently, finance, human resources, technology, and processes can be acquired.

Naturally then it is a “no-brainer” for NOCs with global ambitions to compete for foreign reserves and production. Entering this competition makes sense for those NOCs that have limited reserves or high production costs at home or where they can export home-grown technologies abroad. It does not make sense for the new Seven Sisters

who have abundant domestic reserves at relatively low production costs. In the latter it makes more sense to stay home and develop national reserves. But where do the IOCs fit into all of this?

Original Seven Sisters

A decade ago the price of a barrel of oil languished at USD 10/bbl. This triggered “mergeritis” and reformed the original Seven Sisters, a term coined by the Italian oil tycoon Enrico Mattei. The original seven were Exxon (Esso), Shell, BP, Gulf, Texaco, Mobil, Socal (Chevron), plus an eighth, the Compagnie Francaise Des Pétroles (CFP-Total). During the 1990s the new prize for these companies was finding synergies and economies of scale. Management consultants were set the task of merging these great disparate entities and analysts evaluated the mergers in terms of restructuring and costs.

In the corporate cost-cutting that ensued, locations and operations were rationalized. Many IOCs consolidated their international operations in Houston. Research and development, technology activities, and technical disciplines were seen as unnecessary fixed costs that could be more profitably outsourced. At that time, only a handful of voices questioned rationalization; it made sense financially and operationally. Ironically, this would strengthen the oil curtain and return to haunt IOCs.

Outsourcing Technology

As operators and well profiles became leaner, service companies grew. They were required to contribute more value than ever before; to reduce well cost and optimize performance. IOCs contracted out technical niches such as directional drilling or reservoir modeling as well as entire technical disciplines such as drilling or reservoir management. Simultaneously, service companies commercialized projects that IOCs cast off.

In the old days, IOCs conferred access and monetized oil reserves. IOCs alone had the technology, capital, and know-how to tap the wealth of an unknown hidden natural resource. Naturally, they bargained hard and got the lion's share. Those old ways show that oil reserve holders used to recognize IOC as equals, perhaps, even as holding the upper hand as the IOC was required for revenues to be realized.

Even before the oil curtain, some IOCs noted that the pool of acces-

sible oil reserves would one day shrink. Progressive IOCs repositioned themselves for the future, some seeing “beyond petroleum” and others shut out by the oil curtain. However, this does not imply the fall of IOCs. Some are perfectly adapted to evolve and there is still a healthy global E&P environment for them to adapt to.

The drawback is that this environment of extreme E&P has high replacement costs as margins are squeezed by technical challenges. Extreme E&P opportunities exist in ultradeepwaters, the Arctic, unconventional, and in a dazzling array of gas-related technologies. Additionally, nationalization and resource sovereignty has made business more difficult. **JPT**

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