The increasing role of NOCs

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National Oil Companies (NOCs) are increasingly coming out from behind the shadows of their private counterparts. They are proving themselves able to compete head-on with International Oil Companies (IOCs) in everything from field development to mergers and acquisitions. Saudi Aramco has silenced many sceptics by significantly boosting the kingdom's output without the help of foreign partners. In some cases, NOCs are now competing directly with IOCs for projects and investment opportunities overseas, long the preserves of the super-majors. Companies from China, India, Malaysia and Brazil have won concessions to explore for and develop petroleum resources overseas. And in spring 2005, CNOOC, the Chinese state offshore oil company, was a serious contender to buy the American major Unocal, though ultimately it lost out to Chevron. In the same period, the Iranian National Petrochemical Company was a strong bidder in the competition to acquire a Shell–BASF petrochemical venture, but was unsuccessful partly because of political pressure. These ambitious moves show that it is no longer inconceivable that an NOC could swallow up a major oil company.

In most important oil-producing regions of the world, the oil industry has been nationalised. Ninety percent of the world's oil reserves are entrusted to state-owned companies. In a minimalist definition, NOCs are not restricted to those companies owned entirely by government and in possession of exclusive rights over the mineral domain. A number of NOCs have evolved beyond the attributes that initially defined them and, to some extent, protected them. Today an increasing number of NOCs coexist and cooperate with foreign private companies on national soil. This is the case for the Abu Dhabi National Oil Company (ADNOC), Sonatrach, the National Oil Corporation of Libya, Petronas of Malaysia, Pertamina in Indonesia, NNPC (the Nigerian National Petroleum Corporation), the Qatar National Gas Company and PDVSA (Petróleos de Venezuela SA). Others have the structure of a private-sector company but with a majority of government shares at the voting level—this is the case for Petrobras of Brazil and Statoil of Norway. The configuration of the industry in Russia and China is still evolving but it includes both state and private-sector enterprises. With the growing commercial focus of most NOCs and the increasingly liberal agenda of governments legislating on these matters, there is more flexibility than in the past regarding the status of NOCs. In this more liberal view, they need not be exclusively state-owned operators of the national hydrocarbons sector. But there are forces within NOCs, state institutions and societies that resist this evolution.

NOCs are not IOCs

Many national oil companies have a strong domestic reserves base, unlike most IOCs, which have been struggling recently to find and exploit commercially attractive deposits of oil and gas, as opportunities dwindle. Five national oil companies (NOCs) - Saudi Aramco, the Kuwait Petroleum Corporation (KPC), the National Iranian Oil Company (NIOC), Sonatrach (Algeria) and ADNOC - together produce one quarter of the world's oil and hold one half of the world's oil and gas reserves. The very large size of the Middle Eastern NOCs' reserves means that they do not necessarily need to develop internationally, as have the private oil majors. They have plenty to do at home, and expansion overseas is much more a luxury than a necessity. Sonatrach may be in a different position: it will need either to acquire new upstream assets abroad or to increase its oil reserves with new exploration and the application of new technology to existing reserves in Algeria—with IOC help as appropriate.

Financially, national oil companies remain different creatures than the private oil companies. Their finances are not independent of government. NOCs are different from IOCs too in their long-standing engagement in the promotion of social welfare, for example through educational programmes, infrastructure development, local procurement and new private sector business development.

Fundamentally, NOCs are not like international oil companies because they have a monopoly or near-monopoly over their countries' resources and do not have a majority of private shareholders. A number of state companies have experimented with a degree of private ownership, offering shares to the public while allowing firm government control to be maintained. Models such as Statoil, Petrobras, Pemex and Russia's gas giant Gazprom, which is traded on the stock exchange but is now under strong control by the Kremlin, have grown into new entities that have characteristics of both an NOC and an IOC.

However, a distinguishing characteristic remains: national oil companies are instruments of the state. Their operations and strategy are restricted by government directives and do not always operate on the basis of a commercial rationale. For instance, NOCs have an obligation to supply the domestic market with affordable energy and much of the natural gas produced is dedicated to fulfilling this aspect of their mission.

At the same time, the relationship between NOCs, their society and their government is a complex one. NOC managers are, for the most part, noticeably apolitical, perhaps with exceptions like Iran. Their priorities are the allocation of resources for the industry, their operational autonomy and national economic challenges. But events in the oil and gas industry carry a political significance for the societies of producing states. Public opinion pressure tends to be exerted on government and to reach the NOC only indirectly. Governments deal with contrary interests and respond to short-term threats to political stability. This political process can lead governments to have incoherent goals – for instance, seeking greater revenue from the oil industry while asking the NOC to carry out social programmes that hamper its operations and increase its costs. But NOC managements seek the freedom to manage the industry so as to mobilise the country's oil wealth without government intrusions that would cripple their economic and technical capacity. There is, in this respect, a constant institutional struggle between government and NOC.

NOCs are unlikely to become IOCs

Outside the producing countries, many people think NOCs should be privatised and that their governments and societies would benefit most from such a step. But it is not the predominant view in the producing countries. NOCs serve state interests more directly than do private companies because they are instruments of the state. They are not "just companies": NOCs are often the best employer.

Moreover, there remains a deep emotional attachment to sovereign control over natural resources among many Middle Eastern societies, as is also the case in Latin America. As the former Secretary-General of OPEC Dr Subroto stated: "Although several decades have passed since the era of nationalisation, our national oil companies continue to possess a rather unique political status in the eyes of their respective nations. They are still regarded as the symbol of national sovereignty that controls the most important and the most valuable resource endowment in our countries." This was evident in public responses to the hydrocarbon sector's reform initiated in Algeria: civil society groups strongly voiced their opposition to any possibility of privatising Sonatrach.

Becoming a top-notch NOC

However, there is no reason why their national status should prevent any of these companies from being highly competent and efficient. NOC strengths come from their relationship with, and support from, their government and society. Furthermore, the state's assets are strengths of the national oil company because it usually enjoys exclusive or preferential rights on home territory. These assets include, besides natural resources, the geographic location of the country and the government's network of alliances and relations with other countries, potential hosts of the NOC's overseas development.

In most cases, their weaknesses pertain to poor processes, both internally and in their relationship with government. Consultation is a traditional decision-making process in the Middle East. But internally, many companies in that region have centralised, top-down and rigid decision-making processes, which hinder their responsiveness to new trends. Management could introduce more consultative, consensus-building processes instead, as ADNOC has done.

Another weakness of regional national oil companies concerns the burden of national mission expenditure. However, many governments will willingly take on the companies' social programmes. This transfer of national mission to the state has already been accomplished in Iran. Ideally, NIOC will retain the capacity to develop programmes that benefit its own strategic objectives – as Saudi Aramco and Sonatrach have demonstrated with investments in training to build national capacity, which increases the pool of skilled labour for the company to recruit from. They and NIOC work with local content policies that increase business for the national private sector, and this ultimately reduces the dependence of the non-hydrocarbon economy on hydrocarbon revenues.

A key factor for success within the NOC model will be to improve accounting processes. At least internally, clear financial accounting is needed in order to make costs and profits explicit. More generally, a clear accounting of activities will allow benchmarking between NOCs. The benchmarking of cost efficiency or HSE standards would be a valuable way for governments to assess the performance of the national industry.

It is also crucial for the state and society to recognise that the NOC cannot be expected to solve the country's economic problems on its own. The state must make sustained efforts to diversify the economy and avoid a situation in which, 15–20 years from now, it is so dependent on the NOC for revenues that it smothers it. An NOC free to operate commercially, within the boundaries delineated by state oil policy, will establish the reign of the oil titans for years to come. ■

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