FP Foreign Policy

States of Play

National oil companies control 80 percent of the world's oil. But they're not all the same.

BY VALERIE MARCEL | SEPT. / OCT. 2009

"Big oil," as Daniel Yergin **notes**, isn't what it used to be. Forget the "seven sisters" -- those huge companies that dominated the oil business in the 20th century. Today, at least 80 percent of oil reserves are in government hands, and three quarters of the 20 biggest oil companies are owned by states, many of them struggling to meet the needs of their populations.

With the global economic downturn walloping companies large and small, it's worth asking: What happens to all that state-owned oil? After all, national oil companies, those state-owned petroleum giants that just last year were enjoying $100-plus-a-barrel oil, aren't immune from the recession. Their revenues have slipped as oil prices tumbled. Today many of them are hurting, and the big question is whether they are equipped to invest in the downturn. Lack of investment in the lean years could provoke a price spike -- or worse, a supply shortfall -- when demand picks up.

Not all national oil companies are the same, however. Operating costs vary wildly between the easy-to-drill onshore fields in Saudi Arabia and the expensive ones lying deep, deep off the coast of Brazil. Access to finance is another crucial, though little understood, part of this picture.

There are basically two types of national oil companies: those with ready access to capital and those without. In good times, the first group operates more like the publicly traded private oil companies -- like the Shells and ExxonMobils of the world. They sell the crude oil they produce and retain earnings after paying their government and shareholders the royalties, tax on profits, and dividends owed. This group includes Saudi Aramco, the Kuwait Petroleum Corporation, the Abu Dhabi National Oil Company, Algeria's Sonatrach, China's CNOOC, Brazil's Petrobras, Malaysia's Petronas, and Angola's Sonangol. Many of them are able to finance their own projects from retained earnings, without resorting to loans or investors (as are most of the private oil majors).

In bad times such as the present, this system isn't free of trouble. These cash-rich national oil companies remain instruments of the state and can be forced to transfer more revenues to the government in times of falling oil prices and dwindling state coffers. They may also have to increase their contribution to national welfare programs. If they have been able to accumulate cash reserves in times of plenty, they will be more insulated from the market downturn. But if the government becomes too needy or too greedy, the companies have to turn to other financing vehicles, such as issuing bonds to outside investors to raise capital. Some national oil companies, such as Petrobras and Norway's StatoilHydro, are more protected from government needs and interference because they are partially listed on stock markets. They raise capital that way and also enjoy better access to loan and credit markets due to their higher standards of corporate governance and transparency.

But for national oil companies without ready access to capital, such as the National Iranian Oil Company, Mexico's Pemex, and the Nigerian National Petroleum Corporation, tough economic times can be much harder. They essentially function like government ministries and are susceptible to budget cuts. They sell the crude oil produced for the state and the revenues go straight to the treasury, while the companies receive back only their costs and sometimes a fee for each barrel sold. To pay for new drilling rigs and other capital expenditures, they must compete with other pressing government priorities, such as education and healthcare.

Over the years, these national oil companies have had to devise creative mechanisms to fund their most capital-intensive projects when oil prices fall. Some of them are financially adroit and have tapped into a variety of mechanisms to access finance independently from the state: loan markets, bonds, Islamic bonds, and oil futures, for example. Some have also set up foreign companies that generate revenue independently from national constraints. They have also turned to foreign investors and some $50 billion in oil-for-loan agreements with Chinese national oil companies. (The Chinese companies invest in those countries in exchange for a guaranteed future supply of oil from those projects.)

But the oil industry might be changing with these leaner times. As both types of state oil companies are forced to get more creative in finding ways to access capital, they will have to improve their standards of corporate governance and disclose more information on their operations. If they don't, outsiders will be less willing to invest, particularly in countries with perceived political risk, such as Nigeria and Venezuela. And that could mean less oil -- and higher price -- for everyone.

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