

## **The rise of the national oil company**

*The rapid rise of national oil companies is driving international oil companies to rethink strategies for achieving high performance.*

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Record profits among international oil companies (IOCs) would suggest they are hitting their stride as high-performance businesses. Are these good times here to stay? No company is counting on it. An unexpected challenge has arisen: the rapid rise of national oil companies (NOCs) to the global stage.

As the dominant players in today's oil markets, IOCs strive for high performance. Historically, they have been the partner of choice for many major resource holders, undertaking large, complex or groundbreaking oil and gas projects. However, times are changing. Technology ownership has shifted dramatically from operators towards the oil services sector over the last decade, while the capabilities of many NOCs have grown.

In parallel, a wave of aggressive international acquisition activity by certain NOCs has raised eyebrows across the industry. Add to this the creation of NOC consortia and some creative deal making by previously conservative NOCs and suddenly the role of IOCs in the industry is coming under close scrutiny.

### **The new relationship**

As part of Accenture's High Performance Business initiative, we identified key elements that differentiated high-performance independents from their peer group. One is that they have a growth-oriented strategy. This also is the overriding metric for IOCs – the ability to replace and grow reserves typically drives business strategies and shareholder value. However, the rapid rise of NOCs on the international stage has complicated the ability of the IOCs to build business with the resources-holding countries where they would typically find these reserves.

To examine the new relationship between IOCs and NOCs, Accenture profiled 20 NOCs, each wholly or partially state-owned/controlled, and interviewed senior leaders from 12 of them. The findings highlight the priorities of key NOCs and the potential steps IOCs may take to become, or remain, high-performance businesses in this new competitive landscape.

NOCs often have a variety of national objectives, with the result that their priorities vary widely. Of the priorities Accenture discussed with the NOCs, no single, common priority made the top three. This means that for the IOCs, there is no substitute for detailed knowledge, intimacy, on-the-ground insight and understanding of not only the NOC, but also the country it serves.

NOC executives were reluctant to identify preferred characteristics for a business partner, instead they cited the deal-specific nature of relationships. By deal the NOCs interviewed did not necessarily mean a single joint venture to produce hydrocarbons – some deals described were longer-term relationships. However, while relationships between NOCs are becoming longer term and more strategic, those between NOCs and IOCs appear to be increasingly transactional. This transaction mindset may be troubling for IOCs that aspire to create longer-term relationships with NOCs in order to avoid time-consuming cycles of bidding and deal-making activity.

All the NOC interviewees indicated openness to new deal types and relationships beyond traditional joint ventures or production-sharing contracts. When asked about preferred partnership structures, one representative said: “No fixed way as long as there are benefits.”

### **Integrating and internationalizing**

Every NOC executive had clear ambitions to both internationalise and expand their company’s capabilities across the oil and gas value chain. In 2005, for example, NOC deal activity reached an all-time high. This internationalisation suggests IOCs will come face-to-face with NOCs more often – not only as customers, partners or custodians in developing a host country’s resources, but also as commercial competitors on the world stage.

These supply hungry NOCs are formidable competitors, changing the currency of competition by making deals with a larger and longer-term strategic value. For example, China’s CNPC has committed to local economic development in Kazakhstan through investment in power stations, chemicals plants, railways and natural gas pipelines.

Encouragingly, most NOCs still see a clear role for their international cousins. A number of executives cited interest in the IOCs’ downstream assets and technology capabilities – particularly in liquefied natural gas (LNG), gas to liquids (GTL), secondary recovery, unconventional oil, ultra deep water and alternative energy/fuels.

Additionally, IOCs’ tough-to-replicate market, trading and infrastructure linkages present an appealing strategic offer to many hosts. The presence of a large IOC can send a signal to the international community that a country or market is opening up, which is vital when emerging from a period of isolation – for example, Libya.

NOCs also respond well to IOCs that think strategically about local-content issues. In Accenture’s experience, the kind of offer NOCs prefer extends beyond adherence to local-content requirements in project plans. Instead, the offer includes elements such as energy security, trade and supply chain development, broad-based job creation and industrial development, environmental protection and development of NOC capability.

### **How should IOCs respond?**

IOCs face a market in which they must do business with and compete against a varied and sophisticated group of internationalising NOCs, while striving to deliver high performance. How can they respond? Five capabilities are critical – and crucially, most are equally important both to working with an NOC on its home turf and to competing effectively internationally.

#### **1**

**Know the resource holder:** having recognised that a new breed of competitor has emerged, to compete effectively, IOCs’ strategies must evolve. Successful entry by an IOC into an NOC country is usually characterised by heavy in-country activity well ahead of any deal, focused on understanding the people, organisations, culture and processes at work. While broad-brush characterisations of NOCs may be tempting, the huge variation in NOCs’ commercial and political roles, decision-making processes and aspirations means IOCs cannot take short-cuts with on-the-ground intelligence gathering and relationship building. Only through this degree of insight can IOCs develop a differentiated commercial offer aligned to the needs of the host country.

## 2

**Tailor a strategy:** each IOC needs to develop highly tailored strategies to target and cultivate relationships with its key NOCs. The strategy must be based not only on deep knowledge of the NOC involved, but also on a strong sense of self-awareness. The leading IOCs offer competitive scale, expertise and track records, but there is a need to differentiate themselves from each other in many NOCs' eyes. Understanding these perceptions enables IOCs to create a strategy that both plays to their own strengths and differentiates them from other IOCs.

Perhaps most difficult, IOCs must develop a view on how the value of relationships fits into their overall commercial framework. Competing in one market while being venture partners in another is traditionally how the oil industry works. This structure has evolved as oil exploration and production (E&P) has required substantial investment and ever-increasing risk. This partner/competitor dynamic is magnified as the IOCs both partner and compete more with the NOCs.

## 3

**Integration across the value chain:** for IOCs, scale, complexity and integration in deals offer the best opportunities to differentiate themselves from one another as well as from NOCs. As projects link across geographies, value chains and markets, the global scale and asset base of the IOCs provide a competitive advantage.

Risk sharing is another important component of an NOC's desire to make a deal. NOCs can share risk with each other or in partnership with a services company. But what IOCs offer that is differentiating is a balance of expertise that covers technology, project management and markets. The combination of these factors – upstream and down-stream – makes them an attractive partner for many NOCs concerned about the risks of high-cost technologies, complex projects or new markets.

With this in mind, IOC business developers need to integrate at every opportunity, blending their E&P, gas and power, downstream and chemicals businesses as necessary to build a more appealing commercial deal. They must be willing to bring all of their assets and capabilities to the deal. The geographic flexibility and sophistication of IOCs is also appealing to NOCs.

The topic of swaps – deals where the stand-alone valuation (net present value, cash flow) of assets exchanged remains the same – came up often. In the past, many IOCs were not keen on swaps because, theoretically, no value is created. However, to NOCs swaps have a clear strategic value because they enable the NOC to do something else, such as gain experience in a key technology, such as LNG, or enter a market.

## 4

**Broaden local content:** the IOCs that have moved beyond a philanthropic model of local content to one that contains elements that meet the long-term strategic goals of NOCs and the nations they serve are those that have been more successful in winning business and securing a licence to operate.

This means considering environmental protection and long-term skills development for local workforces, with the intent of handing over operations as well as leveraging everyday local business, employment and supplier spend. The IOC that integrates itself to maximise its use of a local workforce and supply chain can have a substantial effect on the economy, while benefiting from a simplified sourcing model and economic savings on imports.

In Accenture's experience, that type of winning offer extends well beyond adherence to local-content requirements in project plans and includes elements such as energy security, trade

development, broad-based job creation and industrial development, developing NOC capability and environmental protection. To maximise the effect of this type of offer, IOCs must become adept at conveying the dimensions of the value they bring.

While the dominant source of value is likely to be derived directly from monetising resources – the main focus for IOCs – the contribution made by adopting local supply chain and labour resources, coupled with a less tangible effect on national skills, standards and capability development, can add considerably to create a compelling offer.

## 5

**Excel at technology and the basics:** deals in which technology and the management of complexity are essential and form the natural battleground on which IOCs differentiate themselves from one another and to host governments. The capabilities required for an organisation to deliver these projects and achieve high performance are difficult to replicate or acquire in the short term.

If IOCs can craft enough of these opportunities, their role in both markets will be safeguarded, leading to a more competitive global marketplace. Additionally, IOCs are likely to remain the developers of choice for much of the activity emerging from the technical fringes of traditional business, such as GTL, the hydrogen economy and some areas of renewable energy.

However, many opportunities – particularly on NOCs' home turf – will offer neither the technical nor commercial complexity on which IOCs thrive. In such commodity projects the basis of competition is around operational excellence.

Capital project management is an area where IOCs often claim to offer leadership, but in Accenture's experience is an area that still offers significant opportunity for progress in developing capabilities that lead to high performance. An innovative IOC that can operate this type of project with both ruthless cost efficiency and unparalleled effectiveness in hydrocarbons recovery could potentially create a new premium market, where its technical and operational capabilities differentiate not by doing what others cannot do, but by doing what others can do in a superior way.

IOCs that can credibly demonstrate this capability will be positioned well to address not only the new competition presented by NOCs, but also the emerging role of services companies as a substitute for IOCs in a number of markets.

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Going forward, IOCs must master a basket of at-times unfamiliar skills, but those that can master new skills on their journeys to achieving high performance will be well placed to deal with the fast-changing role of their dynamic NOC counterparts.