This document represents the oral presentation given at the Baker Institute 2007 – National Oil Company Capstone Event on March 2, 2007 by Claire Lawrie, Accenture

Introduction

Ladies and Gentlemen - Good Morning.

I'm Claire Lawrie – and on behalf of Accenture - I'm delighted to be here to share our perspectives on how International Oil Companies (IOCs) can respond to the increasing global reach and competition from National Oil Companies.

One year ago, Accenture presented the results of its own NOC study. In our conversations with various clients globally it was clear that NOC and IOCs have very different perceptions about one another. This is essentially what led us to undertake a study on IOC and NOC relationships. There was a disconnect in how IOCs **thought** they were doing in accessing reserves and building relationships with NOCs and how they were **actually** doing.

In our study, we wanted to understand the ingredients for good partnerships between IOCs and NOCs. So, we simply asked a selection of NOC executives what they thought. We carried out interviews with executives in 13 NOCs, as well as profiling 20. We selected NOCs that were resource rich and resource poor. We interviewed NOCs in all geographic regions. We included those which were purely domestic focused and others which were international players. We covered those which were strongly linked to their governments and others which were more autonomous.

What I would like to do here today, is share with you some of the findings from this study. Plus, I'd also like to share with you some of my own experiences in working with Energy Ministers, governments, NOCs and IOCs across the world in locations such as Angola, North Africa, the Caspian and Trinidad.

Context

Let me first provide context on changing energy dynamics.

Ten years ago, the energy industry was rapidly opening up. IOCs were thinking about merging. They wanted to be better able to compete in the global upstream market. Today, with many mergers undertaken, the competition for upstream assets seems to have become even more intense. Plus, competition for people and supplies has also intensified.

One reason for this is the continuing rise in energy demand. By 2030, global oil demand is expected to reach 120 million b/d. In the past, this demand would have been met by the more traditional areas of supply like the North Sea.

As areas such as the North Sea have become more mature, international oil companies are looking for reserves in frontier markets. Access to these new reserves is, of course, primarily controlled by National Oil Companies (NOCs) and or resource holding governments. 9 out of the top 10 reserves holders are indeed NOCs.

These NOCs are different to a decade ago. NOCs are competing more internationally – they are more confident, asset hungry and outward looking. NOCs are having higher expectations at home. Most are concerned about the development of their economies. We also see the return of resource nationalism in places such as in Venezuela and Russia. And almost all are cash–rich.

So - we are in a situation where the competitive landscape has changed.
However, with high and sustained energy demand - the good news is that IOCs and NOCs will need each other and have to work together to serve that demand.

The NOC Agenda

Much has been said about the increasing power and maturity of the NOCs.

We have, in particular, seen the Chinese and Indian companies becoming more international and more aggressive in their bids for resources. We are also seeing a number of NOC consortia and they increasingly prefer to make deals with each other – often leveraging government to government relations.

There are several factors that are positioning NOCs to compete for assets more effectively than before.

- Firstly, they raised the game on their technical capabilities. This is reducing their reliance on IOC expertise. In fact, over the last decade many IOCs have underinvested in technical capability. NOCs are showing greater confidence in contracting with oil service companies such as Halliburton and Bechtel. This is particularly true of companies like Petrobras and Statoil who are moving into international arenas such as deepwater Gulf of Mexico.

- Secondly, they are moving outside of their domestic borders into the international arena. The number and value of deals NOCs are undertaking has been increasing year on year since 2000. In 2005 alone, NOC M&A deal activity reached $33 billion. Chinese and Indian NOCs are increasingly looking for opportunities in resource rich nations in Africa, and the Caspian. CNOOC and CNPC for example, already derive one – third of their revenues from overseas assets. Even the internationally shy Sonatrach announced last year, that by 2015 it wanted 30% of its revenue to come from foreign activities.
- National Oil Companies have also become successful in making deals globally because they are willing to invest downstream to access assets upstream. A good example of this was the Nigerian licensing round of 2005. Here, Asian companies bid for key blocks against the IOCs. These companies agreed to invest in Nigeria's refining

businesses. In return, they expected and received preferential treatment in the award of E&P blocks.

- With the sustained oil price, any doubt about the ability of NOCs to finance their own deals has disappeared. Many NOCs are semi-privatized, listed on key stock exchanges and adhere to the same financial controls as IOCs. As a result, they are combining good financial management with the ability to self- fund many of their operations. Added to this, is of course, their ability to rely on their government for financing. When CNOOC was making its bid for Unocal, it was making its offer in cash - $3 billion of it from its own balance sheet. Such funding is very hard for any IOC to match.

- Finally, many NOCs, have strengthened their governance and independent decision making. NOCs like Aramco and Statoil are structured so their company operations are kept separate from the ministry.

So, where does this leave the IOCs?

It sees them coming face to face with the NOCs more often, not only as customers, partners or custodians of a host country's resources, but as commercial competitors.

Technology and capital are no longer sustainable differentiators as all the leading IOCs can offer these and more.

What can IOCs do?

IOC Response

Accenture believes that one of the most fundamental steps is for IOCs to invest the time to truly understand NOCs and their priorities better. We cannot group all NOCs together. They are all different and should be handled as such. They have different objectives, governance structures and styles.

In the interviews we did for the study, security of supply and revenue growth did not rank in the top 2 as a priority for all the NOCs. Many of the resource poor NOCs are focused on meeting the high demand of their domestic markets and opening up their downstream. They are hungry for suitable assets abroad in return for downstream access at home. Other NOCs are focused on very specific priorities like developing their gas marketing, deepwater or LNG project skills.

Another key finding from the study was that NOCs are tending to adopt a very "project based" mindset when dealing with IOCs. What this means is that they view their IOC relationships primarily in terms of the requirements of their projects. This means that IOC dealings with NOCs are becoming more "transactional". However, the NOCs are very open to new deal structures, but for the IOC looking to build a long term relationship, this transactional approach can be hard to manage.

Finally, NOCs also told us that they want to play more across the value chain. There is evidence that they are interested in becoming fully integrated international oil companies. Many NOCs are translating their need for supply security into a hunt for those assets which can drive future growth and capabilities for their companies across the whole value chain.

The IOC Response

Based on these findings, one clear priority stands out in terms of dealing with NOCs. That is, to be successful in this new world where access to opportunities is becoming more limited, IOCs need to differentiate themselves.

How can they do this?

We believe that there are a variety of ways…

The first would be that the IOC needs to understand the individual NOC and its key priorities. They need to develop an NOC strategy as they would any market entry or customer strategy. They need to think of the NOC as their client. This is about having more of a marketing and service provider mindset than an engineering one.

Without such an approach, they will overlook the specific NOC priorities and run the risk of commoditising themselves. The outcome of this approach will be a strategy which is tailored much more tightly to the specific NOC.

What should this offer look like?

It should be able to create value, meet the compliance needs of the company and be differentiating. At its heart, it should set up a win-win situation for the NOC and IOC alike.

In securing partnerships, IOCs need to be flexible and be prepared to be more creative in deal making. Making an offer based on commercial and technical credentials alone is no longer differentiating. As some companies are calculating project NPVs, other very successful companies are securing deals in other ways. Some have secured deals that link investments between upstream and downstream. Others through linking assets across multiple geographies and/or across a product range.

For example, in Libya, the energy minister has expressed a desire for more downstream investment in order to grant the IOCs upstream opportunities. The signing of the Marsa el-Brega integrated LNG project between Shell and the Libyan NOC in 2006 is a good example.

NOCs also like creative deals which offer them long term value. Asset swaps were mentioned frequently in our interviews. NOCs see this as a way to build the portfolios they want. There is a strategic aspect to the swap that can be value creating- i.e. it enables the NOCs to develop a skill or enter a market by creating long term value beyond the standalone value of the asset. .The asset swap Shell did with Gazprom back in 2005 is an example of a swap.

IOCs should see that the deals they make are part of forming a long term strategic relationship with the NOC. The deal should aim to broaden local content for that nation. Such approaches are being successful for IOCs in countries like Angola. Here the majority of the population live on less than $2/ day. IOCs are focusing on building a supply chain to increase the competitiveness of the Angolan oil sector. This in turn will increase in-country spend, creating jobs and services. Economic development of their nation is always a key consideration in the mind of any NOC.

In short, IOCs that are linking company success with country success are being more successful in NOC relationship.

Increased local sourcing is one way of reducing costs for the IOC and creating economic wealth for the country. IOCs often spend more on supplies than they would pay in tax revenue so in country sourcing can make a very significant material impact on a country. There are local supplier development programmes set up in Azerbaijan that have had the impact of channelling more dollars in country and at the same time reducing procurement costs by 15% p.a. for many major oil companies. This programme is jointly steered with the NOC SOCAR.

When I worked in Trinidad, the government, NOCs and IOC formed a joint team to develop the strategy for developing the nation economically and socially. This was about teaming and using business acumen to solve social issues. For example, IOCs collaborated and aggregated demand for local fabrication yards to help build out country infrastructure.

Finally NOCs will value those IOCs who excel at two key areas, basic operational management and delivering cutting edge technology.

In many projects today, the basis of competition is around operational excellence—simply delivering the basics of the business more efficiently and effectively.

A number of high-profile project overruns over the last year have tarnished IOCs' track records. Just this month ExxonMobil announced the cancellation of a multi-billion GtL project in Qatar, citing rising costs as a reason. What was significant, however, was that in its statement ExxonMobil said that the project was not consistent with its investment approach which aims to maximise value for both the host government and their shareholders. If projects do not set up the win-win, IOCs must be prepared to walk away.

This emerging competitive landscape will now see IOCs facing NOCs on two fronts:

1. In open international markets, where NOCs now represent both a potential venture partner or commercial competitor

2. In major resource holding nations, where not only is there a host NOC but other NOCs are now regularly also competing for assets

To collaborate with the NOCs as a partner and to bid against them as a competitor requires a clear understanding of their priorities.

NOCs continue to value the IOCs project management, integration and gas industry capabilities. They often encourage the presence of IOCs in their markets which can send a signal that their country is really opening up, which has been the case in Libya.

High oil prices are increasingly empowering resource rich nations to extract more value for their future. If IOCs want to be part of that future, they need to start talking a different language which includes words like client, collaboration, oil funds, social responsibility and economic development.

The world is very different in 2007.

Finally, to steal a line from another speech you just might know –

Ask **not** what the NOC can do for you **but what you can do for that NOC**…..

Thank you.