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PETRONAS: A NATIONAL OIL COMPANY WITH AN INTERNATIONAL VISION

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WITH

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ABOUT THE POLICY REPORT

THE CHANGING ROLE OF NATIONAL OIL COMPANIES IN INTERNATIONAL ENERGY MARKETS

Of world proven oil reserves of 1,148 billion barrels, approximately 77% of these resources are under the control of national oil companies (NOCs) with no equity participation by foreign, international oil companies. The Western international oil companies now control less than 10% of the world's oil and gas resource base. In terms of current world oil production, NOCs also dominate. Of the top 20 oil producing companies in the world, 14 are NOCs or newly privatized NOCs. However, many of the Western major oil companies continue to achieve a dramatically higher return on capital than NOCs of similar size and operations.

Many NOCs are in the process of reevaluating and adjusting business strategies, with substantial consequences for international oil and gas markets. Several NOCs have increasingly been jockeying for strategic resources in the Middle East, Eurasia, and Africa, in some cases knocking the Western majors out of important resource development plays. Often these emerging NOCs have close and interlocking relationships with their national governments, with geopolitical and strategic aims factored into foreign investments rather than purely commercial considerations. At home, these emerging NOCs fulfill important social and economic functions that compete for capital budgets that might otherwise be spent on more commercial reserve replacement and production activities.

The Baker Institute Policy Report on NOCs focuses on the changing strategies and behavior of NOCs and the impact NOC activities will have on the future supply, security, and pricing of oil. The goals, strategies, and behaviors of NOCs have changed over time. Understanding this transformation is important to understanding the future organization and operation of the international energy industry.

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PETRONAS: A NATIONAL OIL COMPANY WITH AN INTERNATIONAL VISION

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This is an analysis of the Malaysian national oil company, Petroliam Nasional, or as it is popularly called, Petronas. While the company has been in existence for only about thirty years, it has transformed itself radically during this period. In the first half of its life, it was learning the ropes of the petroleum business and concentrating primarily upon upstream operations with limited downstream activities. In the following fifteen plus years it expanded its domestic activities into downstream operations including retail business and petrochemicals, entered into overseas operations in some 35 countries, developed its role as a dominant player in oil and gas shipping, and helped finance a series of mega projects in Malaysia.

This analysis assesses how this development took place, how the company organized this expansion, and what Petronas' political and economic role has been in Malaysia and the world. To gain insight into these questions, we will focus primarily on five major points; 1) its history

over the past approximately thirty years since its formation in 1974 and changes in policies and strategies; 2) the organizational and administrative capacities of the company; 3) an assessment of its domestic and international upstream and downstream operations as well as its business strategy; 4) the relation of Petronas to the Malaysian economy; and, 5) geopolitical considerations.

PETRONAS HISTORY

Oil was first discovered in the Borneo territories of what is now Malaysia in the late 1870s, but appreciable amounts were not found until the beginning of the twentieth century.¹ The predecessor to Sarawak Shell, the Anglo-Saxon Petroleum Company, received a petroleum concession in 1909 and oil was struck in Miri, Sarawak in 1910.² In nearby Brunei, which eventually did not become part of Malaysia, oil was found in 1929. Although the Miri field ultimately produced approximately 80 million barrels of oil, pre-World War II production was limited. It reached 15,000BBD (barrels a day) in 1929 and then declined. The oil fields were seriously damaged by scorched earth policies and bombings during the war. There were no other drilling activities elsewhere in Borneo or Peninsula Malaya until the 1950s.

Prior to the founding of Petronas in 1974, petroleum activities in Sabah and Sarawak expanded markedly in the 1960s with the discovery and development of offshore fields. Shell initially was the major player. In the succeeding years, Shell and Esso dominated both upstream production and downstream refining and sales, but agreements were also signed with Elf Aquitaine, Oceanic and the Telseki Oil Company.³ In the late 1960s foreign petroleum companies also turned to offshore Peninsula Malaysia and then Esso and Conoco received concessions for oil and gas off the east coast of the Peninsula. By the time Petronas came into

¹ Arief and Wells, "A Report on the Malaysian Petroleum Industry," 2-3.

being, four of the then nineteen oil fields in Malaysia that had been discovered were in production producing 90,000 to 99,000BBD. For comparisons sake, by 2004 even with declining reserves, national production was 750,000BBD.

Several powerful economic and political forces came to play in the initial formation of Petronas. At the beginning of 1972 the price of oil was US\$1.50 /BBL and then rose to US\$2.28. The war in the Middle East and the OPEC oil embargo combined to raise the price to US\$12.00/BBL. This alone was a major incentive for the Malaysians to seek a means of increasing their portion of the profits. However, several other factors were also important. This was a period in which several countries were moving from the traditional concessions approach to Production Sharing Contracts (PSCs), including Abu Dhabi, Egypt and, perhaps most importantly, neighboring Indonesia. In the formative years of Petronas there was close association between the heads of Petronas and the Indonesian national oil company, Pertamina.⁴ Pertamina offered technical assistance and other counsel to Kuala Lumpur. Given these conditions and advice, PSCs appeared considerably more favorable to the Malaysian leadership than the concessions system.

The Government of Malaysia also believed that the foreign concessionaires did not properly inform it of petroleum activities taking place in its territory. The then official in charge of oil stated that all he got from Shell was a check and did not have information on new discoveries and developments and was unable to properly inform members of Parliament.⁵

The early 1970s also saw growing economic nationalism in Malaysia culminating in the New Economic Policy (NEP) of 1973. The NEP sought to develop more Malaysian control over

² Petronas, Satu Dekad Perkembangan Petronas.

³ Esso became known as Exxon, which later became known as ExxonMobil.

⁴ P. Bowie, "A Vision Realised and Gale, "Petronas: Malaysia's National Oil Corporation"

⁵ "IDOC," Asia Oil Politics: 87.

the modern sector and to provide greater opportunities to the bumiputra (“sons of the soil“, i.e., primarily Malay Muslims) in business, education, and the economy in general.⁶ This entailed considerably more governmental intervention into the economy than had been the case in the past. It should be noted, that at a time when Malaysian business was dominated by local Chinese, Indians, and Europeans, the original organizers and managers of Petronas were primarily Malay. Its first head was Tengku Razaleigh Hamzah, a Malay Prince, entrepreneur and politician, and in the succeeding years many, in management came from Malay members of the Malaysian civil service. To many Malays Petronas is known as an example of a successful bumiputra-run organization, which has been relatively free of corruption. At the same time, there was no move towards confiscation of upstream assets, as was the case of Venezuela and the Middle East, although some opposition politicians favored that strategy.

Petronas was incorporated in 1974 under the 1965 Companies Act. Initially it was to be called HIKMA, an acronym for Hidrokarbon Malaysia, but after further discussion Prime Minister Tun Abdul Razak proposed Petronas for Petroliam Nasional.⁷ The original proposal was to make Petronas a statutory body rather than a corporation, but this was rejected in part to make it easier to deal with other commercial organizations. This decision was also part of a concerted effort of the Malaysian government to avoid criticism that the new system was a form of nationalization. The ruling coalition was based upon a conservative leadership and constituency, and one of its major political party opponents was avowedly socialist. Malaysia also had suffered through a decade’s long conflict with communist insurgents. Any appearance of socialism was to be avoided. Thus, even the NEP, which called for major government interjection into the economy, was never self-defined in that form.

⁶ Von der Mehden, “Communalism, Industrial Policy and Income Distribution in Malaysia.”

⁷ Petronas, *Satu Dekad:20*.

Petronas also reflected the desire to present itself as a commercial enterprise with the goal of making a profit.⁸ It retains profits earned and, unlike Pertamina, has not sought funds from the national treasury. In tax terms it has been treated like any other major oil company. At the same time, Petronas was given unopposed control over the nation's petroleum resources. The company received its powers from the 1974 Petroleum Development Act. That piece of legislation granted Petronas ownership and exclusive rights and powers over Malaysia's hydrocarbon resources. Thus, Petronas, as the holding company, has never been privatized and has continued to state that it has no intention of being privatized.⁹ At the same time, the government acts as a shareholder and receives dividends.

The philosophy of the company may be inferred from the ambitious goals formulated at its inception:

To safeguard the sovereign rights of Malaysia and the legitimate rights and interests of Malaysians in the ownership and development of petroleum resources; To undertake proper planning for the orderly exploitation and utilization of Malaysia's petroleum resources so as to satisfy both present and future needs of the country; To participate actively in the exploitation of petroleum and in the marketing and distribution of petroleum and petroleum products; To ensure that the local market is supplied with petroleum and petrochemical products at reasonable prices; To encourage local participation in the manufacturing, assembling and fabricating of the plant and fabrication of plant equipment used in the oil industry and in the provision of ancillary and supporting services; To contribute to the development of the agro-based sector of the economy by making available nitrogenous fertilizers; and To ensure that the people of Malaysia as a whole enjoy the fullest benefits from the development of the country's petroleum industry.¹⁰

However, the establishment of the company was only the formal beginning and in the next two years it faced serious problems with state governments and foreign firms holding petroleum concessions.

Malaysia is a federal system, and states with oil resources wanted to maintain some

⁸ For an early interpretation of the Petronas legal position see Moorthy, "The Malaysian Oil Corporation: Is It a Government Instrumentality?"

⁹ See the statement of the Chairman in 2003 in Petroleum Intelligence Weekly (PIW). June 17, 2003.

control over petroleum operations and revenues. States that did not have petroleum resources (such as Negri Sembilan and Perak) sought to establish their own state-supported, petrochemical plants. The Constitution guaranteed oil revenues to Sabah and Sarawak when they became part of Malaysia in 1963, although the national government argued that these rights did not exist beyond the three-mile limit and that the fields were further offshore. However, through some financial inducements and political pressure the states succumbed to Petronas' monopoly position. In part, this was accomplished through the 1974 Petroleum Development Act, which granted royalties to the petroleum-producing states of Terengganu, Sabah, and Sarawak. This agreement was further aided by the fact that the same political coalition dominated not only the national government, but also most state governments at that time.

However, state revenues derived from oil remained an issue; the national government was to use its power to punish state governments held by the opposition. Thus, in 2001 Petronas' Islamic opponent Partai Islam Se-Malaysia (PAS), which ruled the state of Terengganu, filed suit because it was cut-off from direct control of oil and gas revenues and funds were only doled out for specific projects. During this period, other states, including those without oil or gas, also sought royalties or higher payments.

It was a more difficult problem convincing the foreign oil companies to give up their lucrative concessions. Esso initially even suspended its operations in opposition to the national government's actions. The issue was further complicated by other early Malaysian proposals, which were seen as antithetical to foreign business interests. One proposal suggested that Petronas receive "Management Shares" that provided the company with multiple voting shares for the appointment and dismissal of any staff member of a petroleum company.¹¹ Another

¹⁰ Bowie, *A Vision Realised*: 63-64.

¹¹ Bowie, *A Vision Realised*: 47.

problem was the Industrial Coordination Act, which required manufacturers to obtain licenses from the government before operating.¹² Many foreign companies viewed this as a means of control over their operations, so opposition was widespread among overseas investors. Under the pressure of negotiations, the national government backed off the management shares concept and severely weakened license regulations.

Ultimately, concession holders accepted the new system. The first Production Sharing Contract was signed with Shell in 1976, and other companies soon followed. The initial contracts called for a maximum cost recovery of 20% (25% for gas) and the government received a 10% royalty. The remaining 70% was split, with 70% going to Petronas and 30% to the oil company. The contract was for twenty years, backdated to April 1, 1975.¹³

All of this occurred during a period when Petronas management was undergoing a steep learning curve. Given the previous control of the industry by the concessionaires, there had been little opportunity for Malaysians to learn the business. Their activities in the early years were primarily management, but it was necessary to take a crash course on petroleum issues.¹⁴ Malay management was faced with two problems related to the “bumiputra” culture of the time. Malays were normally not trained in engineering, evidenced by the fact that there were only five Malays studying engineering at the University of Malaya in 1970. While they dominated upper levels of the civil service and military, Malays were not prone to entering business or manufacturing, leaving those occupations to Indians, Chinese and Europeans. In 1970 Malays only composed seven percent of manufacturing management. In order to help meet the problem of insufficient Malaysian personnel in engineering related fields, Petronas launched major scholarship programs.

¹² Gale, “Petronas: Malaysia’s National Oil Company,”:1138.

¹³ Bowie, *A Vision Realised*: 52.

In the following decade Petronas expanded its domestic operations, concentrating on upstream activities while initiating some downstream projects. This was in part accomplished by operating through wholly owned corporations and joint ventures. Thus, in 1978 it formed the wholly owned Carigali Corporation for the purpose of oil and gas exploration. It almost immediately bought out Conoco's interests on the east coast of Peninsula Malaysia and became a major player in oil and gas exploration in the country. In 1983 it opened its first refinery at Kertih, Terengganu on the Peninsula's east coast. In 1985 the first fertilizer plant was commenced. Petronas Dagangan Sdn Bhd, another wholly owned corporation, was formed in 1981 to retail gasoline through its own service stations, and by 1984 it had 45 in operation. The initial LNG shipment was sent to Japan in 1983. By 1980 petroleum and petroleum products became Malaysia's chief foreign exchange earner and accounted for 28% of government revenue in 1983.¹⁵

Oil and gas production within Malaysia rose markedly in the first decade following the inauguration of Petronas. By 1984 there were 23 producing fields bringing in 440,000 BBD (up from 4,000BBD in 1968 and 90,000BBD in 1973. In addition there were two operating gas fields producing 500MM CFD (million cubic feet per day).¹⁶

The next fifteen years saw Petronas further enlarge these activities. Continuing expansion was evident in both upstream and downstream activities. The company built two refineries with a combined capacity of 240,000BBD.¹⁷ LNG exports increased to the point that present-day Malaysia is the third largest exporter in the world, behind Indonesia and Algeria. There are now nine gas liquidification trains. Through a subsidiary, Petronas Gas Bhd, a domestic gas grid was

¹⁴ See Hashim, The Young Turks of Petronas.

¹⁵ Although that percentage severely declined in later years due to the expansion of other parts of the economy.

¹⁶ Petronas, *Satu Dekad*: 34.

¹⁷ Petronas .com, 2005.

established that covers both the east and west coasts and reaches to Singapore. Malaysia claims to have proven, “1-P” gas reserves of 87MM TCF, from which it produces an average of approximately 5 billion cubic feet per day. Based upon this largesse of gas, petrochemical operations have grown and two large integrated petrochemical complexes have been built.

Petronas has continued to develop PSC at home and abroad. The following table shows the present PSC agreements:

ALLOCATIONS, 1985 PSC			
	Shallow Water Blocks (less than 200m*)	Deep Water Blocks (200-1,000m*)	Deep Water Blocks (over 1,000m*)
Royalties (% of gross production)	10%	10%	10%
Cost Oil (% of gross production)	50%	70%	75%
Cost Gas (max) (% of production available for tax)	60%	60%	60%
Profit Oil & Gas:**			
<i>Oil</i>	50:50 to 70:30	30:70 to 50:50	14:86 to 50:50
<i>Gas</i>	50:50 to 70:30	40:60 to 60:40	40:60 to 60:40
*Meters (m)			
**Range depends upon the volume of production (Petronas-PSC Contractor)			

In 1997 the company launched a new agreement based upon “revenue over cost.”¹⁸ The company states that it was introduced in order to encourage contractors to increase their investments in oil and gas by formulating a measurement that increased or decreased the contractor’s share depending upon levels of profitability. An “R/C Index” was calculated on the basis of the contractor’s cost and profit on oil or gas. To date, Petronas has signed more than 60

PSCs with international petroleum companies.

Petronas has also expanded its downstream retail and marketing and now has 729 service stations in Malaysia, accounting for 40% of the market share. As of 2005, it also maintained over 1250 service stations in South Africa through its Engen Limited subsidiary and another 117 service stations in Thailand and retailed petroleum products in the Sudan and Indonesia. Petronas also has a substantial share in a new refinery under construction in Sudan and plans to expand its retail operations there.

The major expansion of Petronas into other areas was not generally expected and in a speech in 1989 the then head of the organization, Azizan Zainul Abidin, gave no hint of coming changes.¹⁹ However, the company also entered into three significant new areas in the 1990s; 1) overseas operations; 2) shipping and other maritime related activities, and; 3) support of non energy government projects.

Perhaps the most noteworthy and unique move by Petronas in the past two decades has been its expansion into international operations in an effort to become a global player in the oil and gas business. Today, 50% of company revenue comes from petroleum exports from Malaysia, domestic market revenues account for 20%, and international activities bring in 30%. Although Petronas had been involved with marketing abroad, the company fully entered the international oil and gas scene in the early 1990s with the inauguration of activities in Myanmar (Burma) and Vietnam. It also became particularly involved in Africa where it saw a general lack of interest from other petroleum companies.

By 2005 it had agreements in 35 countries throughout the world. Petronas is involved in upstream exploration and production in 59 ventures in 26 countries and is the operator for 29 of

¹⁸ Petronas, 2005 Annual Report.

¹⁹ Azizan Zainul Abidin, "Overview of the Prospects for the Asian Market."

these ventures (Petronas Media 2005). Countries operated in include Algeria, Angola, Bahrain, Benin, Cameroon, Chad, Egypt, Equatorial Guinea, Ethiopia, Gabon, Indonesia, Iran, Mauritania, Morocco, Mozambique, Myanmar, Niger, Pakistan, Sudan, Togo, Vietnam and Yemen.²⁰ The Prime Minister's office stated in December 2004 that joint venture investments in oil and gas exploration and production were \$9.2 billion, and Petronas reported that its international sources revenues for the year ending March 31, 2005 from international operations were over \$12 billion. There were also downstream ventures involving activities such as petrochemicals, retailing, gas pipelines and LNG and engineering. These were in Argentina, Australia, Brunei, Cambodia, Chad, China, Egypt, Indonesia, the Philippines, Seychelles, South Africa, Sudan, Switzerland, United Kingdom, and Vietnam.

These ventures were developed under a wide range of types of agreement. These included joint ventures with state or private entities, joint operator ship, Production Sharing Contracts, interest in exploration and production agreements, and partnerships. Another striking example of the Petronas effort to go global was its 2006 purchase of US\$1.1 billion stake in Russia's Rosneft, its first Russian venture. Petronas indicated an interest in expanding that involvement. While some of its overseas investments have not been particularly successful, it is seen as a more rounded and competitive organization than its Indian and Chinese counterparts.

There were both economic and political forces behind this move. Domestic reserves were never of the class of those in Indonesia or the Middle East and declined in spite of conservation programs. In the early 1980s Petronas reported recoverable oil reserves in the amount of 2.9 billion barrels. Aggressive exploration increased reserves to 4.3 billion barrels in 1996, although by 2005 they were reported by the EIA to be down to 3.0 MMBBLs.²¹ (Others estimated it as

²⁰ Noteworthy is the fact that some 15 countries were part of its strategy of emphasizing the African continent.

²¹ EIA, "Malaysia."

high as 4.3MMBBLs). In 2004, the Prime Minister's Office reported that petroleum reserves would be exhausted in about 18 years and natural gas in 35 years,²² and Petronas reported in 2006 that at current production crude oil and condensates have a reserve life of 20 years and natural gas of 34 years.²³ Petronas leadership thus considered it essential to develop exploration and production abroad. By 2005 the company was involved in the upstream sector in 25 countries and reported international reserves of 6.29 billion barrels of oil equivalent.

A second factor that might have been in play in this overseas strategy was the interest of then Prime Minister Mohammad Mahathir in placing Malaysia more firmly on the international stage. The Prime Minister had long sought to emphasize the country's role in regional and world Islamic affairs and was rarely reticent in making his opinions known on a variety of international events. According to the Ministry of Foreign Affairs, when Mahathir took office there was a dramatic shift in policy including an orientation towards the interests of developing countries, south-south cooperation and Islamic unity.²⁴ There are also those who would argue that the movement of Petronas into countries such as Myanmar, Vietnam and Sudan were a means of challenging the United States, which was opposed by Mahathir on many foreign policy issues and which had defined these governments' relationship as unfriendly in the past.

However, a far more likely scenario was that Petronas saw opportunities in places where Western, and particularly American, companies had difficulties operating because of issues pertaining to their own governments' foreign policies or non-governmental critics of these regimes. According to Mahathir, there were countries that found it difficult to work with some majors. The PM noted that Sudan was an example of a target of opportunity that was "not very

²² Aliran reported 15 and 44 years respectively, although they had a cause for their reporting lower estimates. Aliran, 2005:40.

²³ Petronas Group, "Financial Results Announcement", March 31, 2006.

²⁴ Malaysia Ministry of Foreign Affairs Official Website, "An Overview of Malaysia's Foreign Policy," 2006.

popular with some of the big powers.”²⁵ However, Petronas activities in places like Sudan, Iran and Myanmar brought strong negative reactions from the United States and some human rights organizations. Because of Petronas involvement in Iran, US sanctions were legislated but President Clinton refused to authorize them.

Another issue surrounds the extent of Petronas operations in Muslim countries. Historically, Malaysia has shown an interest in interacting with other Islamic countries and IT had supported many world Islamic causes. In part this has resulted from domestic political needs to counter domestic Islamic opposition, but it also reflects a sincere interest in co-religionists.²⁶ Petronas Chairman, Mohd Hassan Marican, has stated that his company always seeks more presence in Organization of Islamic Countries member states and has spent about \$5 billion in the past year in these countries.²⁷ However, Petronas has not succumbed to domestic pressure to move into a state simply because of its religious composition. At the same time, there is some pride in the involvement of Malaysia and Petronas in developing other Islamic societies.

Petronas expansion into maritime assets was initially a contentious issue revolving around questions of political interference and possible corruption. The company entered the shipping business after disputes over freight costs for its LNG operations. In 1991 the French shipyard Chantiers de Atlantique was commissioned to build five LNG tankers. The first employment of these ships began in 1995. Petronas then acquired other shipping interests including the shipping company PNSL. Eventually, all of Malaysia’s LNG shipping came under one body, the Malaysia International Shipping Corporation or MISC (now called MISC Bhd). This expansion became *cause cerebra* when the shipping assets of Prime Minister Mahathir’s

²⁵ Star, August 24, 2004.

²⁶ See Shariti Nasr, *Islam in Malaysian Foreign Policy*. Interestingly, in this comprehensive analysis of Islam in Malaysian foreign policy published in 1997, Petronas is not mentioned.

²⁷ Bernama, June 21, 2005.

son, Mirzan, in the Konsortium Perkapulan Bhd were purchased by MISC. Although the company stated that this was a purely commercial action and it turned out to be a profitable purchase, there were accusations that this was a case of nepotism meant to bail out Mirzan.²⁸

By 2005 the MISC had 127 vessels, more than two thirds of which serviced energy transportation. Additional vessels are controlled through subsidiaries. This presently profitable business has resulted in this Petronas subsidiary being the world's largest single owner-operator of LNG vessels and the world's second largest owner-operator of Aframax tankers. Most recently, the MISC has obtained its first Floating Production Storage and Offloading (FPSO) units and for the first time has signed a major third-party shipping contract for LNG carriers. The MISC will manage under term charter two LNG tankers now under construction in Japan that will be used to allow Yemen to begin LNG sales in 2009. A considerable amount of crude imported into the United States, particularly from West Africa comes in MISC vessels or those of MISC affiliates. Although there is fear of a tanker glut, MISC is in relatively good shape due to its strong presence in the expanding LNG trade and the fact that it builds ships on the basis of firm contracts or charter hires rather than on a speculative basis.²⁹

The third significant area of expansion has been in Petronas financing of major government sponsored infrastructure projects in Malaysia outside its traditional core energy interests. The two most noteworthy mega-projects have been the building of the Twin Towers, the then highest building in the world, and the construction of the new national government administrative center Putrajaya. The Twin Towers was part of an overall effort to make use of the land previously part of the Selangor Turf Club in the middle of a fast growing section of Kuala Lumpur. It was to be financed by a joint venture between Petronas (with 51% equity) and

²⁸ Asia Times, June 22, 1999.

²⁹ Malaysian Business, June 1, 2005: 39.

Usaha Tegas and the Selangor Turf Club. While touted as a commercial venture which would replace its then headquarters building, the construction of the then tallest building in the world fit into the national leadership's desire to provide a platform for illuminating the country's position as a modern and successful society. The building was also presented as the centerpiece for developing downtown Kuala Lumpur and its surrounding park was extolled for its addition to the city's quality of life. It should also be noted that this was constructed during the Asian economic crisis of the late 1990s and provided jobs and other profitable opportunities to Malaysian workers and firms.

The second "mega project" was the building of a new Federal Government capital, Putrajaya, outside Kuala Lumpur. This new capital is intended to relocate Federal offices from other city centers, particularly those in Kuala Lumpur, to a new, more open and modern set of facilities. Again, Petronas was the major equity holder, this time in partnership with Khazanah Nasional, the Federal government's investment arm, and the National Heritage Fund.

Both of these projects brought a series of criticisms. It was claimed that there was government coercion of Petronas to provide the financing and that these "mega projects" were illustrations of Mahathir's self-glorification. Why should a small country such as Malaysia construct a monolith like the Twin Towers? Others saw these efforts as outside the Petronas core interests and a drain on the company's finances, particularly during the Asian economic crisis. It was argued that money spent on the Twin Towers and Putrajaya could have been better used in expanding the firm's core energy activities and particularly its overseas projects.

There is little question that Petronas has been a "cash cow" for a variety of government projects. However, two points also need to be made. Petronas management has not always "rolled over" to government requests as seen by the refusal to take fiscal responsibility for the

ailing national airline MAS. Secondly, not all of these projects appear to have been ultimately unprofitable to the company and are not examples of government confiscation of the firm's funds without repayment.³⁰ At the same time, it is legitimate to ask if Petronas would have entered into these projects without its close association with the national government.

ORGANIZATION

The management of Petronas has an interesting reputation. On the one hand, it is generally seen as highly competent and effective. In his book on Asian energy, Robert Manning states that it “garnered a reputation for solid commercial management and profitability.”³¹ On the other hand, some observers more concerned with ethics and transparency are less supportive. Its activities in rogue states such as Sudan and Myanmar have been noted. A Spanish-based business ethics firm ranked Petronas last among 15 major firms studied in terms of transparency, corporate governance, social responsibility and ethics.³² Issues raised included Petronas support of government-sponsored projects and corporate transparency. However, later that year the firm recanted and apologized to Petronas for inaccurate reporting.³³

The management of Petronas shows the close relationship between the Government, particularly the Prime Minister's Office, and the company. Petronas is organized under a Chairman and Board of Directors who report directly to the Prime Minister [see the organization chart in Appendices].

The Chairman is selected by the Prime Minister and has considerable personal power. The former, recently deceased, Chairman was Azizan Zainul Abidin; he held the position from 1988 to 2004. Prior to that time he was a well-regarded civil servant and secretary general of the

³⁰ For an optimistic view of the Putrajaya operation, see *Malaysian Business*, June, 2005.

³¹ Manning, *The Asian Energy Factor*: 180.

³² *Malaysiakini*, May 14, 2006.

³³ *Star*, November 30, 2006.

Home Ministry. He headed Petronas in its years of domestic and international expansion. He had close ties to former Prime Minister Mohammad Mahathir. The present Chairman is Mohd Hassan Marican. He is considered a strong, independent leader and has a reputation for integrity and effective management skills. He joined Petronas in 1989 after a distinguished career as a private accountant. Marican is characterized as more forceful than his predecessor.

The Board is composed of the Director General of the Economic Planning Unit, the General Secretary of the Ministry of Finance, the Director of the Economic and Coordination Unit, and the independent advocate and solicitor. There are also four members from Petronas: the President and CEO; the Senior Vice President of Finance; the Vice President of Corporate Planning and Development; and the Vice President of Oil.

The Management Committee reports to the Board, and some of its members are on the Board. The four business divisions (headed by Vice Presidents) are Oil Business (covering refining and marketing of oil products), Exploration and Production, Gas Business, and Petrochemical Business. There is no separation of domestic and foreign operations. Operations are by function and departments report to the particular Vice Presidents. Within this system, the Chairman has considerable power and influence, as does the Prime Minister, when he seeks to use it. Petronas is largely independent of the influence of other government entities and is unusual in that it does not even report its energy accounts to the Ministry of Finance.

The Petronas Group controls a wide range of domestic and international operations. There are presently some 62 direct subsidiaries, 42 of which are wholly owned. Of the wholly owned subsidiaries 27 are domestic and 15 foreign. There are also 22 associated companies, all but three of which are domestic. (Refer to the Appendices for a full list of companies). From 1980 to 2004 Petronas manpower rose over more than a dozen times from 2,116 to

approximately 30,000. Its ratio of employees to sales is better than that of Pemex, PetroChina., Lukoil, Gazprom and Sinopec. There is some question as to whether the company has overextended itself with its proliferation of international activities and whether it has sufficient administrative and professional staff to continue to operate as efficiently as it has in the past. Part of the problem is insufficient experience in middle and upper management; in 2003 the average age of the staff was 37.5 years. This question becomes evident when we describe the breadth of its domestic and foreign operations.

OPERATIONS AND CORPORATE STRATEGY

Upstream

Petronas is involved in oil and gas development and production both at home and abroad. In 2004 of the 50 major petroleum companies, Petronas was ranked 19th in revenues, 7th in net income, 12th in total assets, 24th in oil output, 10th in gas output, 20th in liquid reserves, and 11th in gas reserves.³⁴ (Refer to the Appendices for complete data on all 50 companies). With proven domestic reserves which continued to decline, in spite of new finds, 2004 liquids production was 855,000 BBD, including 80,000 BBD of natural gas liquids.³⁵ This offshore production has been carried out or planned in conjunction with ExxonMobil (the largest crude producer in Malaysia), Royal Dutch/Shell, Amerada Hess, Murphy Oil, Talisman Oil and Lundin. Last year Petronas exported 57% of its petroleum, processed 84.3 million barrels in its own domestic refineries, and supplied the remainder to other domestic refineries.

In addition, Malaysia is heavily involved in natural gas production and exploration. It has 87 TCF of proven reserves (proven reserves are not necessarily commercially exploitable) and annual production reached 1.7 TCF (5.66BN CFD) in 2002. Piped domestic gas involves

³⁴ PIW, December 12, 2005.

Petronas, ExxonMobil, and Talisman with LNG including Petronas, Shell, Nippon Oil and the Mitsubishi Company. The country accounts for approximately 14% of world LNG exports and also exports natural gas to Singapore by pipeline. Petronas, together with Thailand's PTT and the US independent Hess, developed offshore gas resources in the Joint Development Authority (JDA) tracts in the Gulf of Thailand. Despite delays, the first phase has been completed and reached full production output of 425MM CFD of gas by the end of 2006.

Upstream operations abroad are varied in terms of geography and management arrangements. They include exploration and/or production agreements with Algeria, Angola, Bahrain, Benin, Cameroon, Chad, Egypt, Equatorial Guinea, Ethiopia, Gabon, Indonesia, Iran, Mauritania, Morocco, Mozambique, Myanmar, Niger, Pakistan, Sudan, Togo, Turkmenistan, Vietnam, and Yemen. In these operations, Petronas has partnered with international petroleum corporations, local private companies, and national oil companies.

Downstream

Petronas is deeply involved in both refining and petrochemical plants at home and abroad. In Malaysia, it owns and operates refineries at Kertih and in the state of Melaka. In 2005, Petronas reported that the Group and its associates had produced 7.8 million metric tons of petrochemicals in its worldwide operations in the year under review. In Malaysia, Petronas and its associates produce naphtha, methane, propane, butane, Ethylene, propylene, benzene, toluene; and xylene. (Note: naphtha and butane (LPG) are not petrochemicals, but feedbacks; ethylene, propylene, benzene, toluene and xylene and petrochemical are intermediate products). Through its wholly owned subsidiary, Petronas Dagangan Berhad, the company holds 40% of the domestic market share. It has expanded to 729 local service stations and sold a variety of petroleum products, lubricants, and LPG. It has partnered with Dow Chemical, Kaneka,

³⁵ EIA, "Malaysia":1-2.

ConocoPhillips, Toray, Polyplastics, Mitsubishi, Mitsui, Dairen, BP, BASF, Titan, Idemitsu, DSM, Eastman Chemicals, and Thirumalai.

Overseas, Petronas has been involved in pipeline projects in Argentina and Australia and oil and gas pipelines in Chad and Indonesia. It is involved in retail and marketing ventures in Cambodia, India, Sudan, South Africa, and Thailand. Terminal ling and distribution projects are in China, the Philippines, and Seychelles. A variety of other projects including refining, petrochemicals and LNG and engineering are in Brunei, Egypt, Indonesia, South Africa, Switzerland, the United Kingdom, and Vietnam.

Shipping

Petronas, through MISC (formerly called the Malaysia International Shipping Corporation Berhad), owns 30 container ships, 13 chemical and parcel tankers, 53 bulk ships, 23 LNG ships, 13 crude and product tankers, 2 passenger ferries, and 3 liquefied petroleum gas carriers. Additional ships are also under MISC control. The MISC also operates a travel agency, port operations, food products, warehousing, palm oil storage, haulage, container repair, and shipping agencies. In 2004 its sales amounted to \$1,998.2 million and its income was \$601.5 million. The head of Petronas, Mohd Hassan Marican, chairs the board of directors of the MISC.

Petronas operations have also included a series of ventures which have not been that central to its core interests. We have noted its support of government-sponsored projects such as Putrajaya, Bank Bumiputra, and the Twin Towers. Petronas also bought and then divested 27.2% of the shares of the cash strapped national car company, Proton.

Current Corporate Strategy:

In 2005 a Vice President of Petronas speaking before the Asian Energy Forum presented

the firm's corporate strategy.³⁶ He emphasized several elements including growth and maximizing returns for shareholders. Growth has brought the move towards a global strategy with the desire to be an overseas investor in upstream and downstream sectors as well as encouraging foreign investment in Malaysia, while maximizing shareholder profits; he also noted the company's efforts to benefit local needs through a long-term program involving Malaysia, host countries, and other firms.

He asserted that it is important for Petronas to work with credible partners for several reasons:

1. risks mitigation
2. access to market
3. access to proprietary technology
4. political strength
5. Government to Government relationship

Mitigating risks necessitates credible partners to spread financial risk and attract other financial institutions. A more equitable sharing of risks can also be attained through engaging host country cooperation and the development of non-recourse or limited recourse financing. The latter can be done through engaging multilateral institutions such as the World Bank and Export Credit Agencies. It is also important to develop a trained local staff and to have the strong backing of the Malaysian government in implementing its efforts. Finally, not all risks can be mitigated, and this situation calls for careful portfolio management to withstand failure without bankrupting the company. Under Marican, agreements normally have been for a limited duration or have defined terms of repayment.

³⁶ Asian Energy Forum, 2005.

RELATIONSHIP TO GOVERNMENT

Any analysis of relations between Petronas and the Malaysian government must be made against the backdrop of how that political system works. Several key observations are in order. First, Malaysia is a country where parties and elections do matter; although from a Western perspective, there are some limits on the democratic process. It has been run by a ruling coalition, which has varied in its party composition since independence and is now called the Barisan Nasional. Its Malay partner, the United Malay National Organization (UMNO), from which have come in recent decades all ministers of Finance, Foreign Affairs, Home, and the Prime Minister, has always dominated this multi-racial coalition.

Given the long-term dominance of the coalition, with its overwhelming parliamentary majority and a perennially weak opposition, the Prime Minister is able to determine national policy with few limits to his power. At this time only 39 of 219 members of Parliament are not part of the ruling coalition and the vast majority of bills are not amended in that body. A similar pattern exists in most states, although governance of individual states by the opposition is not unusual. There has also been a long relationship between UMNO leadership and top levels of Petronas management. Thus, both the first Chairman of the firm and the Chairman from the 1980s until this decade were powers in that party. This helps to explain the close relations between the Prime Minister's office and Petronas leadership.

It should be noted that there even remains a role for the Prime Minister after retirement. Former PM Mahathir became an "advisor" for both Petronas and the national car company, Proton, in which Petronas holds shares. However, critics' expectations that Mahathir would play a significant role in determining Petronas policies have not come to fruition, and Mahathir's relations with his successor have not always been cordial.

Secondly, Malaysia has a civil service, which, by Southeast Asian standards, is relatively efficient, professional and incorrupt. (Malaysia ranks 5 on a scale of 1-10 on corruption, but this ranking is better than all its neighbors with the significant exception of Singapore). Upper levels of the civil service have traditionally come from the Malay Muslim population, and there have been school, family, and other personal relations between members of the Malay party, UMNO, and Malay civil servants. Significant numbers of Petronas personnel originally came from the Malay contingent of the Malaysian civil service and helped to frame the bureaucratic environment of the company. However, today, there are also high-ranking officers in Petronas who are not Malays, as the company seeks to widen its range of talent and experience.

Thirdly, Malaysia has a working federal system, although the states do not have the degree of autonomy found in the United States. This has presented Petronas with several issues. It has been necessary to consider state demand for royalties. Secondly, the opposition has controlled states with petroleum resources and this has brought Petronas into dispute between the coalition-led central government and politically hostile state leaders. However, the dominant position of the Prime Minister and Barisan Nasional generally has allowed the central government to override local opposition, and there has been a long-term erosion of state power in a variety of areas aside from energy issues.

Finally, Malaysia is a monarchy, but with an unusual system of governance. A new King (*yang di pertuan agung*) is chosen every five years by the Council of Rulers. He is selected from the sultans of the nine states with hereditary rulers. The sultans have limited powers and have never been involved in Petronas affairs in any significant manner.

What then are the particulars about the relationship between the government and Petronas? In a 2003 interview, the then CEO of Petronas, Hassan Marican, stated, “We are

different from other national oil companies to the extent that we own our national reserves. We are the sole concessionaires of the nation's petroleum reserves. We award the PSCs; there is no petroleum ministry. The minister of petroleum is the prime minister. That's how we are structured."³⁷ While the Prime Minister is the final arbiter in company policy and has frequently been the source of decisions and strategy, this obscures other elements in the relationship between the company and government.

Several general observations can be made. Petronas is expected to operate as a commercial entity that makes a profit. Philosophically, this was the basis of the company when it was formed under the Company Act rather than as a statutory body of the government. It complies with rules from the Securities and Exchange Commission; some of its subsidiaries are listed on the Malaysian Exchange, and there is foreign equity participation in its subsidiaries. It has to act more openly in financial matters than in the past.

However, the leadership of Petronas has long displayed a close relationship with the Malaysian Prime Ministers. One was secretary to an earlier PM and others have come from positions where they came into contact with top leaders of the government and political structure. It may be best to describe this as an "Old Boys Network" where there is a certain commonality of interests and goals. The role of the Prime Minister can be central. After he retired, former PM Mahathir stated, "When I was PM, they [the management] reported directly to me. They were willing to listen to my advice but the decisions were made by themselves based on good business practices." He said that this is how it operated when things were going well. "When it is not doing well, then the government will have to ask many questions," he reportedly stated with a smile.³⁸ A recent example was the involvement of Prime Minister Badawi when

³⁷ PIW, July 17, 2003.

³⁸ Star, August 24, 2004.

Chad threatened the expulsion of Petronas and its partner Chevron. He ordered Petronas to investigate and provide him with a detailed report. However, Prime Ministers have also defended Petronas from politicians and ministries attempting to interfere with the company or to use its revenues for pet projects.

Frequently noted has been the firm's involvement in government sponsored non-energy projects requested by the Prime Minister. As one banker noted, "The problem is that there are so few fat cats around." The company has thus become an extremely important resource for large-scale state undertakings. Petronas has argued that the end results of contentious investments sponsored by the government, such as those in Bank Bumiputra, the MISC, and the Twin Towers, ultimately turned out to be profitable, or at least financially imperative. Thus, it has been noted that the involvement in both MISC and the Towers has been long-term financial successes. The MISC has grown into a giant in the LNG shipping business. Although there were initial problems with vacancies in the Twin Towers, and the Petronas move there appears to have taken some urging, its square foot value has risen five-fold since its opening. In the cases of Putrajaya and the Bank Bumiputra, it is somewhat more difficult to make that argument. It is a questioned whether the Putrajaya investments will prove profitable, and the Malaysian national car company, in which Petronas has invested, is currently in financial trouble. Petronas has asserted that its investment in Bank Bumiputra was necessary to save the country from a national economic crisis, and the bank's bad loans did not come out so badly since many were secured by assets in Hong Kong which rose considerably in value.

It should be noted that, from its very beginnings, Petronas declared that its agenda included acting for the benefit of the people of Malaysia. Its initial statement of company philosophy called for it to exploit petroleum resources "so as to satisfy the present and future

needs of the country.” This was articulated again in 1998 when Petronas was prepared to buy a very large amount of government bonds to provide liquidity to cash-strapped banks during the Asian economic crisis. The then-Chairman asserted that “Whatever we do, we should ensure that it won’t undermine the confidence of the country.”³⁹ More recently, Marican has argued that these activities were a national necessity that aided national development.

This does not mean that there have not been disagreements between the company and government. There have been rare examples of the top leadership of Petronas challenging the Prime Minister on important issues and other examples of the Prime Minister determining specific policies. The abortive effort to get the company involved in the Malaysian national airline MAS may be a case in point of Petronas independence. At an earlier time, an example of direct policy making by the Prime Minister would be the setting of Petronas pricing from his office.

More recently, when Petronas was considering withdrawing from an LNG project in Iran if it did not meet Petronas investment standards, Prime Minister Abdullah Ahmad Badawi reported, “I had a heard of that, and in my meeting with [Prime Minister] Khatami brought the matter up. As a result of our discussions, we both agreed that Petronas remain in the project and if there are any problems on the Petronas side, especially on the commercial terms of the deal, discussions between them and their partners should proceed as soon as possible.”⁴⁰ Petronas has pulled out of part of the project, but since 1995, it has invested over US\$1.3 billion in three projects in southern Iran. The Prime Minister’s decision was in part due to the fact that he was visiting Iran at the time and wanted to foster good relations between the two countries. Perhaps more importantly, though, Iran is Malaysia’s fifth largest trading partner, and at the time Badawi

³⁹ Alexander’s Oil and Gas, 3:23, September 23, 1998.

⁴⁰ Business Times, May 13, 2005.

stated that he did not want hindrances to commercial ties.

There have also been internal differences within Petronas regarding fundamental long-term strategy. Thus, there was serious questioning regarding the decision to go global as some wished to concentrate upon Malaysian domestic interests. This was part of a general issue founded on the view of some at the management level that the company was moving away from its core charter and over-reaching its ability to manage its interests.

Overall, it must be emphasized that Petronas has remained relatively independent of the government in its day-to-day operations. Opposition political parties criticize the company for a lack of transparency, its involvement in government sponsored projects, and a lack of parliamentary oversight, but these external bodies have no real influence on Petronas actions. Members of government parties would like to use Petronas profits for pet projects but have been blocked by Petronas with the help of the Prime Minister. Prime Ministers have usually been careful not to appear to be too deeply involved in day-to-day activities of the company. In part, there is recognition that the appearance of an overly interfering government would have a negative effect on world markets. At the same time, it is to be expected that when the national interest is paramount or there is need to tap into the financial resources of Petronas, there will be state involvement. However, the “Old Boy Network” will generally blur the appearance of unwarranted interference.

PETRONAS AND MALAYSIA’S ECONOMY

Today, Malaysia has Southeast Asia’s third largest economy behind Thailand and Indonesia, in spite of the fact that its population of almost 26 million is considerably smaller than these two states. Its GDP was \$229.3 billion in 2004 and growth has usually been 4-6% in recent years, in line with most of its neighbors. Per capita purchasing power is estimated at \$10,725,

making Malaysia an upper middle-income state by World Bank standards. It also has a low level of poverty for a Southeast Asian country, only 4.3% in 2004. Literacy is over 95% and there is a good system of tertiary education.

When analyzing the role of petroleum in Malaysia's economy, it is important to recognize the considerable change that has taken place in recent decades. During the years of colonial rule and the first years of independence, then Malaya was known as a fortunate, dominant producer and exporter of a number of primary products including rubber, tin, spices, coconut and copra, palm oil and hardwoods. At the time of independence, Malaya's \$726 million in exports included neither manufacturing nor petroleum among its seven principal exports. (Indonesia supplied Malaya with petroleum products). Major industries at the time were related to processing primary products, engineering and producing handicrafts. Only 10% of the work force and 11% of the economy were involved in manufacturing, and economic analyses of the country during the period paid little attention to petroleum resources.

Beginning with the development of the electronics industry in the early 1970s, Malaysia concentrated on manufacturing. By 2004, electronics and electronic machinery accounted for 67.6% of total exports, and manufacturing as a whole amounted to 81.2% of exports. The formerly dominant primary products sector accounted for only 4.2% of the country's exports. In this transition period, petroleum played a far more central role as manufacturing was gearing up and primary products were declining. In that era of the late 1970s and early 1980s, petroleum and petroleum products had a more significant place in Malaysia's economy and in exports. Then, although gas and oil continued to bring in a healthy income, manufacturing overtook them. In 2004 crude petroleum and natural gas exports accounted for 7.3 % of the total and petrochemicals also came to 7.3%. In the domestic manufacturing sector, chemical and chemical

products as a whole were only 14.4% of the total in 2004 and 2005.

Petronas is also an important contributor to national revenue through the tax system. In recent years approximately 20% of total government revenue has come from petroleum, primarily from the Petroleum Income Tax (PITA). Petroleum revenues to the government originally started at 12% when PSCs were inaugurated in 1975, rose to 36% in the mid 1980s and declined thereafter. Most recently, high oil prices have increased profits and tax revenue. In June 2005 Petronas reported a net rise in profits of 50.3% or US\$9.35 billion.

Malaysia's energy resources have also been important in providing the country with more steady government controlled energy prices and an assured basis for power for its expanding manufacturing sector.⁴¹ The government has been establishing policies to better link its energy and manufacturing sectors and is cognizant of the need to conserve depleting resources for the future. To that end, it has inaugurated a National Depletion Policy (NDP) to cap the rate of crude oil production.

In addition, it has been observed that Southeast Asian petroleum producing countries like Malaysia have carried out economic and social policies more useful for national development than those policies followed in most Middle Eastern countries with oil and gas resources. In a study by Oystein Noreng the following comparisons are made:⁴²

⁴¹ Baharuddin, *Malaysian Development Experience*: 264-66.

⁴² Norang, *Oil and Islam*:196.

ECONOMIC AN SOCIAL STRATEGIES IN THE MIDDLE EAST AND EAST ASIA

<u>Issue</u>	<u>Middle East and North Africa</u>	<u>East Asia</u>
Growth	Oil led stagnation	Export led growth
Income Inequality & Poverty	Rising inequality in stagnation; Redistribution away from poor	Increasing equality in growth; Redistribution to poor
Agriculture	Neglected	Priority
Export Performance	Only oil, gas and oil products	Manufactured products
Population Growth Rate	Persistent rapid growth	Declining growth
Investment & Saving	Low domestically	High domestically
Human Capital	Elite education priority	Mass education priority

While these comparisons are more accurate for Malaysia than Indonesia and may be less true for Gulf States such as Dubai, they emphasize a more wide-ranging development strategy in Southeast Asia than is to be found in oil and gas producing states of the Middle East.

The financial reputation and success of Petronas are illustrated by the ease with which it has launched large-scale international bond sales over the years, including a US\$2.675 offering in 2002 which was the largest bond issue by an Asian corporation. Bond sales are decided upon by the Board and there are no official restrictions on Petronas borrowing. Increased profits from high prices have negated the need to enter the bond market in recent years. It can be argued that the reputation of Petronas significantly strengthens the foundation for Malaysia's financial standing in the international debt market.

GEOPOLITICAL ROLE

Malaysia is a relatively small country with a population of 26 million and a modern but

small military. It does play an important, though not paramount, role in the Association of Southeast Asian States (ASEAN), the regional organization that includes all countries in the area. Malaysia's oil does not function as a significant diplomatic, economic or political tool in the region; although, the development of its petroleum reserves no longer makes it dependent on Indonesian oil as it once was or temporarily, upon the Middle East. Malaysia's exploitation of its natural gas has initiated close cooperation with neighboring countries. Malaysia is a major natural gas supplier to Singapore with whom political relations have not always been easy. It shares JDA gas resources with neighboring Thailand, imports gas from Indonesia, and has been party to ASEAN efforts to develop a regional natural gas grid. Prime Minister Badawi has called for greater energy cooperation within Asia including areas of conservation, commercial ties, technological partnerships, increased joint investments, and a more robust institutional framework to achieve these goals.⁴³

There have been issues related to jurisdictional questions regarding territorial waters. These heated up in the South China Sea in the 1970s and 1980s, primarily relating to China's view that the area was theirs. At that time, there were serious discussions of the possibility of violent conflict over the seabed and islands in the region.⁴⁴ However, while that question has become less contentious, there remain other territorial questions involving Malaysia and its neighbors. Most particularly, there were long-term issues between Malaysia and Indonesia regarding concessions near the Sipadan and Ligitan Islands that went to the International Court of Justice in 2002. More recently, there have been tensions with Brunei over ultra deepwater blocks off the east coast of Sabah.⁴⁵

As previously noted, outside the region, the expansion of Petronas was in part an effort of

⁴³ Asian Oil and Gas, July/August, 2005:28.

⁴⁴ For an analysis of disputes in the area see Valencia, Sharing Resources of the South China Sea.

former Prime Minister Mahathir to project Malaysia onto the global scene. The company also saw these efforts as a means of showing the world its own capabilities. As the head of Petronas Hassan Marican said about involvement in Africa, “We decided it would be good to prove to the world, to the industry, that we are a credible and capable player before we get accepted by the supermajors.”⁴⁶ The expansion of Petronas across Asia, Africa and even Europe has given the company and Malaysia more prominence than it held previously.

Some of the countries in which Petronas has developed projects have also put Malaysia and Petronas into delicate political issues. Its willingness to become involved in Iran, Sudan and Myanmar in opposition to the wishes of human rights organizations and the United States government are cases in point. As previously noted, some have suggested that this has been part of Mahathir’s desire to irritate Western and, particularly, American interests. However, they are more likely part of economic-business goals of the company. In fact, it can be argued that Petronas has not been particularly concerned with world attitudes towards its actions and has been driven by business interests rather than by moral or political concerns (although the company protests that it is cognizant of human rights issues).

The Sudan case illustrates how the business interests of Petronas can clash with the foreign policies of other countries and the attitudes of human rights groups. The civil war in the Sudan, which began in 1983, has led to the death of an estimated two million people. The central government in Khartoum has been charged with atrocities, neglect of the needs of minorities, and unwillingness to disarm pro-government militias. Oil was discovered by Chevron in the 1970s, but the company left Sudan in the 1980s. Proven reserves are now stated at 563 million barrels of oil and are expected to increase substantially over time.

⁴⁵ Asian Oil and Gas, March/April 2005.

⁴⁶ PIW, June 17, 2003.

Malaysia became involved in the Sudan in 1996 when it invested in the Greater Nile Petroleum Operating Company (30 percent) and in 1997 in Lundin's Block 5A. In 2003 Lundin sold its interests to Petronas making it the largest owner of that block. Since that time the company has become involved in other fields, refining, and management consultancy. The actions of Petronas also brought to Sudan other Malaysian companies and investments.

These activities have led to accusations that Petronas is aiding a country with a poor human rights record and a history of supporting terrorist activities elsewhere. There are complaints that Khartoum uses its oil revenues to buy arms, and Petronas has even been accused of supplying arms to the Sudanese government. Petronas on its part states that it continues to conduct itself with concern for human rights and the needs of the Sudanese population.

The firm's projects in Sudan have also put it in conflict with U.S. Government policies. The U.S. imposed economic sanctions on Sudan in 1997, and Sudan has been on its list of terrorist-exporting states since 1993. The U.S. has also accused Khartoum of allowing slavery, committing human rights violations and denying religious freedom. In 2001, Congress attempted to bar oil companies operating in Sudan from trading securities in the U.S., but this was opposed by the Bush administration and did not come to fruition. Petronas was one of several targets of that bill. Individual American states have also sought to block investments in companies dealing with the Sudanese government. However, Petronas continues to see its Sudan operations as a profitable financial accomplishment and an example of a successful program under difficult circumstances. These actions by Petronas are seen as a perfect candidate for Mahathir's "Prosper Thy Neighbor" motto and an example of aiding an economically downtrodden society.⁴⁷

If they so chose, Petronas and Malaysia could play a central role on the global scene, in the area of shipping activities. With the largest LNG fleet in the world owned by Petronas

through MISC investment, the company is a major player in supplying LNG throughout the world. Its other ships are also essential to transporting oil to other countries. A case in point is the heavy dependence of the United States upon Petronas vessels for its crude oil imports, particularly from West Africa. However, there is very little possibility that Malaysia would play any such role that would be inimitable to Petronas economic interests.

SUMMARY

Petronas has several attributes that tend to set it apart from many of its national oil company counterparts. The firm is not necessarily unique in each of these elements, but as a whole it is different. Four attributes need to be highlighted:

1. Petronas is a generally well-run company with a leadership that has developed a good reputation for administrative and financial accountability. Petronas is relatively free from corruption.
2. Petronas is an integrated global company with upstream and downstream operations in countries in Africa, the Middle East, Asia, Europe and Australia. A significant percentage of its profits come from these overseas enterprises. Petronas has been willing to enter areas not usually emphasized by the majors. These include its major involvement in Africa and operations in so-called pariah states such as Myanmar, Sudan and Iran.
3. Petronas has been largely free of government interference in its day-to-day operations. It sees itself as a business with profit as a prime objective. There have been cases of state interference in decisions, and Petronas has been a major financial supporter of state supported mega-projects outside its core interests, such as the Twin Towers and Putrajaya.

⁴⁷ Bowie, *A Vision Realised*, Pp. 275-76

This is not a case of nationalization, although nationalism was a factor in its original formation. It has been a generally solid and well-respected partner to both private and state entities around the world. While it has become involved in a wide range of agreements with other companies and states in which its equity percentage has varied, Petronas itself is 100% state owned. It has no present intention to privatize.

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