

Developing Global Champions: Why National Oil Companies Expand Abroad

Written by Andrew Cheon

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ANDREW CHEON, OCT 24 2019

State capitalists have gone global, prominent among them behemoths such as China and Russia. The Belt and Road Initiative, as well as its predecessor Going Out Strategy, underscores China's growing ambitions in the economic sphere. One running theme for these state capitalists, whether in Africa or Central Asia, has been the use of state-owned enterprises (SOEs) to increase their international presence. In an article published in *Economics & Politics*, I focus on a type of SOE—national oil company (NOC)—often deemed “the most important company of the country” for its role in revenue generation and energy security (Stojanovski, 2012; Hults, 2012).

Perhaps most well-known to the public, China National Offshore Oil Corporation (CNOOC)'s failed bid for the Californian oil company Unocal in 2005 (valued at \$18.5 billion) was only the tip of the iceberg. Beginning in the late 1990s, NOCs from across the world have invested hundreds of billions of dollars in foreign oil and gas assets. Though Western private oil companies, such as Shell and Standard Oil, had once claimed dominant ownership of reserves in resource rich countries, the rise of resource nationalism and NOCs has since reduced their share of the world's oil and natural gas base to less than 10% (Jaffe and Soligo, 2010).

To secure additional revenues and fuel supply, governments understandably want their NOCs to develop into global competitors (Jaffe and Soligo, 2010). However, governments also face formidable challenges monitoring their NOCs (Hults, 2012), which are considered inefficient (Wolf, 2009; Losman, 2010; Eller, Hartley, and Medlock III, 2007, 2011). Given finite political and economic capital, governments must weigh potential benefits from their global expansion against its costs, such as information asymmetries and inefficiencies associated with NOCs (Victor, Hults, and Thurber, 2012; Marcel, 2006). Why have some governments significantly increased their NOC outward investments across the value chain, while others have been more hesitant (Victor, 2007)?

There are a number of potential explanations. First, NOCs operate as rational profit maximizers, responding to perceived business opportunities abroad. This may be a useful first cut, but it overlooks the push and pull of politics in the management of state-owned enterprises. Second, the extent to which NOCs internationalize may be explained by the heterogeneity that exists among the NOCs themselves, such as the degree to which they have become “a state within a state” (Stevens, 2008). This is a promising line of inquiry, but a number of studies quite convincingly demonstrate that managerial processes in NOCs cannot be understood apart from the political institutions that govern them (Losman, 2010; Hults, 2012; Rai, 2012: 778).

I argue that NOC global expansion must be traced back to the contentious deliberative process by which governments weigh its costs and benefits. Given its resource nationalist origins, an ideal NOC serves dual functions as an agent—a commercial entity held to the standards of economic efficiency and an instrument of the state held to the standards of public accountability. The rigors of global competition will often strain the NOC's ability to deliver on either score. The extent to which NOCs internationalize will therefore depend on their institutional principals and the varying capacity of those principals to tolerate potential failures and coherently oversee a long-term expansion strategy. Competition may prevail among principals to varying degrees at two different levels of government, national and bureaucratic.

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National principals include the head of state and the opposition party. An NOC's capacity to expand abroad ultimately depends upon the political and economic capital that the head of state is willing to devote to developing a global champion. The opposition party can also influence NOC development by serving as checks against the head-of-state (Tsebelis, 2002; Schultz, 1998; Schelling, 1960). Opposition parties can make global expansion more costly to sustain by legislatively vetoing additional outlays and mobilizing public opinion. I hypothesize that an NOC overseen by an autocratic government is more likely to invest abroad than an NOC overseen by a democratic one.

Bureaucratic principals include ministries and agencies formally charged with overseeing NOC commercial operations. Consistent with Hults (2012), a designated bureaucratic principal is preferable to bureaucratic competition for optimizing NOC performance, because it ensures internal cohesion of government intervention in that policy area (Evans, 1995). In mandating and overseeing long-term strategies, states need to act as corporate entities with collective goals, rather than the sum of the strategies of individual utility maximizers (Evans, 1989). I hypothesize that an NOC overseen by a designated bureaucratic principal is more likely to invest abroad than an NOC overseen by bureaucracies competing for authority.

To test these hypotheses, I rely on GlobalData's Oil and Gas eTrack database to identify international investments of 79 countries with NOCs, spanning 2000-2013. I define international investments as asset purchases, firm acquisitions, and joint ventures involving an NOC and a foreign government or firm on foreign soil. Asset purchases involve acquiring rights to explore or produce from hydrocarbon blocks, as well as purchasing refinement facilities, pipeline infrastructure, and retailers. Acquisitions refer to obtaining a majority stake in other firms engaged in hydrocarbon activities. Joint ventures are undertaken to share the costs and benefits of hydrocarbon activities.

I further devise an original binary indicator of designated principal and bureaucratic competition by surveying the energy sectors of 79 countries based on reputable sources, such as the Energy Information Administration and International Energy Agency. Multiple ministries and agencies are usually charged with overseeing some facet of NOC operations at the bureaucratic level. The finance ministry, for instance, may oversee the issuance of company-related equity, while the energy ministry reviews the specific quality of investments. Isolating bureaucratic competition from such examples of division of labor required specifying a narrower area of energy policy—exploration and production of oil and gas. I thus code bureaucratic competition using evidence of overlapping authority or governance roles in upstream hydrocarbon operations.

As per the national hypothesis, I find that a point increase in a country's Polity score—the most widely used measure of regime type with democratic governments taking on higher values—would be associated with a substantively significant 7.5% to 8.4% decrease in the incidence of NOC international investments. Interestingly, this dynamic seems to operate more strongly in oil-producing countries than non-oil producing countries. The second hypothesis, however, finds little support. I demonstrate the robustness of my findings through a battery of tests. To anticipate potential criticism that idiosyncrasies of autocratic governments—rather than democratic constraints—drive the results, I conduct additional split sample testing. To address the possibility that NOCs that have invested abroad are qualitatively distinct, I also model selection.

Taken together, my findings suggest that the internal debates surrounding NOC global expansion are deeply political ones. Whether NOCs are successful in their attempts to expand abroad will depend in large part on the political and economic capital wielded by their principals. An exclusive focus on information asymmetries would not be productive. While information asymmetries are likely to influence political debates, perfect information concerning NOC operations would not be sufficient to convince the political critics of NOC global expansion. The absence of a strong relationship between bureaucratic structure and investments raises questions of its own. Are NOC investments proceeding despite dysfunctional bureaucratic oversight? What are the implications for the outlook of national oil companies?

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