POLICY BRIEF
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# ASSESSING NIGERIA NATIONAL PETROLEUM CORPORATION (NNPC) CONTRIBUTION TO THE ECONOMY

## *NNRC/CPEEL ENGAGEMENT WITH STAKEHOLDERS IN THE NIGERIAN OIL & GAS INDUSTRY*

### Executive Summary

Nationally Owned Resource Companies, all over the world represent active government intervention to control a strategic sector of their economy. In the oil and gas Industry, National Resource Companies or National Oil Companies (NOCs), control approximately 90% of proven oil reserves and 75% of production worldwide. These Companies are important vehicles through which governments pursue varied economic and socio-development objectives such as maximizing the economic rent derivable from their resource endowment, employment generation, local content development, technology acquisition and human capacity development. The Nigerian National Petroleum Corporation (NNPC) is one such National Oil Company.

Established in 1971, NNPC has been the primary "gatekeeper" of the vast oil and gas assets on behalf of the Government and people of Nigeria. It controls activities in the Industry through majority ownership (60%) in oil and gas assets (as mandated by Organization of Petroleum Exporting Countries (OPEC)), issues licenses to prospective participants through bid rounds, ensures Government gets its fair share of economic rent through fiscal regime(s) and regulates industry practices through the Department of Petroleum Resources (DPR) – recently transferred to the Ministry of Petroleum Resources. In the Nigerian Petroleum sector, contractual arrangements have evolved from concessionary arrangements in the sixties, Joint Ventures of the seventies and Production Sharing arrangements that are currently popular.

Due to the strategic nature of the oil and gas sectors to the Nigerian economy, and level of contribution to total country export revenue (in excess of 75%), the performance of NNPC and its contribution to the overall Nigerian economy assumes national significance. The Nigeria Natural Resource Charter (NNRC) is dedicated to improving resource sector governance for the overall benefit of the Nation state and has conducted three benchmarking exercises to assess Petroleum Resource Governance against a set of twelve precepts representing various components of good governance. The latest Benchmarking exercise in 2017, specifically as it relates to Precept#6 (State Owned Enterprises) focuses on the following key questions:

Precept 1

**STRATEGY, CONSULTATION AND INSTITUTIONS**

*Resource management should secure the greatest benefit for citizens through an inclusive and comprehensive national strategy, clear legal framework and competent institutions*

Precept 6

**STATE OWNED ENTERPRISES**

*Nationally owned companies should be accountable, with well-defined mandates and an objective of commercial efficiency*

***1. Does the government clearly define the State Owned Enterprises' role and establish a working funding mechanism for the company?***

***2. Do the SOE's corporate governance systems limit political interference in the company's technical decisions, while ensuring effective oversight?***

***3. Are SOE decision-making and operations transparent and accountable?***

The highlights of the 2014 exercise indicated the commercial viability of NNPC was in question as it repeatedly failed to meet cash call obligations leading to underfunding of Joint Venture Assets, assets contributing more than 50% of current country production. The 2017 Benchmark Exercise Report (BER) noted some positive developments in the sector such as the passage of the Petroleum Industry Governance Bill (PIGB) by the Senate, removal of subsidy on petroleum motor spirit (PMS) by the Federal Government and marginal improvement in the availability of NNPC's operational and financial data. However, the report also highlighted continuing confusion between NNPC's commercial functions with non-commercial/regulatory requirements. In order to explore further the ramifications of these findings, NNRC commissioned a research study by the Center for Petroleum, Energy Economics and Law (CPEEL) of the University of Ibadan to assess NNPC's contributions to the overall Nigerian Economy. The results of that study are presented in this policy brief.

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## Introduction

CPEEL's Research would focus on the Benchmarking Exercise findings on Precept's Six (6) – Nationally Owned Resource Companies or State owned enterprises. The results of the research would be disseminated in a Policy Dialogue with stakeholders in the Nigerian Oil and Gas Industry in a 1-Day Engagement Meeting in Lagos, Nigeria.

Three activities were proposed to be carried out by CPEEL:

- ***Analysis of NNPC Group's Operational and Financial accounts/data***

- ***Econometric modelling of the NNPC contributions of NNPC/subsidiaries to the economy***

- ***Stakeholder consultation on the findings of research, its implications and policy suggestions/recommendations based on feedback from stakeholders***

The specific findings of NNRC's 2017 Benchmarking Exercise Report relating to Precept 6 are:

- ***NNPC's business roles remain diluted with its non-commercial and auxiliary regulatory functions, which is at variance with guidelines provided by the NNPC Act. This leads to confusion and conflict of interest with DPR, the designated regulator of the oil and gas sector.***

- ***NNPC is not incentivized and motivated to deliver commercially-viable services in the oil and gas sector which in turn, engenders operational inefficiencies***
***Top positions in NNPC are subjected to political influence and ratification hampering merit-based recruitment and effective functionality of the executive directors.***

- ***NNPC is fully owned by the government with shares not publicly traded or transferable. Hence, it is accountable only to the government and its commercial drive is limited to the priority and goals set by the government.***

- ***NNPC's disclosure requirements are not the same with other publicly quoted companies. The corporation audited accounts are not made public knowledge and key financial information are guarded with the utmost secrecy.***

- ***The quality of the audited reports are usually affected by inadequate and improper financial records which limit sound financial judgment.***

## Methodology, Analysis and Results

A review of the global oil and gas industry was carried out as well as an assessment of the roles and responsibilities of National Oil Companies as value creating entities. A review of the Nigerian oil and gas industry was also done focusing on the petroleum value chain and the parameters of performance in each sector of the value chain. The Input/output (I-O) Econometric Model was utilized in assessing the impact/contribution of NNPC in the Nigerian economy. The I-O model has been used in several studies to examine the contribution of a sector to other sectors of the economy especially with respect to value-added, output wages/salaries and employment. The contribution of a sector, firm or a group of firms (industry) to the economy is decomposed into direct, indirect and induced contributions. These sets of contribution are also referred to as: direct effects, indirect effects and induced effects.

Direct contribution/effect comes from purchases made by the firm/sector across sectors/firms in the economy; indirect contribution arises from purchases made by suppliers of the concerned firm/sector across sectors of the economy. Induced effect results when employees employed by the firm/sector and its suppliers spend their wages/salaries.

A 1-Day Dialogue with Key Stakeholders in the Oil and Gas Industry was held in Lagos on Thursday, March 29, 2018 at Protea Kuramo Waters to disseminate findings of the research, lead discussions on implications of the study and suggest policy recommendations while highlighting the linkages with the Natural Resource Charter (NRC) Framework towards improving Oil and Gas Sector performance.

## Analysis

The starting point of our analysis is NNRC's Precept#6; State Owned Enterprises (SOE) which posits that "Nationally owned Companies should be accountable with well-defined mandates and an objective of commercial efficiency" to maximise benefits for Nigerians. We focus on the requirements for accountability, clearly defined mandates and commerciality on the path of the SOE. We start from a very broad framework that SOE or NOCs exist and hold in trust more than four-fifths of World Oil Reserves and for a number of reasons continue to be an important vehicle for host governments to achieve national developmental objectives through their resource endowments. Their experiences and trajectories in creating value from the resource endowments are varied ranging from commerciality levels comparable to those of the IOCs to those NOCs that just seem to be hobbled in terms of their value creating potential. The intent is to learn from the many varied experiences of these NOCs and extract broad universal principles that seem to work and those characteristics that hinder.

An extensive World Bank study (Toldo 2011) on State Owned National Resource Companies reached the following important conclusions:

***•There is hardly any such thing as a purely commercial mandate, when it comes to NOCs. It is mostly a matter of degree. For some NOCs, national mission objectives constitute a large part of their mandate, and do create demands on scarce resources that would otherwise receive a different allocation.***

***•What constitutes the national mission is country specific, but usually includes the creation of some kind of backward or forward linkages – fostering the transfer of technology, creating employment opportunities, increasing local ownership and control, and promoting economic growth and diversification.***

***•Internal governance mechanisms – the procedures and processes that govern the functioning of the institutional structure of governance – are more critical for NOCs value creation than external governance mechanisms (ownership structure and Country governance variables)***

***•Government interference in the NOC decision making processes seem to be more closely related to the degree of economic dependence on the petroleum sector of a country, rather than the percentage of independent Board of Directors (BOD) or BOD committees members.***

On a Country level, the study also concludes that "the political, institutional, and societal qualities of a country – more than the actions of its NOC – are critical to determining to what extent its Oil and Gas resources will translate into value creation.

The foregoing sets the national and institutional context in which NNPC as a group is analysed in this research. First, the impact of the political and institutional environment is amply demonstrated in the broader Nigerian industrialisation process, which has been highly constrained, subject to frequent policy changes and lack of long term strategic orientation. As itemised by Adeoti (2009), the industrial sector is characterised by low capacity utilisation, low contribution to GDP, low contribution of SMEs and Medium scale enterprises to the economy and absence of local industrial research and development. Stunted industrialisation and the collapse of the agricultural sector has exacerbated the degree of dependence on revenues from the Country's Oil and Gas resource endowments leading to excessive government control over a perceived strategic industry. NNPC, as the sole "gatekeeper "of the Oil industry is expectedly overburdened with non-commercial objectives or what are generally termed National Mission objectives. National mission objectives need not completely hamper NOC value creation as shown by the experience of some NOCs. Where the national mission objectives are closely aligned with NOC objectives, these non-commercial objectives may have much more impact on the overall economy than maximizing economic rent. Several NOCs exhibited these value creating characteristics and have made significant contributions to their respective national economies. Petronas (Malaysia) is a prime example of an NOC with a large portfolio of national mission objectives. Petronas has played and continues to play a key role in the development of the Malaysian economy through backward and forward linkages of the Oil industry with the rest of the economy. In the case of NNPC, poor alignment between National mission objectives and NOCs commercial objectives has been the major constraining factor in the Group's performance over the years. The current state of the National Oil Company and expected future developments addressing the specific questions that Precept#6 highlights are detailed in Table PB#1 at the end of this Policy Brief.

## NNPC - Comparison National Oil Companies

Figure 1 compares NNPC Group in terms of value creating potential with often cited "flagship" NOCs (Statoil, Petrobras and Petronas) using a 2x2 Matrix.

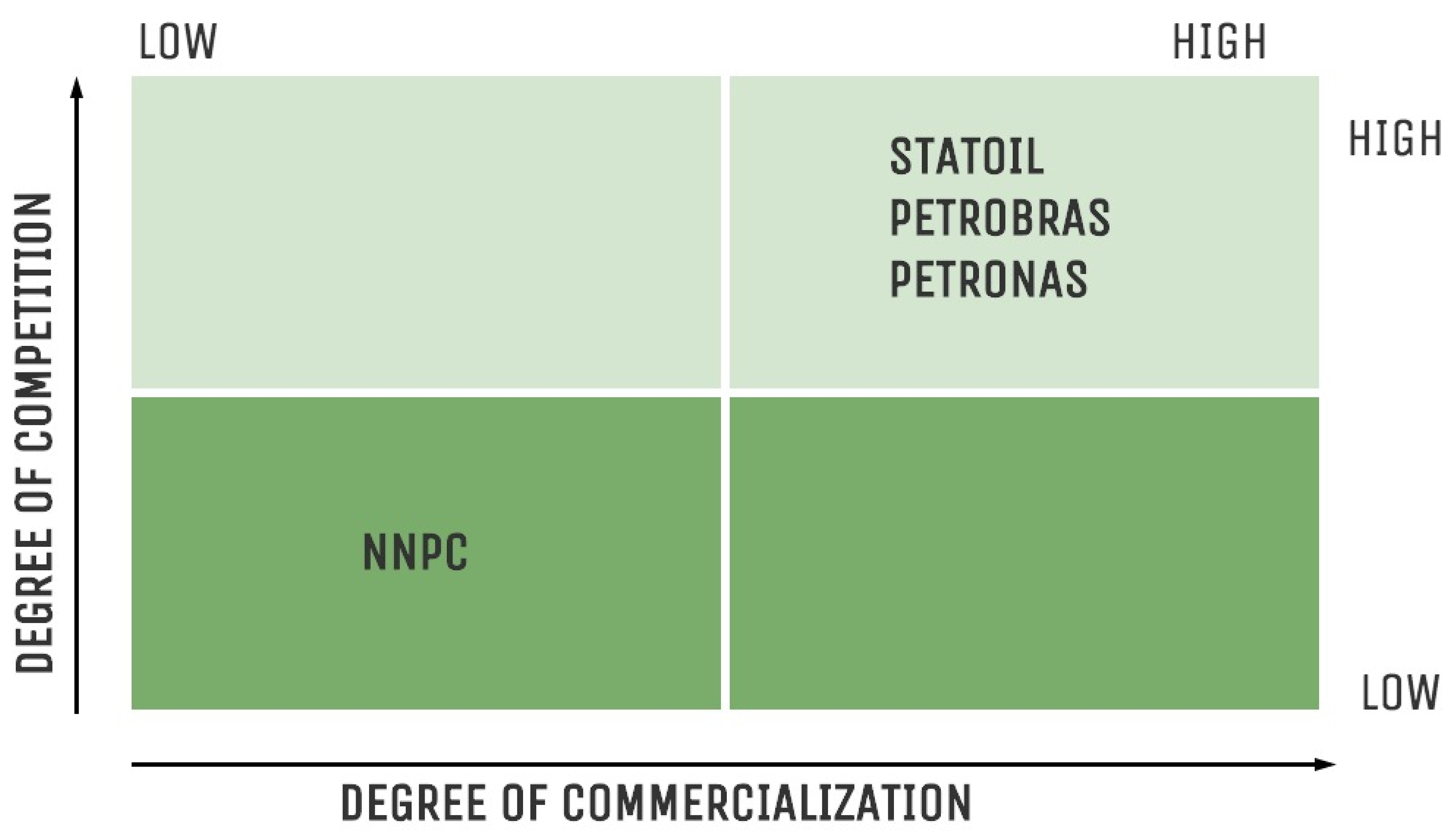


Figure 1 – Selected NOCs Classification (Adapted from Toldo)

This is a "coarse" classification system using only two dimensions: degree of competition and degree of commercialisation. NNPC is quite hampered on both dimensions compared to these comparison NOCs. While Statoil and Petrobras are publicly quoted Companies, Petronas is wholly owned by the Malaysian Government. All three NOCs have deep internally developed technological and managerial competences that evolved over time. The governments of the three NOCs had an overarching desire to use their Oil and Gas Industry as a spring board for economic development and consistently crafted policies that granted administrative and financial independence as well as commercial focus to the NOCs. There was sustained efforts to ensure a high degree of alignment between National Mission objectives and NOC objectives to ensure the commercial focus of the NOC is not diluted particularly in the case of Petronas, a wholly owned NOC. All three NOCs are and have been self-funding entities. When they enjoyed special privileges from their Governments, those privileges were targeted at achieving set strategic objectives and promptly withdrawn before they became sources of operating and financial inefficiencies.

NNPC, on the other hand, without a clear definition of its commercial and non-commercial roles and excessive political interference is severely hampered in its value creating capabilities. The recently passed Petroleum Industry Governance Bill (PIGB) attempts a clear definition of roles, envisions viable commercial entities and makes provisions for self-funding and a divestment of the shares of the soon to be incorporated National Petroleum Company and the National Petroleum Assets Company as well as the Regulator. These provisions have the potential for increasing the commercial orientation of the new entities in which the state will have majority shareholding.

The Input-Output Model utilized in the econometric evaluation of NNPC's contribution to the economy showed very little contribution to the Nigerian economy across selected value measures of Gross Domestic Product (GDP), Value added, Taxes and job creation. Fuller analysis is detailed in the consolidated report of this research finding.

## Key Insights/Results of Research

*• National Oil Companies (NOCs) hold vast amounts of oil and gas reserves in trust for the Government and people of resource endowed countries and possess value creating potentials that depend on size of resource endowment, the country and sector governance context and Corporate governance context*

*• In addition to creating shareholder value, NOCs (NNPC) also have to create social value such as employment, technology transfer or acquisition, local content and such other non-monetary value measures of economic development. However, their value creating potential can be assessed in three dimensions – operational performance, financial performance and Social Mission Performance.*

*• Operationally, current country reserves stands at 37 Billion Barrels supporting a production capacity of approximately 2 Million Barrels a day. Efforts to boost reserves have not been successful because of the uncertainty surrounding the Fiscal Regime (the Petroleum Industry Fiscal Bill – PIFB) which has significantly curtailed funding for new exploration and development.*

*• In recent years, pipeline disruptions and other security threats to oil and gas infrastructure have played a major role in constraining production and Country's ability to meet allocated OPEC quota.*

*• Aggregate Refinery Capacity Utilization consistently below 30% and often less than 20% due to chronic underfunding and problems with Turn-Around-Maintenance (TAM) resulting in rising levels of product importation, pressure on scarce foreign exchange and subsidy on petroleum products. Compared with Global Refinery Capacity Utilization of 80%, the country's low Capacity utilization indicates significant value loss in the Midstream sector*

*• Gas flared has trended down towards single digits (2015), in percentage terms due to increased Gas utilization for Exports (NLNG) and surging demand for power generation due to implementation of key projects under the Nigeria Gas Master Plan.*

*• There is very little data to neither estimate NNPC contribution to local content development, nor entire industry contribution to local content, a key National Mission Performance indicator especially share of total industry spend domiciled in-country.*

*• For 2016, NNPC's contribution to Gross Domestic Product (GDP) (and other sectors of the economy) captured under Oil/Gas/Refinery and Pipelines is approximately 5% while contribution to Value Added created in the economy is 7%.*

*• NNPC's contribution to Indirect Taxes, Compensation to Employees and Total Employment is less than 1% in each of these three measures*

*• A sector or firm's contribution to the economy is a function of its integration or linkage with the rest of the economy. The low level of contribution of NNPC across all measures considered in-spite of its significant share in the nation's export and government revenue portfolio is due to its low linkage with the rest of the economy*

## Conclusions

A significant portion of value realized through NNPC is in the upstream sector of the Petroleum value chain viz. export of crude oil, NLNG exports and more recently, sale of gas through the West African Gas Pipeline. The largely export orientation of the Industry implies weak linkage with the rest of the economy and low contribution to Gross Domestic Product.
Value derivable from the midstream and downstream sectors remains elusive due to low refining capacity utilization, poor sector and corporate governance. Political influence and non-commercial considerations continue to hobble the value creating capacity of NNPC. Poor sector governance ranks highest of the limiting factors followed by poor corporate governance.

## Implications and Recommendations

• *A change in the business model and/or ownership structure will improve corporate governance and value creation capacity of Nigerian National Petroleum Corporation (NNPC) and enable it to realize the enormous potential value it can contribute to the Nigerian economy. The recently passed Petroleum Industry Governance Bill (PIGB) by the National Assembly is eagerly anticipated to bring this about.*

• *There is a need for concerted efforts to promote accountability in the management and turn-around-maintenance of the refineries; the "NLNG" model seems to be working very well and should be replicated in the Refining sector.*

• *A well-developed nation-wide system of pipelines to transport and distribute petroleum products will significantly reduce current cost through road haulage due to economies of scale.*

• *Infrastructure optimization through co-location opportunities should be explored to quickly turn around the performance of critical oil and gas assets.*

• *Efforts should be made to intensify the drive towards local content development. Currently, a significant portion of inputs required in all aspects of the Industry is sourced externally; leading to high leakages from the Nigerian economy. Aggressive targets and milestones could be achieved through effective implementation of the Local Content Development Act.*

• *An accurate assessment of total industry spend domiciled In-Country should be done and updated continuously due to the capital intensive nature of the Oil and Gas business.*

• *Local Content development will strengthen the linkage of the Oil and Gas Industry with the rest of the Nigerian economy and improve sector contribution to overall GDP form current low levels.*

## STRATEGY, CONSULTATION AND INSTITUTIONS

Table PB#1

| Specific NOC Tenets | Current State/Future Developments of NNPC Group |
|---|---|
| *6.1* | |
| *Does the government clearly define a commercial role for the NNPC that reflects the company's actual financial and technical capacity?* | *NNPCs role is to manage the JV and PSC upstream assets, the Refineries and Downstream distribution of petroleum products. However, there are no key operational or financial performance metrics to which management is held accountable e.g. reserves replacement ratio or refinery capacity utilisation.* |
| *Does the government clearly define the company's non-commercial roles? Does this definition limit conflicts of interest?* | *It recruits the best professionals and pay is highly competitive with the best public Companies in Nigeria. It spends significant amount in human capacity development. Top level cadre sometimes are seconded from IOCs to infuse technical capacity. However, executive leadership position is more "political"* |
| *Does the government ensure that the NNPC has a workable funding mechanism?* | *Some of the Companies non-commercial roles are defined viz. Educational thru PTDF Scholarships, Management of Petroleum Pricing and subsidy management. However, boundaries are not set and sometimes, there are confusion in roles with other Agencies e.g. DPR* |
| *6.2* | |
| *Does the government clearly establish the identity and role of state shareholders in the NNPC?* | *Prior to the new PIGB, NNPC was fully owned by the Federal Government of Nigeria. In the new PIGB, not less than 10% of the shares of the proposed Nigerian Petroleum Assets Management Company and the National Petroleum Company will be divested to the public within 5 years and an additional 30% within 10 years of incorporation of the two Companies* |
| *Does the NNPC have an empowered, professional and independent board?* | *Appointments into NNPC Board was the sole prerogative of the Presidency prior to the new PIGB. The Presidency and the Minister of Petroleum will still exercise these rights with new PIGB. However, with divestment to the Public, independent shareholders will be added to the Board that will empower and enhance professional decision making.* |
| *Does the NNPC invest in staff integrity and capacity?* | *There are Company ethic codes regulating Staff engagement with Contract Companies/Contractors, but monitoring and compliance data are unavailable to determine effectiveness of these rules and regulations* |
| *6.3* | |
| *Does the NNPC disclose key operational and payment data?* | *Monthly operational and financial data are published on NNPCs website – however, these are aggregated and it is impossible to disaggregate the data to determine with companies are making profit or losses, a disincentive for individual Company performance* |
| *Does the NNPC subject itself to independent financial audits, and publish the results?* | *Periodic audits are required of the Corporation and there are indeed audited reports which have not been available to the public prior to 2015. From 2015, some of these audited reports have been published, still access is difficult to all and sundry* |

NIGERIA NATURAL RESOURCE CHARTER

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