05.14.2015 13:06

New Faces, New Reforms for Big Oil in China

New chairmen have been seated at the nation's state-owned oil companies, against the backdrop of changing markets and industry reforms

By staff reporter Huang Kaixi

(Beijing) – A new chairman was installed at each of China's three state-owned oil giants simultaneously on May 4, a few weeks after the companies released dismal first-quarter financial reports.

China National Petroleum Corp. (CNPC) and China Petrochemical Corp. (Sinopec) each registered a more than 80 percent decline in year-on-year quarterly income, while China National Offshore Oil Corp. (CNOOC) eked out a 6.6 percent profit increase, but saw revenues plunge 40 percent.

There may be little chance of a near-term turnaround for the companies' fortunes, given a slump in global oil prices that began last year and what some analysts say have been anemic returns on their overseas investments. Chinese oil companies have invested in Canadian oil sands, Brazilian offshore wells, a Myanmar pipeline and other projects around the world.

CNPC, Sinopec and CNOOC – sometimes called China's Big Three – are also in the bulls eye of Beijing initiatives to downsize state-owned enterprises (SOEs) by auctioning off non-core assets and clean up SOE headquarters by weeding out management-level corruption.

The new CNPC chairman is Wang Yilin, who since April 2011 had served as CNOOC's chairman. He replaced the retiring Zhou Jiping, who had led CNPC for four years.

Promoted to Wang's position at CNOOC was Yang Hua, whose job since 2011 had been CNOOC's general manager.

And named to head Sinopec was Wang Yupu, a former deputy dean of the Chinese Academy of Engineering. He took over the chairmanship that had been held by the retiring Fu Chengyu since 2011.

Each appointment was announced by the Communist Party's Organization Department, which chooses SOE executives.

Officially, these personnel decisions were spurred by the fact that Zhou and Fu each turn 63 years old this year, the standard retirement age for top executives at central government-supervised SOEs.

Also notable is that Zhou, Fu and Wang Yilin are survivors of the 2-year-old campaign against graft that's already taken down several oil company executives. Since August 2013, eight senior officials under Zhou at CNPC have been detained for corruption. The latest additions to the list of disgraced executives are two former general managers, Liao Yongyuan and Wang Tianpu, who were ousted in March and April.

Silver Lining

Despite serious challenges, some analysts see a silver lining for the cloud that's been shadowing the oil companies: Thanks to current conditions, they say, it seems the time is right to accelerate a reform campaign promoted by the central government aimed at streamlining the nation's oil and gas sector.

Guo Jiaofeng, a deputy director at the Institute of Resources and Environmental Policy under the State Council's Development Research Center, said recent changes in the international and domestic energy markets – changes marked by falling profits for oil companies – have offered an opportunity to push China's energy reform agenda.

Several sources told Caixin that central government officials have ordered agencies and think tanks to work together to complete **a general plan for oil and gas sector reform** by the end of this year. A draft version of the plan was to be submitted to Beijing authorities by the end of June.

Major reforms began last year at CNPC and Sinopec, when the companies started inviting outside investors to bid for assets made available through their so-called "mixed-ownership" reform strategy.

To date, Sinopec has accomplished more than CNPC. Under Fu's direction, the company has restructured more than 10 subsidiaries and cut the workforce to about 920,000 from 1.06 million in 2011.

Last year, Sinopec sold off about 30 percent of its retail business to private investors, raising more than 100 billion yuan. The new company is expected to go public within three years. Meanwhile, the company officially launched oil and gas production from a shale-fracking site in Sichuan Province, in the southwest.

On the other hand, a person familiar with the energy sector reform program said that CNPC officials are still negotiating the terms of their reform strategy. It's unclear whether having a new chairman at the helm will help or prevent CNPC from following a successful reform course.

Yet Zhou was applauded for reform initiatives. Last year he unveiled a plan to invite new investors to buy into CNPC's upstream exploration operations. He also spearheaded a pipeline business restructuring, and crafted a plan to spin off oilfield service subsidiaries.

"New people will bring new ideas," the source said. "Many ongoing restructuring plans and reform projects have to be reviewed by new leaders which leads to delays or adjustments that make the original timetables useless."

Guo said gas and oil sector reforms should be system-wide, changing not only the Big Three but every niche of the oil and gas industry.

Efforts should be made to let more companies participate in upstream oil and gas exploration, Guo said, by for example encouraging oil companies to realign subsidiaries in the oilfield services arena. He also sees a need for the government to reform its resource tax system.

The Big Three should spin off oil transportation and retail businesses, he said, while the government should move to liberalize oil import rights and energy pricing systems.

"We fully discussed all aspects while researching the plan," Guo said. "The industry has reached a basic consensus on the reform direction. And companies have agreed to make great changes."

Falling In Line

Guo said Sinopec's reform measures pushed by Fu were in line with government plans for overall energy market reform.

Beijing's plans were highlighted in June 2014, when President Xi Jinping told top policymakers that it was time to hasten the pace of oil and gas sector reform. Central government agencies and state companies were ordered to map out reform plans.

Since late last year, sources close to policymakers said, the National Development and Reform Commission and the National Energy Administration have been asking experts at think tanks and other agencies to study energy industry reform plans. Major aspects under scrutiny include measures that would help companies access markets, liberalize pricing mechanisms and improve the business environment.

Some experts have advocated mergers among CNPC, Sinopec and CNOOC to form mammoth oil conglomerates that can better compete on the international stage. Others say each company should be split up to create smaller, more agile companies.

Guo said the Big Three could spin off subsidiaries and merge their own operations at the same time if the government's final reform plan calls for shuffling their assets to form subsidiaries focusing on special niches.

An SOE reform expert said it's typical to hear calls for merging companies when an industry is on the downside of a business cycle. But the expert said: "It's unrealistic to merge the oil companies … Each company has huge assets and a complicated internal structure. A merger would create more trouble, but spin-offs and reshuffling businesses according to specialization would boost efficiency."

China doesn't need a super national oil company, said Zhu Tong, a researcher at the Institute of Industrial Economics at the Chinese Academy of Social Sciences. In his opinion, oil security issues can best be addressed by raising efficiency levels for exploration, production and sales through competition. Competition, he said, would help reduce China's reliance on imported oil without new control measures.

What happens next for oil and gas industry reform will be closely connected to the government's big-picture plan for reforming all of the country's SOEs.

Vice Premier Ma Kai is leading a special team in charge of drafting an umbrella reform plan, a source close to the State-owned Assets Supervision and Administration Commission (SASAC) said in May. The team was formed in late 2014, and its work was expected to be completed "soon."

"As reforms deepen deeper, nothing will be easy for reform," said an industry source who asked not to be named. "To succeed, industry reforms must move in tandem with SOE reforms."

But until an "overall SOE reform plan" is in place, the person said, "it's unrealistic to push forward oil and gas reform separately."

Work Ahead

The three new chairmen took their seats against the backdrop of trouble. Many analysts say global oil prices are likely to remain depressed for a while, putting pressure on business operations and the bottom lines of the Big Three.

Business was good for the oil giants before 2014, mainly due to the dominant market positions achieved in the late 1990s following early SOE reforms. Success in recent years helped them expand domestically as well as overseas.

The companies are also major employers. In addition to CNPC's current workforce of about 920,000, Sinopec counts more than 1.67 million employees and CNOOC has about 100,000. Royal Dutch Shell, BP and ExxonMobil each employ fewer than 100,000 people.

Analysts have faulted the Big Three for lax management practices that swelled labor forces at the expense of productivity. These issues became problematic after market conditions changed, forcing the companies to reassess business plans and look more closely at reforms.

Sinopec's 29 percent decline in net profit last year from 2013 followed five straight years of growth. CNPC's 2014 profit slipped 17 percent.

Each of the Big Three reported a declining return on invested capital (ROIC). Sinopec's listed arm saw its ROIC fall to 6 percent last year from 13 percent in 2010. During that same period, the rate of return on common stockholders' equity declined to 7.1 percent from 17.1 percent.

A source close to the companies said that values for investments in oilfields and other resources around the world are falling due to the oil price slump. Some analysts have estimated that CNPC's and Sinopec's overseas asset values may have been cut by more than a half.

CNPC and Sinopec employees have also felt the chill. The companies have tightened hiring and imposed salary cuts. And each of the Big Three says it plans to cut expenditures in 2015 by more than 10 percent from the previous year.

How each company approaches the changing marketplace is likely to be strongly influenced by the new leaders.

Wang Yupu, 58, spent years working at CNPC's Daqing Oilfield in the northeastern province of Heilongjiang. In 2003, he was named Daqing's chairman and general manager. He got a political appointment in 2009, becoming the province's deputy governor. He later joined the China Academy of Engineering as a deputy dean.

Wang Yilin, 58, served as CNPC's deputy general manager for seven years before his 2011 appointment to chair CNOOC.

Yang, 53, joined CNOOC in 1982 and started getting involved in the company's overseas expansion activities in 1993. He also helped the company go public in Hong Kong and New York in 2001.

Yang was appointed CNOOC's chief financial officer in 2004, and later was promoted to company deputy general manager and vice chairman.

Last August, Fu said at a Sinopec conference that central government officials had decided to let him keep the chairmanship for a while after reaching retirement age.

Also last year, Zhou asked for but was denied permission to retire early. He had made that request a few months after anti-corruption investigators detained a former CNPC colleague, Jiang Jiemin.

Jiang had served as CNPC's party boss until early 2013, when he took a new job as head of SASAC. Zhou then became the oil company's new party head. A few months later, party graft fighters detained Jiang.

(Rewritten by Han Wei)