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Petrobras: The Unique Structure behind Latin America's Best Performing Oil Company

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Energy Challenges in the Americas

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Cover Image:

Ribeirao das Lajes dike with its forest bordering the reservoir, an example of Light S.A.'s reforestation program. Light, a subsidiary in Brazil of the French company EDF (Électricité de France), distributes electricity to 80% of the State of Rio de Janeiro and implements environmental protection programs. ANTONIO SCORZA/AFP/Getty Images.

Petrobras: The Unique Structure behind Latin America's Best Performing Oil Company

Genaro Arriagada and Chris Cote

Brazil's oil and gas giant Petrobras stands among the world's most successful businesses, admired by the public as well as by private and state-owned national and transnational oil companies. Petrobras today is active in 23 countries in the exploration, production, refining, distribution and sale of oil, gas and energy, as well as petrochemicals, biofuels and electricity.

Latin America's most successful oil company owes its success at least in part to Brazil's condition as an oil-poor country with a government that does not see it as a cash cow. Unlike the other state-owned powerhouses in the region, Mexico's PEMEX and Venezuela's PDVSA, Petrobras grew gradually on a reputation for efficiency, ensuring crucial funding from government and other sources. The recent discovery of pre-salt oil now presents the company with the opportunity to exploit immense new reserves.

A Remarkable Success

After recovering quickly from the recent financial crisis, Petrobras is considered the world's eighth largest corporation and is often described as Latin America's best-managed company.

Brazil's oil and natural gas production are rising: Oil production is projected to increase by 60% by



Petrobras headquarters, Rio de Janeiro, Brazil.

2014 and 130% by 2020 (compared to 2008). Natural gas production is estimated to increase by 100 and 245%, respectively. Company reports estimate that in 2014 Petrobras will produce 3 million barrels of oil per day and 623,000 barrels of oil equivalent (boe) in natural gas.

Petrobras's investment is enormous. Its 2010-2014 Business Plan calls for an investment of \$224 billion (some \$45 billion per year), more than five times the investment level of PDVSA, according to independent estimates.

Petrobras's efficiency compares exceedingly well to oil companies of similar size, although accurate comparisons are difficult as most similar sized national oil companies (NOCs) —the majority in the Persian Gulf—do not provide audited figures. Industry analysts believe that Petrobras vastly outperforms all of them. Petrobras also ranks exceptionally high when compared with the supermajors.

Statists vs. Free Enterprisers

The history of Petrobras is rife with tension, largely between those who wanted a fully state-owned enterprise ("statists") and those who envisioned Petrobras as a private company ("free enterprisers"). The Brazilian government cemented Petrobras's status as a state institution with several laws between the 1940s and 1960s, and the Federal Constitution of 1988, which enacted a state monopoly over all aspects of the hydrocarbons industry, put Petrobras firmly in state hands.

After several unsuccessful attempts in the early 1990s, reform proponents finally had some success under the presidency of Fernando Henrique Cardoso. A 1995 Constitutional amendment authorized the federal government "to outsource oil and gas activities

under state monopoly to private or government-owned companies."

Two years later, Congress set a new industry framework segregating Petrobras's business and regulatory roles. Petrobras kept the former while the latter was transferred to a new National Petroleum Agency (ANP), effective in January 1998. The interaction between Petrobras and the ANP is among the keys to understanding the success of Brazil's oil policy.

The ANP's ample powers include the awarding of exploration and production bids for oil, natural gas and other liquid fuel concessions; approving the import, export and transportation of natural gas, oil and its derivatives; and playing a regulatory, oversight and dispute-settlement role in substantive cases. While maintaining a state monopoly on oil and gas, Brazil grants exploration and production concessions to Petrobras, private companies and joint efforts. In January 2002, the country also deregulated imports, exports and prices.

A Very Special Government Corporation

The recurring conflict between statists and free enterprisers, which has never been fully resolved, is fundamental to understanding how Petrobras became a sui generis national oil company. Petrobras has dual status as a government corporation with a crucial role in Brazilian growth and as a dividend-paying private company.

Private involvement in Petrobras would not have been possible without a legal framework guaranteeing government control. Brazil shares with many other countries a nationalistic concern about oil resources, especially with regard to selling into foreign hands. Rather than risk denationalization

of the industry, Law 9478 of 1997 ensured that private shareholders had practically no non-economic rights, especially over management function, by separating stock into voting common shares and non-voting preferred shares. It also required state ownership of 50%-plus-one of voting shares. A complementary 1999 law extended the possibility of stock ownership to foreign companies and individuals. Foreign-owned stock now exceeds the share in private Brazilian hands.

State Business

A nine-member board of directors heads Petrobras. Seven members are government-appointed, one represents non-government minority common shareholders, and another is elected by preferred shareholders. The board is made up of cabinet-level officials (President Dilma Rousseff was previously a member), former military officials and academics, all with close or direct ruling party ties. One responsibility of the CEO is to propose a slate of six general managers for board approval or rejection. Along with the CEO, these general managers make up the executive board that runs the company. All board members except the CEO have had at least 30 years of experience in Petrobras.

Petrobras works closely with Congress and the administration. State oversight is exercised through legislative approval of multi-year plans that establish general company goals and budgetary and investment guidelines. The plan helps entrench in law a medium-term budget timeframe free from Finance Ministry fiat. Petrobras operational, economic and government policy are harmonized through executive approval of a Global Expense Program.



Oil drilling platform off the coast of Brazil.

Private Investment and Oversight

Private ownership in Petrobras has expanded dramatically in the last decade. The number of shareholders grew by 153,000 between 2000 and 2008, and today one million individuals hold shares in Petrobras-related securities.

Privatization proponents often claim that companies are more efficient and profitable in private hands. Petrobras has performed outstandingly in state hands while keeping the private sector in the role of a mere investor. Placing stock in private hands, however, had a fundamental effect on efficiency. It made Petrobras subject to the same oversight standards that apply to private multinationals, including the Sarbanes-Oxley Act, with audits and oversight conducted by a securities commission. The presence of private shareholders also serves as a check on government attempts to milk NOCs for cash.

Opportunities and Challenges in Pre-Salt

When the pre-salt oil reserves—estimated to contain 50 billion boe—were discovered off Brazil's southeast coast in 2006 and 2007, the Lula administration quickly moved to bring the oil under more direct state control. The government passed four laws in 2010 that effectively limit foreign participation and guarantee Petrobras a majority hand in production.

The first law created a new, state-owned company, Pré-Sal Petróleo S.A. (PPSA), to manage pre-salt production sharing contracts entered into by the Ministry of Mines and Energy. The second authorized the government to cede Petrobras exploration and production rights to the equivalent of 5 billion boe in the pre-salt in exchange for a company share package whose value is set by law. The third made Petrobras the

sole operator of pre-salt projects and gave it a 30% minimum stake in each. Finally, the fourth law created a social fund that will invest pre-salt profits in education, anti-poverty initiatives, the environment, science and technology.

This legislation—especially Petrobras's required operatorship in each project—presents an enormous opportunity to increase production levels over the next decade, but it also demands of Petrobras a high level of capitalization, skilled labor and management, technical expertise and efficiency. While Petrobras is widely considered to be capable and experienced enough to tackle the pre-salt, the amount of new production projects coming online will test the company's human resource capacity and could undermine the sound management and organization that have brought it success up to this point. Critics of greater state control over the pre-salt are also concerned about the loss of competition and resulting inefficiencies that may arise.

These obstacles notwithstanding, Petrobras is well positioned to take on the pre-salt projects. Its investment is on the rise, and capital inflows are increasing from foreign and domestic sources. The technical challenges are surmountable and will give the company greater experience in ultra-deepwater fields, cementing its position as the most successful and experienced deepwater driller. Brazil is already self-sufficient in oil production and consumption. When all of the pre-salt projects come online—probably around 2020—Petrobras should become a major oil exporter. ■

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