The Characteristics of China's 3 Major State-Run Enterprises

Sizhi Guo (ShiShi Kaku)

Introduction

Because of the rapid increase in the demand for oil brought about by China's advanced economic growth, the country has become the world's second largest petroleum consumer after the United States, and China's state-run petroleum companies, which are responsible for China's oil production and supply, continue to be the focus of attention.

The major Chinese petroleum companies CNPC (China National Petroleum Corporation), Sinopec (China Petroleum and Chemical Corporation), and China National Offshore Oil Corporation (CNOOC) continue to develop as new and important players in the international petroleum and energy market. According to Fortune magazine's 2009 business rankings, CNPC and Sinopec's turnovers were 8th and 7th in the list of the world's major petroleum enterprises, and their net profits were 8th and 12th, respectively. The three state-run oil companies continue to develop as new players in the international petroleum and energy market, and are currently attracting a substantial amount of attention.

Therefore, in order to further recognize and understand the three major Chinese state-run petroleum companies, this article considers the background behind their formation, their characteristics, and their relationship with government.¹

1. Changes in organization and function of China’s petroleum companies

1.1. Background behind the formation of China’s 3 major petroleum companies

Between the 1950s and early 1970s, the organization of the oil industry in China was the responsibility of each of the oil refineries and oil field administration bureaus under the immediate control of the government's Petroleum Industry Department. For example, the Daqing, Liaohe, Dagang, Shengli, Yumen and Jianghan oilfield administration bureaus, and the nearby Daqing, Jinzhou, Lanzhou and Tsinan oil refineries were responsible for organizing each of the oilfields’ exploration, development, oil refining and processing. This production system was mainly under the Petroleum Industry Department's administration, which gathered oil-related technology, human resources, funds, equipment,

¹ In particular, due to restriction of information and data regarding the relationship with the government, the research is in its preliminary stage, with further investigations scheduled to be carried out next business year.
etc. from around the country, and through the “petroleum wars (sheer force of numbers)” developed the Daqing, Liaohoe, Dagang and other oilfields, etc. The production system during this period played an active role towards more concentrated management and production resource arrangements, having to deal with insufficient technology, human resources, funds, etc.

Between the early 1980s and 1998, a background of “reform and openness,” oil and gas production systems and management by the oilfields' administration bureaus and oil refineries under the direct control of the Petroleum Industry Department was separated into government and administration, and enterprises, and shifted to a petroleum company (corporation) production system. In 1983, as part of the petroleum industry's government function reforms, the Petroleum Industry Department was separated into Offshore Oil Administration/Production sections (Bohai Sea, East China Sea, and South China Sea oil administration bureaus), and the China National Offshore Oil Corporation (CNOOC) was established. The offshore oil and gas production system was then formed through the Bohai Sea, East China Sea and South China Sea branches established under this.

In addition, in 1988 the Petroleum Industry Department was restructured and renamed the China National Petroleum Corporation (hereafter CNPC), retaining control of the land-based oil production system. In short, the China National Petroleum Corporation (old CNPC) and China Petroleum and Chemical Corporation (old Sinopec) were established to carry out oil exploration and development. The China National Petroleum Corporation was responsible for the oil exploration and development, while the downstream petroleum and petrochemical production and marketing was the responsibility of the China Petroleum and Chemical Corporation. The upstream and downstream functions of the oil industry were split, and under this production system the corporations kept part of the administrative functions of the conventional Petroleum Industry Department, but to some extent the enterprises' autonomous management rights were expanded.

Furthermore, in March 1998, the assets of CNPC, whose operations centered on land-based oil field development, and China Petroleum and Chemical Corporation (Sinopec), whose business centered on oil refining and petrochemical marketing, were redistributed and each were reorganized into vertically integrated enterprises with their responsibilities shifted from exploration and development to refining and marketing.

In this way the new CNPC (China National Petroleum Corporation) and Sinopec (China Petroleum and Chemical Corporation) were born. Subsequently in February and April 2000 both these group companies became holding companies, and under them the limited companies PetroChina Co., Ltd. and Sinopec Corp. were established, and became responsible for the actual production and operations. PetroChina is responsible for exploration and development of oilfields in the northern and western regions, and Sinopec Corp. is mainly responsible for the exploration and development in the eastern and central regions.

2 For example, in order to activate production and improve efficiency of exploration and development, each of the CNPC production sections and oil field companies have begun to implement a production contract system (according to having investigation locally).
Meanwhile, in February 2001, China National Offshore Oil Corporation (CNOOC) established CNOOC Ltd., which is responsible for offshore oil and gas exploration and development. These 3 major petroleum companies' production systems simplify the multi-strata production and administration organization level in the past organization's upstream section and form a “CNOOC Ltd. → mining area → operating well” production organization in an attempt to improve the efficiency of management and production.

In addition, since the latter half of 2004, CNPC and Sinopec have acquired offshore exploration and development rights, and CNOOC have been given land-based exploration and development rights. With this background, it is cited that China's government introduced land-based/offshore competitive mechanisms in order to strengthen its domestic exploration and development. As stated above, between 1998 and 2004, China's new petroleum industry organization changed and the 3 major oil companies' organization and functions were reformed (Figure 1).

**Figure 1. The transition in the organization and function of China's 3 major petroleum companies**

<table>
<thead>
<tr>
<th>Until 1998</th>
<th>1998 up and downstream vertical integration</th>
<th>Since 1999 Limited companies listed on foreign stock market</th>
<th>Since 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNPC</td>
<td>CNPC China National Oil Corporation</td>
<td>CNPC PetroChina</td>
<td>CNPC PetroChina</td>
</tr>
<tr>
<td>Sinopec</td>
<td>Sinopec China Petroleum and Chemical Corporation</td>
<td>Sinopec Corp. China Petroleum and Chemical Corporation (Sinopec's production/operating company)</td>
<td>Sinopec Corp.</td>
</tr>
<tr>
<td>CNOOC</td>
<td>CNOOC China National Offshore Oil Corporation</td>
<td>CNOOC Ltd. (CNOOC's production/operating subsidiary)</td>
<td>CNOOC Ltd.</td>
</tr>
</tbody>
</table>

Source: Prepared by author from various data

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Furthermore, the National Land Resource Department’s (former Geological Mining Department) parent organization China National Star Petroleum Corp. (CNSPC) in March 2001 transferred the rights and interests of its East China Sea natural gas development to Sinopec Corp. In the end it was absorbed and merged.
1.2. Reorganization and reform of state-run enterprises

1.2.1. Background and purpose of reorganization and reform

In March 1983, due to the globalization of the economy and the conversion to a market economy system, the two state-run petroleum companies, CNPC and Sinopec underwent comprehensive reorganization under the leadership of the Chinese government. Initially, as part of the first stage, the assets of CNPC, which until then had concentrated its operations on land-based oilfield development, and Sinopec, whose business focused on oil refining and petrochemicals, were redistributed and each were reorganized into two main vertically-integrated groups, shifting their responsibilities from exploration and development to refining and marketing. In this way the new CNPC (China National Petroleum Corporation) and Sinopec (China Petroleum and Chemical Corporation) were born.

The main background and purpose of this reorganization is as detailed below. Namely, firstly, to separate the functions of the government and enterprises and break down the traditional upstream/downstream monopolies or split system by establishing multi-enterprise competition; Secondly, to promote activity within the petroleum industry by the introduction of market principles/mechanisms. And thirdly, to establish comprehensive petroleum enterprises like the major internationals in order to increase global competitiveness, etc.

1.2.2. Transitions in petroleum industry organization and functions as a result of the reorganization/reforms

As a result of the business reorganization and reforms, the traditional government functions possessed by CNPC and Sinopec changed to autonomous management and self-support. As far as the security of China's oil supply was concerned, these state-run enterprises continued to maintain an important position, but the pre-1998 “public corporation” system that mixed government functions and business functions, like the ones of the old CNPC and the old Sinopec, ceased to exist. Under the new oil industry structure, direct participation in management activities by means of government orders/administrative directives, etc., became impossible. Under state laws and policies related to the oil industry, the oil industry's government administration could supervise/guide the oil industry and business activities. As a result of the intensified and simplified organizational structure as mentioned above, the function of the oil industry's administrative system is mainly to guide/supervise the direction of the industry's management/production activities through laws and policies.7

1.2.3. Separation of government and enterprises

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4 In July 2004, PetroChina received its first offshore exploration/development license from China’s National Land Resource Department, with regards to the exploration and development in the South China Sea (DOWJONES China Energy, July 9, 2004).
5 For details, please refer to p.15 of Guo Sizhi’s “China Oil Industry’s Administrative System” (Published on the Institute of Energy Economics, Japan’s website in Jan. 2004).
6 CNOOC has recently made inroads into oil refinery construction, as well as into the fields of LNG supply and petroleum-product marketing, and is actively accelerating the construction of the vertically integrated enterprise’s continuous upstream and downstream operations to strengthen its structure in order to compete with the two major CNPC and Sinopec petroleum companies.
As a result of the business reorganization and reforms, the traditional government functions possessed by CNPC and Sinopec changed to autonomous management and self-support. The management and production systems of “unified government and enterprises” in the traditional oil sphere, ceased to exist. Under the new oil industry structure, direct participation in management activities by means of government orders/administrative directives, etc., became impossible. In addition, as a result of government structural reforms and the slimming down/improved efficiency of oil industry-related administrative structures, the government, via laws and policies, were able to establish industry plans, development policies, strategies and technical standards, and supervise and guide the industry's activities. Consequently, even though at the time they were under macro policy control, CNPC and Sinopec, as corporate bodies, were able to participate independently in management/production activities, more efficiently than before.

1.2.4. Formation of a vertically integrated structure aiming for competitiveness and economies of scale

In 1998, through the redistribution of assets, the two major vertically-integrated corporate groups, the CNPC and Sinopec groups were established from the hitherto upper/lower-related horizontally divided system, and China's oil industry inherited a new industrial structure. CNPC focused on the development of oil and natural gas, while at the same time also carrying out work in downstream fields such as refinery and marketing. Sinopec not only specialized in oil’s downstream branches, but also carried out upstream tasks such as exploration and development of oil and natural gas. The two new major groups born from the reorganization and reforms continue to experience inter-enterprise competition, while aiming to improve international competitiveness, and realize economies of scale by intensification and expansion of the oil industry.

1.2.5. Slimming-down/improved efficiency of management/production organization

Since 2000, as a result of the reorganization and reforms, China's oil companies have been attempting the “separation of main businesses and auxiliary businesses,” namely, cutting of non-profitable sections from profitable sections and creating limited companies in a bid to improve the efficiency of management and production. In the case of CNPC, as of April 2000, approximately 480,000 of its 1.5 million employees were transferred to PetroChina. In addition, as part of the reorganization,

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8 According to an interview at the CNPC Information Center in April 2003
after its listing on the stock market in 2000, PetroChina made a total of 55,000 employees redundant by releasing approximately 38,400 in 2000 and a further 16,600 in 2001 in cost-cutting reorganizations.

Apart from this, in 2002 CNPC simplified the operational strata of the multilayered production/management of its upper sections to form an “oil field corporation → mining area → operating well” production organization. Furthermore, in carrying out the above “separation of main businesses and auxiliary businesses” reorganization/reforms, in 2004, CNPC also transferred the group's non-profitable auxiliary business sections, such as schools, police structures, hospitals, etc., to the local regional governments. For example, with regards to the transfer of CNPC's Daqing Oil Administration Bureau's schools and hospitals, talks were held towards and agreement with the local Daqing government from the latter half of 2004, and the transfers were almost completed before the end of the year.

In the refining sections too, reforms were promoted and the intermediate “department” strata were merged with the production posts, etc. Furthermore, reforms and reorganization of the marketing system have also been carried out recently. The hitherto headquarters → regional marketing company → provincial marketing company → city marketing company → prefectural marketing company system was simplified and the prefectural-level company abolished.

Sinopec too, prompted by the reorganization of the two major groups in 1998, separated profitable and non-profitable sections, established a limited company, and adjusted recruitment to increase business efficiency. Up to 2001 the company released approximately 213,700 employees. In fact up to 18% of the total workforce were made redundant. In addition, in 2002 the dispersed exploration/development business was reorganized into the Western, Southern and Shanghai offshore oil and gas companies and the intermediate strata of the refining and marketing systems were slimmed down in a bid to improve production/management efficiency. Furthermore, in 2004 Sinopec further reduced its administrative workforce by 18%, and compared to 2003 the number of employees decreased by 9.4% to 775,000. At the end of 2004, elementary and junior high schools and police structures belonging to Sinopec were transferred to local governments, business and non-business sections within Sinopec were separated and the organization was slimmed down even further.

After listing its subsidiary (CNOOC Ltd.) on the stock market in February 2001, in 2002 CNOOC further simplified its production organization by reorganizing the ten specialist companies under its jurisdiction into two companies and listing them on domestic and overseas stock markets. As an example, in five of CNOOC’s mining areas the production and distribution/management duties were united, making practical use of employees made redundant from the headquarters, and increasing profits.

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10 However, from the point of view of the stability of the state and the business, recruitment balance was achieved through the release of employees and in-house transfers. Incidentally, the number of employees released and transferred within the company in 2002 was 11,000.
11 In 2002, the 5 mining areas realized profits of 53.56 million yuan (International Petroleum Magazine” April 2003 edition)
1.3 Listing on overseas stock markets

1.3.1 Listing on the stock markets

Under the reforms/reorganization, China's 3 major oil companies CNPC, Sinopec and CNOOC aligned with the government's direction towards increased structural reforms and listings on overseas markets, and as of the spring of 2000, listed themselves one-by-one on international stock markets (see Table 1). The situation, particularly fund procurement and trading situations, regarding the listings of the three companies and their subsidiaries on the Hong Kong and New York stock markets are shown in Table 1.

### Table 1 Outline of the three oil companies' stock market listings

<table>
<thead>
<tr>
<th>Parent company</th>
<th>CNPC</th>
<th>Sinopec</th>
<th>CNOOC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed company</td>
<td>PetroChina</td>
<td>Sinopec Corp</td>
<td>CNOOC Ltd</td>
</tr>
<tr>
<td>Date of listing</td>
<td>April 2000</td>
<td>October 2000</td>
<td>February 2001</td>
</tr>
<tr>
<td>Number of shares issued</td>
<td>175.58 billion (10% of total)</td>
<td>1,803.85 billion (20% of total)</td>
<td>1.64 billion (27.5% of total)</td>
</tr>
<tr>
<td>Funds supplied</td>
<td>2.89 billion dollars</td>
<td>3.73 billion dollars</td>
<td>1.26 billion dollars</td>
</tr>
<tr>
<td>ADS price</td>
<td>16.44 dollars</td>
<td>20.645 dollars</td>
<td>15.4 dollars</td>
</tr>
<tr>
<td>Listed stock exchange</td>
<td>Hong Kong, New York</td>
<td>Hong Kong, New York, London</td>
<td>Hong Kong, New York, London</td>
</tr>
<tr>
<td>Percentage of shares held by parent company and others</td>
<td>90%</td>
<td>Sinopec 53% Bank of China 27%</td>
<td>67.5%</td>
</tr>
<tr>
<td>Investing companies</td>
<td>ExxonMobil</td>
<td>-</td>
<td>1 billion dollars (approx. 20% of IPO)</td>
</tr>
<tr>
<td></td>
<td>BP</td>
<td>0.62 billion dollars (approx. 20% of IPO)</td>
<td>0.43 billion dollars (14% of IPO)</td>
</tr>
<tr>
<td></td>
<td>Shell</td>
<td>-</td>
<td>0.43 billion dollars (14% of IPO)</td>
</tr>
<tr>
<td></td>
<td>Hong Kong organizations, etc.</td>
<td>0.35 billion dollars (approx. 11% of IPO)</td>
<td>0.2 billion dollars (approx. 5.3% of IPO)</td>
</tr>
</tbody>
</table>


In November 1999, prompted by the aforementioned group reorganization, CNPC established PetroChina in order to make its profitable sections independent. Then, in April 2000, listed PetroChina on the Hong Kong and New York stock markets.

In February 2000, Sinopec severed its non-profitable sections from its profitable sections with superior assets, created a limited company, -Sinopec Corp. -and in October of the same year listed the company on the Hong Kong, New York and London stock markets, raising 3.462 billion dollars' worth of funds. The shares were distributed so that the state owned 23.1%, state-run corporations (parent company) owned 56.9%, and other parties owned the remaining 20%.

In October 1999 the offshore oilfield exploration and development specialists CNOOC
established China National Offshore Oil Corporation Ltd. (CNOOC Ltd.), and in February 2001, followed PetroChina and Sinopec Corp.'s above listing by being listed on the Hong Kong and London stock markets. In this way, China's petroleum companies raised funds from the international capital market, strengthened measures regarding intensive fields of growth, implemented effective investment and investment expansion, and realized strategic foreign-capital alliances, including those with major corporations.

The transitions in the petroleum administration system were promoted by the reform/liberalization of China's petroleum market. Starting in the beginning of 2000, one by one the state-run petroleum companies were listed on international stock markets. In this way they were able to raise funds from the international capital market, strengthened measures concerning intensive fields of growth, implement effective investment and investment expansion, and realize strategic foreign-capital alliances, including those with the majors. These actions have a positive influence on the petroleum industry's management and production systems.

Through IPOs, the three companies – including CNPC (PetroChina) – raised vast funds totaling over 7.8 billion dollars. Almost all of this was large-scale financing by the majors. What's more, through the financing of IPOs, strategic tie-ups with major corporations are steadily leading to various projects.

For example, in upstream exploration/development sections, CNOOC tied up with IPO-financing company Shell, and by making use of those funds and technology/management knowhow, are developing their upstream exploration/development activities.

In refining sections, through their tie-up with ExxonMobil, one of the strategic alliances concluded at the time of IPO acquisition, Sinopec made use of its partner's technology and funds to plan oil refinery expansions in Guangdong, in order to reinforce the treatment of the rapidly increasing import of sour crude oil from the Middle East. In addition, CNOOC tied-up with Shell, and through petrochemical projects, etc., used its partner's economic resources to begin making advancements into...
downstream fields.

In the marketing sections, too, as part of the deregulations/liberalization of petroleum markets due to the transitions in the petroleum administration system, China's petroleum companies are also progressing with strategic tie-ups with the aim of introducing new funding, branding and marketing knowhow, etc. In April 2001, PetroChina jointly established a petroleum-product marketing company with BP, which also financed Petro China's IPO. They are collaborating in the area of gasoline stations, too. As of 2002, Sinopec had already installed and was operating 45 gasoline stations jointly with BP in the Zhejiang Province. In the future, in cooperation with BP, Sinopec is scheduled to establish and operate 500 gasoline stations in the same province, by the end of 2007. Also CNOOC has tied-up with Shell, and through petrochemical project construction, etc., is utilizing its partner's economic resources to begin making advancements into downstream fields.

Since China's three major petroleum companies were listed on overseas stock markets, they have continued to remain highly acclaimed in the international market.

Let’s take a look at the case of the New York stock market\(^\text{15}\). The 3 petroleum companies' stock prices as of September 2003 had doubled since they were first listed on the New York stock market in 2001. The stocks of PetroChina, Sinopec and CNOOC Ltd. rose 88.2% to $33.55; 103.4% to $27.38; and 78.1% to $34.37, respectively.

Concerning the earnings of the listed petroleum companies since being listed, the earnings of PetroChina, Sinopec Corp and CNOOC Ltd. have generally increased. The net profits per share of China's three major stock market-listed petroleum companies are increasing substantially (Table 2).

PetroChina rose from 0.17 yuan/share in 1999 to 0.32 in 2000, and furthermore to 0.40 yuan/share in 2003 and 2004, rising significantly to reach 0.59 yuan/share by 2004, approximately 3.4 times those of 1999.

In addition, Sinopec Corp also rose from 0.07 yuan/share in 1999 to 0.23 in 2000, and further to 0.26 in 2003 and 2004, before rising significantly to reach 0.42 yuan/share by 2004, nearly six times those of 1999.

| Table 2 Earnings of the stocks of China's three major petroleum companies |
|------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Company / Year   | 1999   | 2000   | 2001   | 2002   | 2003   | 2004   | 2005   | 2006   |
| PetroChina       | 0.17   | 0.32   | 0.26   | 0.27   | 0.40   | 0.59   | –      | –      |
| Sinopec Corp     | 0.07   | 0.23   | 0.18   | 0.19   | 0.26   | 0.42   | –      | –      |
| CNOOC Ltd        | –      | –      | 1.00   | 1.12   | 0.40   | 0.39   | 0.62   | 0.73   |
|                  |        |        |        |        |        |        |        |        |
|                  |        |        |        |        |        |        |        |        |
| Source: Prepared from the China National Development Reform Committee's Economic Operation Bureau “Chinese Oil and Petrochemical Industry's Annual Economic Report” 2009. Despite slight decreases in the net profits per share of the 2 companies in 2001 and 2002, they still increased by 52.9%, and 58.8% and 157.1% and 171.4% more than when they were first listed. |

\(^\text{15}\) Refer to p.117 of Yokoi Yoichi’s aforementioned thesis
Furthermore, the net profits of CNOOC Ltd. in 2002 increased to 1.124 yuan/share, a 12.4% increase compared to that of the time they were first listed in 2001. In addition, in recent years, as shown in Table 3, the total market share prices of the three major petroleum companies each rose from $31.124 billion, $31.443 billion and $7.742 billion in 2002 to $93.17 billion, $48.663 billion and $22.108 billion in 2004, respective.

Table 3 Total market share price of the 3 major petroleum companies

<table>
<thead>
<tr>
<th></th>
<th>2001 ($ billion)</th>
<th>2004 ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PetroChina</td>
<td>31.124</td>
<td>93.187</td>
</tr>
<tr>
<td>Sinopec Corp</td>
<td>31.443</td>
<td>48.663</td>
</tr>
<tr>
<td>CNOOC Ltd</td>
<td>7.742</td>
<td>22.108</td>
</tr>
</tbody>
</table>


Figure 2 Transition of China’s 3 major petroleum companies’ stock prices on the New York stock exchange (1999-2005)

Incidentally, the three major petroleum companies’ stock prices on the Hong Kong stock exchange have continued to rise since their listing in 2000. The stock prices of PetroChina and Sinopec Corp at the end of 2002 were HK$1.57 and HK$1.31, respectively, 13.44% and 22.43% more than the same period in the previous year, and in particular, CNOOC’s stocks rose drastically by 42.18% to HK$10.45 (compared to same period in previous year)*. In addition, as shown in Fig.2, the 3 companies’ stock prices have continued to rise since they were listed on the New York stock exchange. The stock prices of PetroChina, Sinopec Corp and CNOOC Ltd., which are the stock market-listed companies of the 3 major petroleum corporations, each rose from their respective values of $16.56/share, $15.25/share and $19.15/
share at the time of listing (April 2000, October 2000 and February 2001, respectively) to $81.08/share, $45.03/share and $69.3/share in 2005 (December 1st).

Above all, 2005 stock prices were influenced by the high crude oil prices, especially those with superior upstream assets like PetroChina and CNOOC Ltd., in December 2005 were approximately 145% and 130% higher than those in January of the same year (see Fig. 3). The fact that the price of CNOOC Ltd. and PetroChina's stocks rose to above $80 and $70 per share, respectively, as a result of soaring crude oil prices during the development of their respective purchase activities with Unocal and in Canada and Kazakhstan (in July, August), drew particular attention.

In this way, since their listing on the stock markets, the three major petroleum companies attracted vast international capital, steadily increased their stock prices, and increased stock profits.

The principal factor for this can be considered to be not only the good domestic management/production achievements attained by the three major petroleum companies under the high international crude oil prices of recent years and the background of China's firm economic growth, but also the fact that earnings increased as a result of active overseas advancement and independent development/interest purchase activities, and the confidence and high levels of attention received from overseas stock markets. Thus, the three companies acquired abundant funds to increase the momentum of overseas investment and purchasing.

**Figure 3  Transition of China’s 3 major petroleum companies’ stock prices on the New York Stock Exchange**

![Graph showing stock prices of China's major petroleum companies on the New York Stock Exchange]

Source: Same as Figure 2
1.3.2 Effects/significance of stock market listing

China's three major petroleum companies created a number of subsidiary limited companies and listed them on domestic and overseas stock markets with the aim of establishing "contemporary enterprise management systems," and the subsequent effect and significance were great.

Firstly, it brought about fundraising effects and changes in the procurement structure.

Until the end of the '70s, the distribution of the central government's finances had been CNPC's principal source of fundraising, but since the 1980s, due to the expanding "reforms/openness," those procurement plans changed to borrowing from domestic banks. Then, the capital gains acquired from direct financing after the listing on overseas stock markets in 2000 contributed to a reduction in domestic borrowing – which in the 1990s had a high interest rate – and the amount of 3.1 billion dollars raised from overseas stock markets was 21% greater than the amount of CNPC's facility investment (for example, 2.57 billion dollars in 1996). In addition, a fundraising structure based on business-profit-based self-funding and “direct financing” on the stock market, developed.

In the case of Sinopec, not only was it listed on overseas stock markets in October 2000, but from as early as the latter half of the 1990s its 16 affiliated companies, including Shanghai Petrochemical Co., Ltd. and Beijing Yanhua Petrochemical Co., Ltd. were actively reorganized into limited companies from their state-owned parent organizations and enterprises, and listed on the domestic stock market (Shenzhen and Shanghai stock exchanges). The total assets of the 16 companies listed on the stock market since 1998 make up 19.3% of the assets of the parent companies (corporations). The method of direct financing from being listed on overseas stock markets enabled the acquisition of 23 billion yuan's (2.8 billion dollars) worth of capital gains. Through these stock market listings, Sinopec's fundraising structure transferred from the method of borrowing from domestic financial institutions to a diversified fundraising structure of financial institution loans, stock market fundraising and self-financing.

CNOOC also changed its fundraising structure. From the early 1980s, the company had been actively utilizing overseas funds through the international bidding for offshore oilfield development and introduction of foreign capital. Since 2000, fundraising targets of 2 billion dollars have been achieved through listing on the international stock market, and by further diversifying its fundraising structure the company has greatly increased its fundraising ability as an international petroleum enterprise.

Secondly, business/enterprise reforms took place and business profits increased. After splitting from their parent corporations and becoming limited companies, PetroChina, Sinopec Corp and CNOOC Ltd. increased their profits, greatly, compared to the years before they were listed on the stock market. CNOOC's total profits in 2002 were 11.65 billion yuan, 18.1% more than in 2000, and furthermore, compared with 1999, Sinopec and CNOOC increased their profits by 128% to 17.6 billion yuan and by 206% to 53.6 billion yuan, respectively. Of this, in 2002, the profits of PetroChina were 46.9 billion yuan – 87.5% of those of the whole CNPC group; the profits of Sinopec Corp were 14.12 billion yuan – 79% of those of the whole Sinopec group; and the profits of CNOOC Ltd. were 9.233 yuan – 62.6% of those of the whole CNOOC group. The main causes of this, other than the distribution of blue-chip assets (profitable production sections) from parent companies, are as listed below: namely, 1.) The rationalization of the production organizations through reductions in surplus manpower* improved
business/production efficiency. 2.) Accurate responses to competition on the international market were made as a result of pressure from investors and international practices and rules, including information disclosure systems17 and international accounting standards18, etc. which brought about international refinement of business management, and links with international markets and business systems. “learning effects” in domestic and overseas markets were brought about, and as a result of tie-ups with foreign enterprises, partners’ business resources were acquired and utilized. As a result of being listed on international stock markets, funds were raised from the international capital market, measures regarding intensive fields of growth were strengthened, effective as well as expanded investment was implemented, and strategic foreign-capital tie-ups, including those with the majors, were attempted.

The tie-ups with IPO-participating foreign petroleum enterprises, which accompanied the stock market listing of the three major petroleum companies, brought about the construction of strategic alliances in terms of funds/technology and management/production in their own company’s fields of intensive growth, as well as promotion of technological transfers and the strengthening of their own management constitutions.

Until this point we have considered the background to the organization changes, the reorganization and the overseas stock market listing of the three major petroleum companies. Based on this, we will now analyze the characteristics of each of the three companies from the perspective of the present scope of the organizations’ management, scale of production, and advancement overseas.

2. Characteristics of the three major petroleum companies

2.1. Organizations’ management scope

2.1.1 CNPC

(1) Organization’s management/production scope

① CNPC is composed of upstream oilfields/oil administration bureaus, downstream refineries/petrochemical companies, transportation/marketing enterprises and gasoline stations, etc.

② Production and business, including oilfields and oil refineries, petrochemical companies, etc. are located in the northeast and western regions, as well as the southwest (Sichuan Province).

③ Twelve oilfields, including the Xinin oil and gas fields, as well as those in Daqing, Liaohe, Changqin, Xinjiang, the Tarim Basin, Yanchang, Yumen, Sichuan and Turfan in the northeast, northwest and western regions


16 In 2002, Sinopec and CNPC reduced/transferred 11,000 and 17,000 employees, respectively (“Chinese Oil and Petrochemical Industry’s Annual Economic Report 2003” p. 264; “CNPC Yearbook 2002” p.258)

17 Concerning the information disclosure, companies are obliged to produce and publicize summaries of four reports - the company’s intermediate reports, quarterly reports, annual reports and extraordinary reports.

18 In the case of being listed on overseas stock markets, it is required that financial guidelines be drawn up based on international accounting standards (IAS) or the accounting standards of the partner country in question.
Ltd., Yumen Oil Refinery, Yanchang Oil Refinery, Changqing Oil Refinery, Dushanzi Oil Refinery, etc., located in the northeast, northwest and central regions.

⑤ Oil and gas pipeline bureaus, which are businesses belonging to CNPC; petroleum process construction and installation companies; petroleum machinery manufacturing companies; technological, engineering and service enterprises; petroleum universities; petroleum planning and design institutes, exploration and development design institutes, etc.

⑥ Sinochem, which is responsible for petroleum export and import trading, and affiliate company ChinaOil

(2) Assets, management/production scale

CNPC’s total assets are worth 1,599 billion yuan (Table 4), of which the majority are upstream assets, holding the main positions.

① Upstream. As of the end of 2007, the proved reserves of crude oil and natural gas were 1.95 billion tons and 2.2 trillion cubic meters, respectively, and 2007’s new proved reserves were 0.12 billion tons and 80 billion cubic meters, and the crude oil production quantity was 108 million tons. At present, CNPC’s crude oil and natural gas production quantities are approximately 2.16 million B/D and 54.3 billion cubic meters. CNPC has 13 oilfields in China’s northeast, northwest, northern and Xinin (Sichuan Province) regions, etc. The area of registered gas and oil fields is 1,050,000 square km, which makes up 83% of the country’s total.

② Downstream. CNPC has oil refineries in 29 locations, including Fushun, Lanzhou, Daqing, Dailian, Quinzhou, Jinxi, etc. Most of these are distributed in the vicinity of oil and gas field regions, and at present has an oil refining capacity of 0.12 billion tons, which represents 38.1% of that of the whole country (total refining capacity of 0.314 billion tons). The annual production/supply quantity of petroleum products (gasoline, kerosene, diesel, paraffin, lubricants, etc.) is over 40% of that of the whole of China. Of this, the production/sales quantity of lubricants is the number one nationwide. In addition, as of the end of 2007, CNPC had a total length of 30,622 km of crude oil/refined products distribution pipelines and natural gas distribution pipelines, including the “West-East Gas Pipeline.” Of this, the natural gas pipelines are 18,995 km, the crude oil pipelines are 9,167 km, and the refined product pipelines are 2,460 km in length.

Table 4 Principal business, production and financial indices of the 3 major state-owned petroleum companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Crude Oil Production (10,000 tons) (% increase over the previous year)</th>
<th>Natural Gas Production (billion m³)</th>
<th>Petroleum Products Production (10,000 tons) (% increase over the previous year)</th>
<th>Assets (billion yuan) (% increase over the previous year)</th>
<th>Sales (billion yuan) (% increase over the previous year)</th>
<th>Net Profits (billion yuan) (% increase over the previous year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNPC</td>
<td>10,765(1)</td>
<td>54.3(23)</td>
<td>11,150(15)</td>
<td>1,599(13)</td>
<td>1,001(15)</td>
<td>114(4)</td>
</tr>
<tr>
<td>Sinopec</td>
<td>4,108(2)</td>
<td>8.0(10)</td>
<td>12,449(14)</td>
<td>996(15)</td>
<td>1,208(15)</td>
<td>32(21)</td>
</tr>
<tr>
<td>CNOOC</td>
<td>2,592(7)</td>
<td>6.4(51)</td>
<td>–</td>
<td>309(23)</td>
<td>162(22)</td>
<td>28(17)</td>
</tr>
</tbody>
</table>

Source: Prepared from the National Development Reform Committee’s “Chinese Oil and Petrochemical Industry’s Annual Economic Report 2008”
Furthermore, in the whole of China there are approximately 22 oil wharfs and 66 berths with a total handling capacity of 309.2 million tons. Of this, the three large-scale crude oil wharfs, Dalian New Port, Quinhuangdao and Yihui, and a total of 15 bases, with a handling capacity of approximately 57 million tons/year. There are also 6 district relay wharfs in Jinzhou, Tianjin, Huangdao, Zhanjiang, etc., with a total of 14 bases and a total handing capacity of approximately 133 million tons/year. In addition, there are 13 loading/unloading wharfs belonging to coastal oil refineries/petrochemical companies, including those in Ningbo Jinhai, Shanghai Petrochemical, Chen Shan, Shanghai Waigaqiao, Fujian Meizhou Bay, Guangzhou Petrochemical Co., Ltd. Maoming Petrochemical Co., Ltd. etc., with a total of 13 bases and a total handling capacity of 119.2 million tons. Of these, the southeast coast mainly features 100,000-250,000 wharfs.

3) Number of employees. As of the end of 2007, CNPC employed 1.087 million workers, of which approximately 300,000 were employed in processing and technology, administration and research and development.

2.1.2 Sinopec

The Sinopec Group (China Petroleum and Chemical Corporation) was born at the same time as CNPC as a result of the reorganization/reforms of the former China Petrochemical Corporation under the instructions of the government.

(1) Organization’s business composition/scope

Sinopec is composed of upstream exploration/development, and downstream refining/petrochemical production and distribution/sales sections.

① Sinopec has 12 oil and gas fields, mainly in the southern and southwestern regions of Changcheng (Guizhou Province, Guang Xi Zhuan Autonomous Region, Yunnan Province).

② Thirty-one oil refineries and petrochemical companies, including the Zhenhai Refining and Chemical Co., in eastern and coastal regions.

③ Of the 30,063 service stations (SS), including those in eastern coastal regions, 26,581 are run independently and 3,482 are franchises.

④ Sinochem, which is responsible for petroleum export and import trading, and affiliate company Unipec.

⑤ Others under Sinopec include service construction/engineering, oil/gas distribution pipelines, research and development/design and planning, university institutions (oil/gas pipeline distribution bureaus, exploration and development design institutes, oil processing companies, construction companies, oil and chemical industry planning and design institutes, petrochemical consulting companies, Beijing Institute of Petrochemical Engineering, petrochemical technology development companies, Beijing Institute of Petrochemical Technology, Sinopec Shanghai Petrochemical Design Institute, Sinopec Fushun Petrochemical Research Institute, etc.)
(2) Management/production scale

Sinopec's total assets are worth 996 billion yuan, of which Sinopec's main role, its refining/petrochemical production center, makes up the majority.

① Upstream. In 2007 the newly proved reserves of crude oil were approximately 2.5 billion tons, newly recoverable reserves of crude oil were 40.5 million tons, and newly proved and newly recoverable reserves of natural gas were 148.6 and 166.5 billion cubic meters, respectively. At present, the quantity of Sinopec's crude oil and natural gas production is 4,108 tons and 8.03 billion cubic meters, respectively, which account for 22.0% and 11.8% of China's total share of production.

② Downstream. In 2007, the quantity of Sinopec's crude oil processing was 166 million tons, which accounted for 59.4% of the two major petroleum groups' total, and the refining capacity of 164.3 million tons/year accounted for 52.2% of China's total refining capacity.

The 29,062 service stations (SS) account for 37% of the country's total number. Retail quantities of 7,662 tons make up 64.2% of the country's total retail quantity. As of the end of 2007, a total of 304,000 km of petroleum product distribution pipelines had been completed. Furthermore, the import of crude oil is 94.06 million tons, and the export of petroleum products is 3.516 million tons.

③ Number of employees

As of the end of 2007, Sinopec employed 775,000 workers, of which approximately 220,000 were employed in processing and technology, administration, and research and development.

2.1.3 CNOOC

(1). Organization's business composition/scope

① CNOOC (China National Offshore Oil Corporation) is composed of the stock-holding company CNOOC Ltd. and technical service-specialists such as China Oilfield Services, Offshore Oil Processing Co., Ltd., China Offshore Ocean Oilfields Service Ltd., as well as CNOOC Gas and Power Ltd. Co. and China Offshore Oil and Petrochemical Trading Co., Ltd.

② Exploration and development takes place in Bohai Sea, East China Sea and the eastern and western regions of the South China Sea. The production/businesses, including oilfields and oil refineries/petrochemical companies, etc. are located in northeastern, western regions and Xinin (Sichuan Province).

③ The LNG import terminal projects, which it is responsible for, are located in 12 locations, including planned/scheduled sites, in Qinhuangdao, Yingkou, Dalian, Qingdao, Tianjin, Shandong, Jiangsu, Shanghai, Ningbo, Fujian, Guangdong Shenzhen, and Guangdong Shantou.

④ Natural gas and electrical generation projects are the responsibility of Hainan Yangpu Power Generation Company, Zhongshan Jiaming Electric Power Co., Ltd., CNOCC Fujian Gas Power Generation Company, Guangdong Huizhou Gas Power Generation Company, CNOCC Zhejiang Ningbo LNG Co., Ltd., under the affiliation of CNOCC Gas and Power Ltd. with the scope of the business region mainly in coastal areas in the Southern China region.

⑤ The natural gas pipeline business is the responsibility of 4 companies, namely Zhejiang Natural Gas Development Co., Ltd., Yantai Zhongshi Gas Company Ltd., CNOCC Pipeline Transportation Co.,
Ltd. and CNOCC Guangdong Natural Gas Co., Ltd., which plan and construct pipelines from north to south in China's coastal regions, connecting the supply zones to the 3 major economic zones, consisting of Bohai Sea - Pan Bohai Sea Economic Zone, East Sea - Changjiang Delta Economic Zone, and the South Sea – Pearl River Delta Economic Zone.

6 Oil refining and petrochemical production are the responsibility of CNOOC and Shell Petrochemicals Co. Ltd., the China National Offshore Oil Corporation/Shell Huizhou Oil Refinery, and CNOCC Oil and Petrochemical Co., Ltd. with petrochemical – including ethylene – production, oil refining and asphalt production mainly located in southern coastal regions, including the Guangdong Bay and Hainan Province.

(2) Assets, management/production scale

CNOOC's total assets are worth 309 billion yuan, with most of the business/assets concentrated in the development of offshore oilfields.

1 Upstream. Proved reserves of crude oil and natural gas, as of the end of 2007, were 0.35 billion oil equivalent tons, with newly proved reserves of crude oil and natural gas in 2007, were 213 million tons, cubic meters, respectively. In addition, the quantity of domestic crude oil produced was 25.92 million tons, and the quantity of natural gas produced was 6.4 billion cubic meters. CNOOC is exploring/developing 24 oil and gas fields. In Bohai Sea, there are 6 oilfields, including Jinzhou 9-3, and 1 gas field; in the East China Sea there are the two, Pinghu and Chunxiao gas fields; and in the South China Sea there are 13 oilfields and 2 gas fields.

2 Downstream. CNOOC and Shell Co., Ltd, with an investment sum of 4.3 billion dollars and an annual petrochemical production of 2.3 million tons, have completed and operated at the end of 2005.

Construction of the China Offshore Oil Corporation/Shell Huizhou Oil Refinery and CNOCC Oil and Petrochemicals Co., Ltd., slated to produce 12 million tons per year, began in 2005 and was completed in the September of 2008.

CNOCC Eastern Chemical Plant Co., Ltd. uses natural gas as a feedstock to produce 1.421 million tons of chemical fertilizer and 600,000 tons of Methanol.

In addition, CNOOC has 3 asphalt production bases in Sichuan Luzhou Aspalt Company Zhejiang Petrochemical Co., Ltd., and Shandong Rizhao Joint Corporation, and the quantity of asphalt production in recent years was 2 million tons, which makes up 30% of the country's total market share. The plan is to increase the asphalt production to over 50% of the country's total market share by 2010. Furthermore, the company's supply/sales of low sulfur fuel oil is approximately 6.1 million tons, which accounts for 8% of the country's total market share.

With regards to oil trading and product marketing, CNOOC joined with Sinopec (capital ratio: CNOOC 60, Sinopec 40) to establish a crude oil import-export trade company, and are importing 3 million tons of crude oil per year (mainly crude oil from CNOOC's overseas interests). The company has also established 500 service stations in the Guangdong Province, and markets products such as gasoline and diesel, etc. from the Huizhou Oil Refinery.
Of the LNG import terminal construction projects being investigated/implemented by China in 21 locations, CNOOC is responsible for 12 projects, and handle 47.2 million tons of imported LNG. The total capacity of CNOOC’s natural gas electricity-generating facilities currently being planned and under construction in the Guangdong and Fujian provinces is slated to be 13,310 MW, of which the capacity of the Guangdong Province and Fujian Province facilities are 12,950 MW and 360 MW, respectively.

2.2 Business and production strategies of the 3 companies

Above, we examined the characteristics of each of the three companies from the perspective of the organizations' business composition/scope as well as their assets, and scale of business/production. The main characteristics of China's three oil companies are as cited below. Firstly, CNPC is predominant in the field of upstream exploration and development, with the main markets/districts of jurisdiction of production and business, such as oilfields, refineries, etc. in northeastern regions and inland areas north of Changcheng.

On the other hand, Sinopec is predominant in the downstream fields of refining and petrochemical production, with markets and refinery, oilfield and business/production jurisdiction areas mainly south of Changcheng in coastal regions such as northern, eastern and southern China, etc.

In addition, the offshore oilfield developer, CNOOC's production/business predominance lies in offshore crude oil and gas producing territories, with the jurisdiction areas of oilfield and business/production in the Bohai Sea and the waters of the East China and South China seas. In recent years LNG projects and oil refining/petrochemical production have been vigorously carried out, with the business and production districts/markets mainly in principal coastal cities such Shanghai, and in the Guangdong and Hainan provinces.

The three companies each possess the predominance of their company's assets and characteristics of their own organization's production/management structures, and have the following strategies.

CNPC, with its predominantly upstream assets, attempts to strengthen oil/gas exploration and development, and at the same time, increase and strengthen its refining facilities and capacities in a bid to overcome the weaknesses of its downstream fields. In recent years, the Guangdong Province under Sinopec's jurisdiction has been planning to establish a joint oil refinery with the Kuwait National Petroleum Corporation, as well as construct a SS(Service Station) network to increase its share in the southern region's market.

On the other hand, in order to overcome its weakness concerning its upstream assets and relatively inferior management resources, Sinopec is making active efforts towards research and development of technology, as well as strengthening its oil and gas exploration/development. Recently, along with carrying out development at its own oilfields, it has tied-up with Petrobras, and is planning to divert efforts into the development of offshore oilfields in the South China Sea, etc. Apart from this, through its predominance in coastal areas, in particular the utilization of its relationships with regional governments in areas under its jurisdiction, and the implementation of LNG projects such as the one in the city of Qingdao in Shangdong Province, Sinopec aims to expand business resources and strengthen itself all around.
In the case of CNOOC, it utilizes the predominance of its existing offshore oilfield exploration/development business resources, and expands its upstream crude oil/gas production, while at the same time carrying out strategies to vigorously advance into the downstream in order to construct a first-class comprehensive oil/energy company – especially recently, with the completion of construction and beginning of operation of a joint petrochemical project with Shell in the Guangdong Province, and the start of construction of a 12-million-ton-capacity refinery. In addition to these it is also using its predominance in offshore distribution by planning and implementing LNG projects in over a dozen coastal regions, and the advancement into natural gas electrical-generation field.

2.3. **Advancements overseas/independent development**

In addition, the important features of China's three major petroleum companies are even appearing in overseas advancement and independent development activities. The three companies' overseas advancements and independent development refer to the foray into upstream sections such as overseas oil investigation and development fields. The three companies are each developing overseas projects like the ones below, in accordance with the characteristics of their business resources.

In 1992, CNPC's (China National Petroleum Corporation) overseas project development in Canada's Alberta North Twing Oil Field opened the door for China's petroleum industry advancements overseas.

Currently, the three major petroleum groups of CNPC, Sinopec and CNOOC are promoting/implementing projects, including oil investigations/development, in regions including Africa, the Middle East, Central Asia, Southeast Asia and Oceania, and North and South America, etc. (Table 5)

China has already invested and acquired exploration/development rights in countries and regions such as Sudan, Indonesia, Malacca, South America, the Gulf of Mexico and Central Asia, etc.

**Table 5 **Overseas and Independent Development by China’s Three Majors

<table>
<thead>
<tr>
<th>Project (cumulative total)</th>
<th>Main Regions</th>
<th>Oil Rights (millions of tons)</th>
<th>Gas rights (millions of m³)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNPC</td>
<td>91</td>
<td>26 countries, including those in regions such as Africa, Middle East, Central Asia, South America, etc.</td>
<td>30</td>
</tr>
<tr>
<td>Sinopec</td>
<td>35</td>
<td>14 countries in Asia, USA, Middle East, etc.</td>
<td>7</td>
</tr>
<tr>
<td>CNOOC</td>
<td>21</td>
<td>5 countries and regions including Asia, Australia, etc.</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Note: ① Project numbers are from data available as of Sept. 2009. ② Joint CNPC and Sinopec projects are included in each of the companies' totals. ③ Oil and gas mining right data are 2009 achievements.

Source: Dow Jones China Energy and materials from the three major petroleum companies.

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19 Major state-owned petroleum/chemical product trading corporation, Sinochem is also making active advancements into upstream areas overseas. In January 2002, Sinochem and PGS agreed and signed a contract to purchase the PGS subsidiary Atlantis. In addition, Sinochem and Sinopec are also planning joint development projects in oil and gas mining areas in Tunisia and around the Arabian Sea.
CNPC utilized its upstream exploration and development superiority, and in 1992, ahead of the other two companies, was able to make advancements overseas. Since the first local production began, a production system with an annual crude oil production capacity of 150,000 tons has been constructed, and although the scale is not relatively large, steady advancements are being made into the fields of overseas oil investigation and development, and a limited number of refining and pipeline projects are also being targeted. In this way, by September 2009, contracts for 91 projects in 26 countries had been signed or implemented, the majority of which were oil investigation/development projects, along with 4 oil refinery and 3 pipeline construction projects.

As of the end of 2007, CNPC had already invested a total of 37.34 billion yuan in the 3 regions of Middle East/Africa, Russia/Central Asia, and South America. In 2001 and 2002 respectively, the company produced 13.5 million and 21.29 million tons of crude oil, and acquired equity crude oil to 5.05 million tons and 10.15 million tons, respectively. Furthermore, in 2003 the same company produced 25 million tons of overseas crude oil and acquired crude oil rights to 12.88 million more tons. In 2004, CNPC's overseas production of crude oil and natural gas increased from the previous year by 20% to 30.11 million tons and by 85% to 3.55 million cubic meters, respectively.

Moreover, according to the February 2009 edition 1 of China OGP and recent East & West Report, as of September of 2009, CNPC has already acquired 30 million tons of equity in overseas crude oil.

Sinopec's overseas and independent development/business activities began in earnest from 2000, much later than those of CNPC. Originally, Sinopec had been established as a specialist in the oil industry's downstream sections, but due to the reintegration/reorganization of the petroleum industry's two groups that occurred in 1998, the unification of the upstream and downstream sections further strengthened the enterprises' constitutions, and Sinopec positioned the globalization of its business/production as an important economic strategy of the enterprise. Beginning in the late 1990s, as the level of dependence on imported crude oil increased even further, overseas exploration and development became an essential task. China processed almost all of the crude oil it imported from the Middle East and began to divert efforts into making inroads into Middle Eastern regions. In recent years the company has forged ahead of CNPC to conclude a contract to purchase LNG from Iran, and is signing oilfield investigation contracts with Iran. In addition to this, groups such as the Shengli Oil Administration Bureau (Shengli Oilfield), which is a subsidiary of Sinopec, are implementing exploration and development, the purchase of rights, servicing and engineering, etc., in active participation/development into overseas business.

As of the end of 2005, because of the short time in which overseas development had been taking place, Sinopec's equity crude oil amounted to a mere 200,000 tons (4,000 barrels/day), and as of September of 2009, overseas equity crude oil amounted to 7 millions tons (14,000 barrels/day), but the number of its overseas projects such as exploration and development have risen to 16 in 14 countries and regions, including Asia, the United States, the Middle East.

CNOOC (China National Offshore Oil Corporation) is utilizing its predominance in offshore oilfield exploration and development to tackle independent development overseas. While aiming at globalizing its business/production, the company is progressing with overseas advancements, and
recently, its active purchasing strategies/activities to secure overseas resources are attracting particular attention. Through its purchasing activities, the company is expanding the quantity of reserves and production in independent development overseas. As of September 2009, its overseas crude oil reserves were 138.7 million barrels, its natural gas reserves were 215.9 billion cubic feet, and its overseas crude oil and gas equity amounted to 1.5 million tons and 2,081 million cubic feet, respectively.

Since the first half of 2005, CNOOC has been the focus of attention from around the world due to its offensive to purchase the major US petroleum company Unocal.

As China's only state-owned offshore oil development specialist, it plays an important role in oil development, and is actively working on independent overseas development and to secure rights according to governments' guidelines.

CNOOC's overseas advancements and independent development began after the 1994 project in which it acquired rights to the Malacca mining area in Indonesia. Subsequently, CNOOC made smooth technical inroads overseas, and has since received orders to build an offshore platform and carry out offshore drilling in the UAE, as well as geophysical investigation and earthquake data collection contracts from other countries. By utilizing its predominance in offshore investigation, it was also able to conduct consultation work regarding oil investigation/development in the Caspian Sea in Kazakhstan.

In recent years, the introduction of LNG to meet the domestic market needs of natural gas has strengthened entry into overseas upstream business/rights-purchasing activities.

Perhaps the most significant recent movement by CNOOC to secure overseas rights and upstream assets was its attempt to takeover towards Unocal. On June 23, 2005 CNOOC offered 18.5 billion dollars for the purchase of major US petroleum company, Unocal Corporation.

CNOOC's plan to take over Unocal had been known for some time, but in April 2005, another major, Chevron agreed to purchase Unocal for a total of 16.4 billion dollars (via a cash and stock swap), effectively canceling-out CNOOC's bid. However, as of May, CNOOC made another takeover attempt, and in early June posted an announcement in the Hong Kong Stock Exchange, acknowledging it was considering a move. On the 23rd it proposed a large-scale $18.5 billion takeover (entirely in cash). The proposal was a large-scale purchase exceeding the value based on the closing price on the NYSE (New York Stock Exchange) on the 21st by over 1.5 billion dollars. The fact that the 18.5-billion-dollar cash bid for Unocal would be advantageous for its stocks and employees suggested a possibility the purchase would succeed.

However, the takeover bid attracted strong opposition from the US Congress. The opposition was far greater than CNOOC had anticipated. In response, CNOOC judged that even if the bid was increased, the chances of it succeeding were slim, and on August 2nd, the company decided to withdraw the bid.

The primary factor in the background to CNOOC's takeover bid towards Unocal was the aim to

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20 In the existing 5-year plan, the aim is for CNOOC to produce 6 million tons of crude oil overseas.

21 Unocal is an independent US petroleum company, and has long been a part of the American oil industry after its establishment in California in 1890. In 1997 the company withdrew from the downstream section, and in recent years has developed oil and natural gas exploration/development projects in Asia, etc., which along with North America is its principal area of business. As of 2003, crude oil reserves and production quantities were approximately 1.76 billion BOE and 1.64 BOE, respectively. Approximately 70% of the company's reserves
promptly secure overseas resources and acquire rights. In particular, it is becoming urgent to secure an import source regarding the LNG import projects CNOOC is planning in China’s coastal cities (operations to begin between 2006 and 2012). CNOOC is currently proceeding with 12 projects in 12 cities from Guangdong Province in the south to Liaoning Province in the north. The scheduled amount of imported LNG is approximately 45 million tons per year, but at present only 3.25 million tons of imported LNG per year has been secured. If the takeover had succeeded, CNOOC’s production of crude oil and natural gas would have both doubled. Proved reserves would have also greatly increased by approximately 80% to 4 billion BOE (barrel oil equivalent).

This time, CNOOC’s takeover bid was unsuccessful, but the impact it had on the international society, particularly the oil and energy industry, was huge. In addition, the case provided important lessons and experience for CNOOC and China’s other petroleum companies.

In the above paragraphs we have made a general survey regarding CNOOC’s advancements overseas and its activities to secure overseas resources. Since 1997, CNOOC has been planning/realizing overseas exploration and development projects, and to date has implemented a total of 12. These business activities have resulted in CNOOC acquiring rights to 1.5 million tons and 2,081 million cubic meters of crude oil and natural gas, respectively. In line with the domestic LNG projects, CNNOC has acquired rights to Indonesian and Australian gas fields in exchange for large purchases of LNG, and the fact that advancements have been made into Southeast Asia and Oceania is a primary characteristic. In this way, since 1992, the overseas advancement/independent development of China's petroleum industry has been mainly been carried by utilizing the characteristics of the business resources each of the three major petroleum groups, CNPC, Sinopec and CNOOC, to promote and implement oil investigations/development projects in extensive regions, including Africa, Middle East, Central Asia, Southeast Asia/Oceania, North America, South America, etc.

As of September 2009, 147 overseas advancement/independent development projects had been planned/implemented by China’s three major petroleum companies in over 30 countries and regions. In particular, in recent years, cases in which local rights have been acquired in the form of purchases have been prominent. Such cases account for approximately 20-30% of all projects. As the strain of China’s domestic oil/energy supply and demand becomes more serious, there is a sense of urgency to accelerate overseas advancement and secure overseas rights.

and 50% of its production is concentrated in Southeast Asia and the Caspian Sea region, with natural gas accounting for approximately 60% of its reserves and production quantities.

22 On October 28, 2002, CNOOC signed a contract with ALNG, the marketing company of Australia’s NWS LNG consortium, to import 3.25 million tons of LNG per year for a period of 25 years, from Australia’s NWS
3. In Conclusion – the relationship between enterprises and government –

3.1 Stock holding/personnel participation

3.1.1. Stock holding

Through its state-run parent companies and state-run banks, the government, too, has a hand in controlling the companies listed on overseas stock markets. The government's stock holding ratio in petroleum enterprises is extremely high, with 90% of PetroChina's total shares, and 80% and 67.5% of those of Sinopec Corp's and CNOOC Ltd., respectively.

With extremely high stock holding ratios like these, it can be considered that the Chinese government has a great degree of influence on the organization, important personnel, assets and decisions regarding intentions of the three major state-owned petroleum enterprises' production/operating subsidiaries, PetroChina, Sinopec Corp and CNOOC Ltd.

3.1.2. Personnel participation

The current CNPC president, Mr. Chen Geng is also the president of PetroChina. Sinopec's president is Mr. Chen Tonghai while the president of Sinopec Corp is Mr. Wang Tianpu. CNOOC's president, Mr. Fu Chengyu is also the president of CNOOC Ltd.

The appointment and dismissal of such personnel is proposed by China's State Council State-owned Assets Control Committee, and finally decided after screening by China's Communist Party Members Organization Department.

These people are the chiefs of the enterprises, as well as top government officials (equivalent to minister or vice-minister-class) and members of China's Communist Party.

3.1.3. Characteristics of human network relationships

CNPC, Sinopec and CNOOC all have interesting human network relationships and their own route of connections with the central organization of China's government/Communist Party.

In the case of CNPC, there are direct relationships with highest leadership departments in the State Council through Public Security Chief (minister) Zhou Yongkang (a former CNPC president), former head of the Oil Department (minister) Wang Tao (close relationship with CNPC president of two generations ago, Jiang Zemin), and Deputy Minister of the State Council's Energy Promotion Office, Ma Fucai (previous CNPC president), which form a wide pipeline to the central government/leadership departments.

Sinopec reports directly to the leadership departments by utilizing the wide pipeline provided by the State Council's Deputy Prime Minister Wu Yi (former president of Yanshan Petrochemical Co., Ltd.), Director of the State-owned Assets Supervision and Administration Commission, Li Rongrong (former president of Sinopec), and State Council Prime Minister Wen Jiabao (former vice-chief/deputy minister of the Geology and Mining Department).

Many of the current Sinopec Star executives who belonged to the Geology and Mining Department were subordinates of former State Council Prime Minister Wen Jiabao.
Furthermore, through human networks via Vice Premier Zeng Quighong (former chief of CNOOC External Affairs Bureau), and Deputy Minister of the chief of the State Council's Energy Promotion Office, as well as the director of the Energy Bureau of the National Development and Reform Commission (NDRC) Xu Dingming (former executive of CNOOC South China Sea Company), CNOOC is able to present statements regarding company plans/strategies directly to the top leadership departments.

Through these pipelines, China's three petroleum companies are able to report their opinions and requests directly to State Council and highest leadership departments of the government. For example, in the case of screening/permission for large-scale projects such as the construction of new oil refineries, etc. the visit of government heads to the country of production can sometimes help the three major petroleum enterprises' actions be implemented more promptly.

3.2. Government policy/command participation

The government not only instructs the three major petroleum enterprises to increase production and profits in terms of business, it also continuously instructs/guides the enterprise bosses, through administrative means and Communist Party documents such as government policies and commands, to ensure the stable development of all the companies. For example, several years ago during the reforms and restructuring of the state-owned petroleum enterprises, particularly those of CNPC and Sinopec, the government occasionally gave orders to the presidents of both companies. For example, as restructuring was being carried out, methods and processes were observed, and with the goal of company's stability, wherever possible, flexibility was adopted in the form of voluntary retirement, temporary layoffs and transfers to suitable external posts (service and assistance sections) to carry out the business organizational reforms/restructuring gradually.

The issue of the stable supply of petroleum products can also be cited as an example. That is to say, because the prices established by the government sometimes lag behind international market prices, they do not reflect changes in the international market swiftly or accurately. Moreover, despite the soaring international oil prices, the government has not revised the retail standard price since it was decided according to the average price of the above 3 markets in August of last year. Since the beginning of 2005, as international oil prices increased even more, even though the government adjusted the price of gasoline and diesel several times, it did not adjust them up to the prices of the international market. As of August 2005, the average price of gasoline on the 3 international markets was 5,505 yuan per ton, but the price of gasoline in China is 3,945.6 yuan per ton, a significant 1,559.4 yuan lower than that of the international market.

As a result of the government's price regulations, a phenomenon has occurred in which there is a negative margin between the wholesale and retail pieces of crude oil and refined products. The oil refineries are unable to recover the soaring crude oil costs from the price of refined petroleum products, resulting in the plants operating in the red; the more production is continued, the more the losses increase. Therefore, production was decreased and exports increased, and compounded by a typhoon around August, the South China market experienced a shortage in supply of refined petroleum products. In
response, the government made attempts to secure the stable supply by implementing several measures, in particular, instructions to increase production at the two major petroleum companies. Despite both PetroChina and Sinopec's refining sections running at a loss in 2005, under the government's instructions the demands of the domestic market were met.

3.3. Preferential treatment in terms of government policies, financing, etc.

As the mainstay of Chinese industry, the petroleum industry is in an extremely important position. The state-owned petroleum companies are regarded as playing an essential role in China's energy security.

With regards to the permission and financing for China's petroleum companies' domestic exploration/development and refining projects, the government responds more swiftly than it does for external business categories/sections. In addition, investigation/production equipment, apparatus and instruments for the purpose of exploration and development of crude oil and natural gas are exempt from import tariffs. The government also provides the three state-owned companies with oil and gas investigation/development rights, oil import rights, exclusive sales rights, and jurisdiction rights for service stations. Currently, China's three major petroleum companies control almost 100% of the upstream share, over 90% of the downstream refining/marketing share, and approximately 90% of the oil reserves and infrastructure's facilities.

Furthermore, as the three major petroleum companies make overseas advancements and independent developments, in order to promote overseas development advancement strategies, China's government lends its support, especially to advancement of resource development enterprises, by implementing a number of support policies and giving preferential treatment.

The principal methods of preferential treatment concerning production/processing enterprises, including overseas independent development (resource development-type) enterprises, are cited below.

(1) Type/rank of priority of overseas advancement projects promoted by the government

① Resource-development projects;
② Production/infrastructure facility construction projects that lead to the export of domestic technology, equipment or labor;
③ Research and development projects that utilize advanced international technology/knowhow;
④ Projects that increase global competitiveness or promote buyout/M&A on international markets.

(2) Financial incentive policies

① Enterprises that conform to financing conditions. In particular, enterprises of the above four types are provided with medium and long-term financing.
② Export equipment/technology/parts/raw materials are provided with priority trust loans and lines of export credit, with simplified procedures.
③ Applications are accepted for overseas (friendly nations) assistance incentive loans and joint cooperation projects.
④ Overseas enterprises may apply to receive state external-trade development funds.
⑤ Overseas enterprises may appropriate profits made in the first 5 years after the year in which
profits were first gained, to investment funds.

6 Overseas enterprises' floating fund loans may receive 2-point interest rate assistance from the state external-trade development fund.

(3) Tax incentive policies
Resource development and other enterprises important to the state are provided with favorable “Tax exemption measures (5-year earning retention and income tax exemption with 20% of profits payable to the state after 5 years).

(4) Foreign currency control policy

1 Overseas profit remittance insurance is tax exempt
2 The following settlement periods for exported equipment/technology/parts/raw materials are extended in moderation

(5) No export tax
Customs Office will not charge export tax on equipment/machinery/raw materials and half-finished articles, etc. exported as actual investments at the time of overseas advancement.

(6) Financial service/policy insurance systems

1 By constructing/maintaining financial support systems/support networks through the increase of overseas branches of state-owned enterprises, the government provides export incentive projects/articles with low-risk and non-commercial guarantee.
2 Equipment/technology/parts/raw materials, etc. in overseas projects are granted insurance according to the terms and conditions of mid to long-term export credit insurance.

(7) Other preferential treatments/incentive policies

1 Priority for export licenses/allotment will be provided for corresponding equipment/technology/raw materials and parts, etc.
2 Easing up on inspection of overseas discovery of resources for management personnel of overseas enterprises
3 The domestic import of overseas production resources

Furthermore, on November 12, 2004, NDRC (National Development and Reforms Committee) and the China Export-Import Bank made a joint notification, providing favorable financial measures such as lowering interest rate further for loans on state-promoted overseas investment priority projects. That refers to the low-interest loan policy reducing the interest rate to two points lower than that of commercial banks. Incidentally, in November of the same year, the interest rate on one to three-year local currency loans from China's commercial banks was 5.76%.

3.4. Supporting resource diplomacy
In order to secure a stable supply of oil, China's government is busy carrying out overseas development and securing oil supplies/stable supply sources in all parts of the world. Since the late 1990s, the leaders and key figures in China's government have visited the oil-producing nations in the Middle East, Africa, South America and Central Asia on over 50 occasions, and have nearly every time invited the heads of oil-producing nations to visit China, promoting the active development of resource
diplomacy\textsuperscript{24}. As a result, many of the aforementioned oil explorations/developments were agreed upon, leading to the three major petroleum companies’ acquisition of overseas rights.

Due to the Chinese government’s active resource diplomacy, the 3 major petroleum companies (CNPC, Sinopec and CNOOC) were able to make active inroads into development overseas. With this, from participating in over 140 exploration/development projects (some carried out jointly) in 35 regions and countries, including the Middle East, Africa, Central Asia/Russia, Southeast Asia, South America, to date, rights to more than 38 million tons\textsuperscript{25} of crude oil per year have been acquired.

On March 14, 2006, at a press conference following the closing ceremony of the 4\textsuperscript{th} conference of the 10\textsuperscript{th} National Peoples’ Congress, Prime Minister Wen Jiabao stated, “In the next three years, China will implement 10 billion dollars’ worth of loan assistance to developing nations.” These nations include oil-producing countries in the Middle East and Africa, and this assistance to developing nations can also be considered to be part of China’s resource diplomacy.

3.5 Recent trends in the relationship between enterprises and the government

3.5.1 Lessons from the Unocal bid

Recently, the frantic pace of Chinese petroleum companies’ investment/purchasing activities around the world in their attempt to secure oil rights has prompted much disapproval/caution, leading to intensified competition. In addition, in given case it invited failure in making purchases or increased the cost of international bidding, not only inflating China’s petroleum companies’ purchasing/bidding prices but also leading to higher cost in their assistance to developing countries.

In response to CNOOC’s failure to purchase Unocal in August 2005, China’s government and related enterprises reflected on what went wrong, and in order to respond to future investments/purchases, decided that: ① the government and enterprises are to cooperate more, with the government staying more in the background, ② deeper understanding of the government and local companies in the related countries is required, and ③ purchases should be made jointly with overseas enterprises.

At the beginning of November 2005, China’s three major petroleum companies and India’s state-run oil and gas company, Oil and Natural Gas Corporation Ltd. (ONGC) agreed to cooperate in joint bidding for overseas assets. By the end of the month the cooperation’s activities were actualized. On November 26, CNPC and ONGC made a joint 1-billion dollar purchase of 38% of the rights to Syria’s largest oil-producing company, which is owned by Petro-Canada.

In addition, in order to strengthen the securing of oil resources, joint developments are planned through negotiating and dealing flexibly with the countries concerned in regional disputes surrounding

\textsuperscript{24} Author’s own piece “China’s Petroleum Strategy” (Yomiuri Shimbun) March 6, 2006

\textsuperscript{25} China OGP, February 2008 edition

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traditional inshore territorial rights. Currently, full-scale joint development has begun in the seas around the Spratly Islands, to which China, Vietnam and the Philippines claim territorial rights.

3.5.2 Compensation for business losses

Towards the end of December 2005, in order to compensate for the losses in the downstream oil refineries caused by the negative margin in 2005, China's government provided 10 billion yuan in compensation in the form of special financial disbursements to debt-burdened Sinopec (30-billion-yuan losses in 2005). It is also said that CNPC made losses of almost 10 billion yuan in its downstream oil refining sections, but the government judged that profits from CNPC’s upstream crude oil production justified aid. Incidentally, the 10-billion-yuan compensation was not enough to satisfy Sinopec, but it supported the company to a certain extent and helped its domestic and overseas investment/purchasing activities.

The purpose of this government compensation was to support the second largest state-owned petroleum company in its time of enormous losses created by the negative margin, while at the same time also to appease the discontent of Sinopec, in particular, its overseas stock market-listed subsidiary Sinopec Corp.

3.5.3 Government Support for Overseas Investment During Global Economic Crisis

Although the Chinese government pulled back on foreign monetary and securities investment by state-owned enterprises such as banking facilities amidst price slumps in assets and severe global economic conditions, it is actively encouraging taking advantage of the falling oil prices and financial restrictions of oil producing countries and enterprises by financing and giving permission to state-owned oil enterprises for the direct investment and purchasing of oil field assets in foreign countries. This is reflected in the government’s “Commerce Bank M&A Financial Risk Management Guidelines”, published at the end of 2008, which expressed potential financial support to M&A, such as investment for oil development in foreign countries. The government, to guarantee long-term oil supply, is backing up enterprises’ autonomous development operations overseas, and has allocated an enormous $2 trillion in foreign currency reserves to establish the “Fund for the Development of Overseas Energy” for the exchange of loans for oil with oil-producing countries.

So far, we have examined the relationship between the government and the state-owned petroleum enterprises. China's three major petroleum companies (CNPC, Sinopec and CNOOC) are certainly state-owned enterprises, constantly influenced by government strategies and policies, such as domestic oil product policy and strategies to secure overseas oil resources. In fact, regarding the acquisition of overseas oil resources, the three Majors' overseas strategy and interests are in almost-perfect accordance with the policies, strategies and interests of the government.

26 Recently, Sinopec has increasing activities to make related companies under its wing, into complete subsidiaries. The government’s compensation integrates the company’s management resources and is used to purchase related companies.
However, the Majors are not aligned with the government on the issue of domestic oil product policy. This is due to the fact that the Majors' production and operating subsidiaries are listed on overseas stock markets, and as privatized organizations, the will of the shareholders, who own 10-30% or more interest, cannot be overlooked, not only in matters of policy, but regarding profits as well.

In this sense, the discord in terms of the government's personnel participation, policies, etc., the enterprise's independence regarding intentions and decisions, and shareholders profit targets, continues to appear.

In the case of overseas advancements/independent development, in the future just how much of the enterprise's independence will appear, and amid that, the relationship with government policy/strategies are also major focal points.

In the future, China's three major petroleum companies' intentions and decisions, the importance of shareholders' profits, and the relationship with the government will surely attract particular attention. It can be thought that the enterprise-state relationship will influence the domestic and overseas business activities of these three state-owned petroleum enterprises in dynamic way. As such, the influence that the three major state-owned petroleum companies' business activities - above all their overseas advancements and investment/acquiring activities - will have on surrounding countries and the international market is bound to attract even more attention in the coming years.

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