PESD National Oil Company Case Study:

China National Petroleum Corporation (CNPC): Corporate Governance and Ownership

BinBin Jiang
April 19, 2007

http://pesd.stanford.edu/
I. Performance and Strategy of CNPC

<table>
<thead>
<tr>
<th>Company</th>
<th>Revenue ($ billions)</th>
<th>Net Profit ($ billions)</th>
<th>Total Capex ($ billions)</th>
<th>Total Costs ($ billions)</th>
<th>Capex as % of total cost</th>
<th>Production (thousand barrels/day)</th>
<th>Market Capitalization ($ billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exxon Mobil</td>
<td>339.9</td>
<td>36.1</td>
<td>19.9</td>
<td>310.2</td>
<td>6%</td>
<td>4237</td>
<td>434.06</td>
</tr>
<tr>
<td>Royal Dutch Shell</td>
<td>306.7</td>
<td>25.3</td>
<td>22.9</td>
<td>263.0</td>
<td>9%</td>
<td>3473</td>
<td>217.99</td>
</tr>
<tr>
<td>British Petroleum</td>
<td>267.6</td>
<td>22.3</td>
<td>17.2</td>
<td>253.6</td>
<td>7%</td>
<td>3926</td>
<td>213.8</td>
</tr>
<tr>
<td>PetroChina</td>
<td>89.0</td>
<td>21.0</td>
<td>11.4</td>
<td>60.7</td>
<td>19%</td>
<td>2273</td>
<td>211.96</td>
</tr>
<tr>
<td>Chevron</td>
<td>189.5</td>
<td>14.1</td>
<td>13.8</td>
<td>138.5</td>
<td>10%</td>
<td>2667</td>
<td>161.73</td>
</tr>
</tbody>
</table>

- **Standard Metrics**: PetroChina Excellent Performance

- **However…**
  - Standard metrics only core (PetroChina) operations
  - non-core separated (CNPC)
  - Allows PetroChina to shift risks off books
  - E.g., overseas unproductive operations
II. Chinese SOEs: Three tiers of governance

- State-owned Assets Supervision and Administration Commission (SASAC)
- China Banking Regulatory Commission (CBRC)
- State Holding Companies (e.g., CNPC, Sinopec)
- State Limited Liability Companies (e.g., PetroChina)
II. CNPC: Centralized and Shared Decision-making

- CNPC Planning Bureau prepares 5-yr plan
- Regional offices and subsidiaries submit investment plans
- Planning Bureau integrates individual plans and submits
- Final Approval from Board of directors and State Council
## II. De facto governance within PetroChina

<table>
<thead>
<tr>
<th>CNPC</th>
<th>PetroChina</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jiang Jiemin</td>
<td>Chen Geng (Chairman)</td>
</tr>
<tr>
<td>Zheng Hu</td>
<td>Jiang Jiemin (Vice chairman)</td>
</tr>
<tr>
<td>Zhou Jiping</td>
<td>Jiang Jiemin (Executive director)</td>
</tr>
<tr>
<td>Duan Wende</td>
<td>Zheng Hu (Non-executive director)</td>
</tr>
<tr>
<td>Wang Yilin</td>
<td>Zhou Jiping (Non-executive director)</td>
</tr>
<tr>
<td>Zeng Yukang</td>
<td>Duan Wende (Executive director)</td>
</tr>
<tr>
<td>Gong Huazhang</td>
<td>Wang Yilin (Non-executive director)</td>
</tr>
<tr>
<td>Wang Fucheng</td>
<td>Zeng Yukang (Non-executive director)</td>
</tr>
<tr>
<td>Liu Haisheng</td>
<td>Gong Huazhang (Non-executive director)</td>
</tr>
<tr>
<td>Liao Yongyuan</td>
<td>Jiang Fan (Non-executive director)</td>
</tr>
<tr>
<td>Xu Wenrong</td>
<td>Chee-Chen Tun (Indep non-executive director)</td>
</tr>
<tr>
<td>Wang Dongjin</td>
<td>Franco Bernabe (Indep non-executive director)</td>
</tr>
<tr>
<td></td>
<td>Li Huaqi (Indep non-executive director)</td>
</tr>
<tr>
<td></td>
<td>Liu Hongru (Indep non-executive director)</td>
</tr>
<tr>
<td></td>
<td>Wang Fucheng (Supervisor chairman)</td>
</tr>
<tr>
<td></td>
<td>Wen Qingshang (Supervisor)</td>
</tr>
<tr>
<td></td>
<td>Sun Xianfeng (Supervisor)</td>
</tr>
<tr>
<td></td>
<td>Xu Fengli (Supervisor)</td>
</tr>
<tr>
<td></td>
<td>Qin Gang (Supervisor)</td>
</tr>
<tr>
<td></td>
<td>Li Yongwu (indep supervisors)</td>
</tr>
<tr>
<td></td>
<td>Wu Zhipan (indep supervisors)</td>
</tr>
<tr>
<td></td>
<td>Liao Yongyuan (other senior management)</td>
</tr>
<tr>
<td></td>
<td>Wang Guoliang (other senior management)</td>
</tr>
<tr>
<td></td>
<td>Jia Chengzao (other senior management)</td>
</tr>
<tr>
<td></td>
<td>Hu Wenrui (other senior management)</td>
</tr>
</tbody>
</table>

- Less than one third of directors are outsiders compared to 75% in western companies
- Yellow names represent overlapping personnel between CNPC and PetroChina
III. Political influence over corporate governance

- All managers appointed by SASAC with no input requested from the board.
- Managers focused on keeping company in line with government ideology and maintain stability more than economic development.
- Heavy infiltration of insiders make it difficult to expel poor performing managers and avoid corruption.
Thank You

http://pesd.stanford.edu/
IV. Main conclusions

• Current corporate governance strategies unlikely to change without a radical change in the political system.

• Implementation of current and past reforms have resulted in a change in the formal organization of NOCs, but not in corporate governance and ownership.

• There is no objective third-party organization that acts as a check against the government/CNPC in the regulation of SOEs.

• Lack of an adequate corporate governance and ownership system will likely be the main obstacle to improving the performance of CNPC.
II. Government Involvement

- Office of the National Energy Leading Group
- Ministry of Land and Resource
- NDRC (Energy Bureau)
- Ministry of Commerce
- State Env’t’l Protection Agency

Approval from the board of directors and State Council
IV. Performance of CNPC

• CNPC has complete control over commercial contracts with PetroChina, PetroChina obliged to maximize benefits for CNPC.

• 86% of PetroChina’s profits go to CNPC

• PetroChina takes on little risk by operating best performing core assets of Chinese oil industry and no risky overseas development

• Shifting funds from one pocket to another to give illusion of profitability in order to garner international support for corporatization and boosts confidence in China’s oil sector.
II. Theoretical governance within PetroChina

PetroChina Limited Liability

- General Meeting of Shareholders
- Board of Directors
- Supervisory Committee
- Other committees
  - President
    - Vice Presidents
    - Chief Financial Officer
II. De facto governance within CNPC

CNPC Parent Company

- President
- Vice President
- Chief Financial Officer
- Assistant Presidents
- Committees
I. CNPC dominates the Chinese oil industry

- **Crude oil recoverable reserves (billion tons)**
  - CNPC: 69%
  - Sinopec: 20%
  - CNOOC: 11%

- **Profit from oil companies ($ billions)**
  - CNPC: 75%
  - Sinopec: 9%
  - Sinochem: 2%
  - CNOOC: 14%

- **Crude Production (million barrels/yr)**
  - CNPC: 59%
  - Sinopec: 18%
  - CNOOC: 14%
  - Other: 9%

Source: Company annual reports 2006, CNPC 2007
II. Theoretical governance within PetroChina

*Company Law of 1994*

For every corporatized SOE:

1) A board of directors must be formed.

2) Shareholders meetings have to be held in order to elect directors and decide on major corporate decisions.

3) A board of supervisors must be established in order to independently oversee and evaluate the behavior of directors and managers.