

Statoil/Hydro Merger

Effects on Diversity and Innovation in the Norwegian Petroleum Cluster

(and suggestions about how to mitigate them)

Hans Henrik Ramm

Ramm Kommunikasjon
Norwegian Petroleum Society
Solstrand 20 September 2007

SOME FUNDAMENTALS:

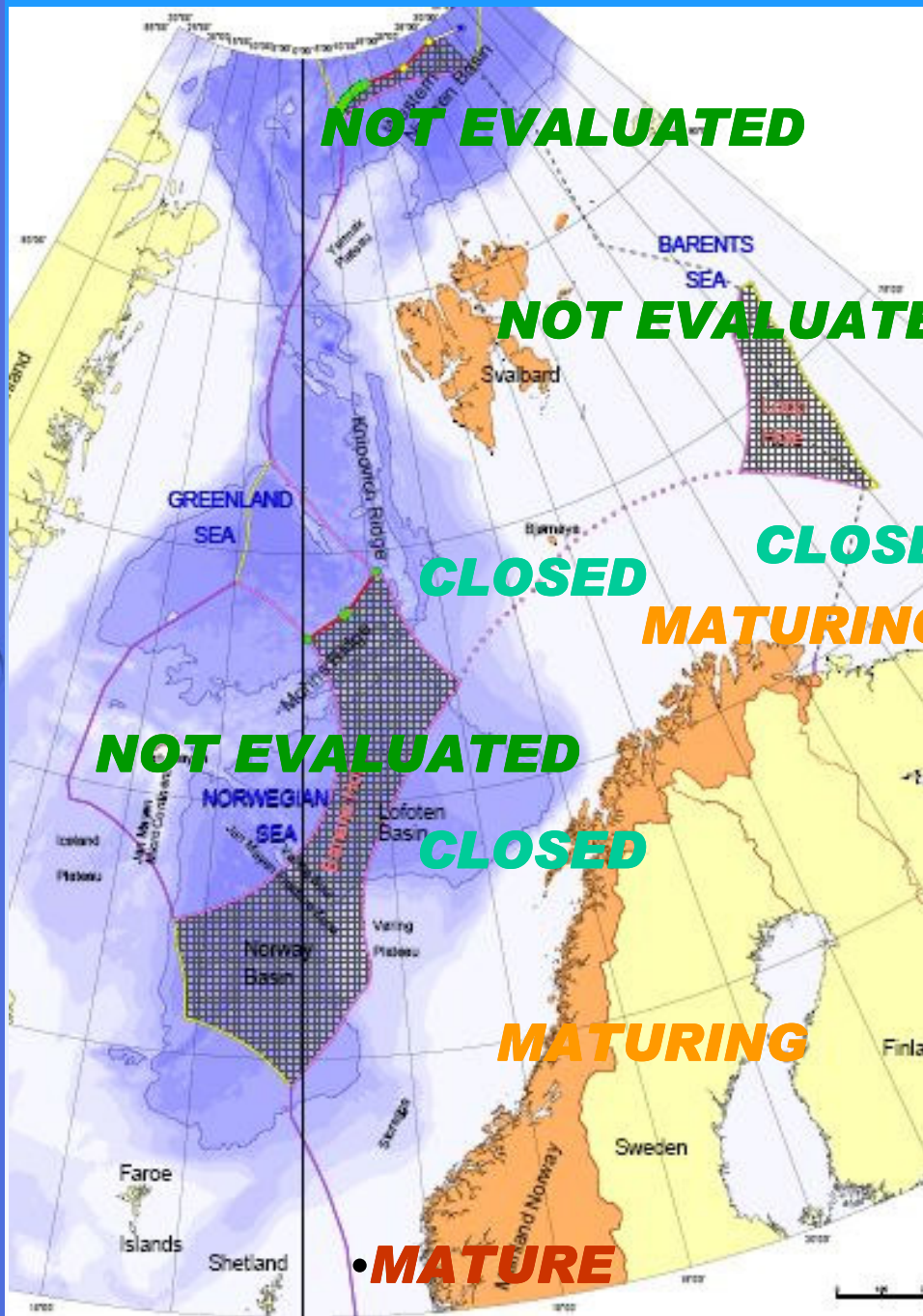
- ✧ The merger is a fact
- ✧ StatoilHydro will be a major Norwegian asset
- ✧ We want to see it develop successfully

BUT:

- ✧ Much diversity and competition has been lost
- ✧ NCS innovation is endangered
- ✧ Merger not the only danger
 - ✧ Access to Acreage, Long Term Financial Incentives
- ✧ Policies should be reconsidered
- ✧ Diversity should be improved
- ✧ We need a "Social Contract" with StatoilHydro

Basic Assumptions for the Discussion

- ⇒ Agenda is about interests of Norwegian society
- ⇒ StatoilHydro's interests may differ
- ⇒ We want to make full use of Norway's natural resources
- ⇒ Some political interests may differ
- ⇒ An innovative Norwegian petroleum cluster is required to achieve this
- ⇒ Cluster/innovation theory is relevant
- ⇒ The NCS market is important as such
- ⇒ Some economists may differ



- Most of the NCS job unfinished
- We can't go to the North Pole and the Greenland Sea with current technology
- Unconventional resources include gas in hydrates, offshore coal, more?
- We need to push the knowledge frontier – and be part of it

(Base map: NPD)

Why Diversity Matters - I

1. Suppliers: Competition on price and contractual terms
2. Best practice – benchmarking in supplier relations
3. Supply chains and cluster mechanisms
4. Internationalization of supply industry
5. Competing ideas about development concepts etc
6. Checks and balances in license groups
7. Diversity in ideas for external R&D assignments
8. Implementation of new technology – company culture
9. Exploration – diversity in geo-interpretation

Why Diversity Matters - II

10. Second-hand license market
11. Rig market
12. Access for smaller companies to AMIs
13. More choices for employees, better development of human capital
14. Benchmarking/best practice on HES
15. Democracy – more diverse ideas/information to authorities
16. Free speech – even a benevolent monopolist inhibits criticism
17. Internationally – distribution of political risk for Norway

YES, THERE ARE ADVANTAGES IN SIZE.

- ◇ But mostly for international activities
- ◇ Easily over-rated also from company perspective

SIZE WORKS DIFFERENTLY FOR NCS UTILITY.

MOST ADVANTAGES OF SIZE IN SINGLE COMPANY HAVE DIMINISHING SOCIAL RETURNS ABOVE OPTIMUM:

- ◇ Local risk distribution
- ◇ Capital strength
- ◇ Size of geo staff

THERE IS ALSO AN OPTIMAL DIVERSITY, BUT VERY COMPLEX:

- ◇ We need different kinds of companies
 - ◇ Norwegian, majors, independents, niche, downstream, industrials
- ◇ We must absolutely have *several* frontier locomotives
- ◇ We should have at least two reasonably large Norwegian companies
- ◇ Majors won't move aggressively in "Class B"
- ◇ Limited frontier diversity particularly negative

STATOILHYDRO IS ABOVE SOCIALLY OPTIMAL NCS SIZE. MANY OTHERS ARE BELOW.

"BUSINESS AS USUAL" TOO SLOW TO COMPENSATE IN TIME.

How to Improve Post-Merger Diversity?

1: Grow outside Norway, reduce inside

- ✧ Unavoidable as main strategy
- ✧ Likely to be investigated if new government in 2009
- ✧ Good idea for StatoilHydro to be prepared

2: Simulate diversity within StatoilHydro.

- ✧ Official Government/company answer
- ✧ "Expectations" and promises
- ✧ Must try, but violates commercial instincts and will not be sufficient.

3: Cluster and company policies

- ✧ Incentives for new technology, R&D
- ✧ Emerging technology firms
- ✧ Intellectual property rights
- ✧ Supply industry ownership

4: Amendments to petroleum policy etc

- ✧ Access to acreage
- ✧ Licensing policies?
- ✧ Second-hand license market
- ✧ Petroleum tax
- ✧ Strengthening of regulatory bodies

ONLY SOME OF THESE ISSUES WILL BE DISCUSSED IN THE FOLLOWING

How to Shift Size Abroad?

- ⇒ We all want StatoilHydro to grow abroad
- ⇒ But it should reduce its size in Norway
- ⇒ Both objectives hard to achieve
 - ⇒ Ethical standards limit opportunities in "3rd World"
 - ⇒ Leverage problem limits opportunities in "the West"
 - ⇒ Barrel in ground costs 2-3 times more than in Norway
 - ⇒ Human capital strongly attached to NCS assets
 - ⇒ Hard to quit in the middle of the job
 - ⇒ Many project organisations will soon have been through one operatorship change, new changes harder the more time is lost
- ⇒ Most political means already lost
- ⇒ State as owner can still use guidelines
- ⇒ But we want to avoid more political interference in internal decision-making
- ⇒ Can we find something not painful to the company?

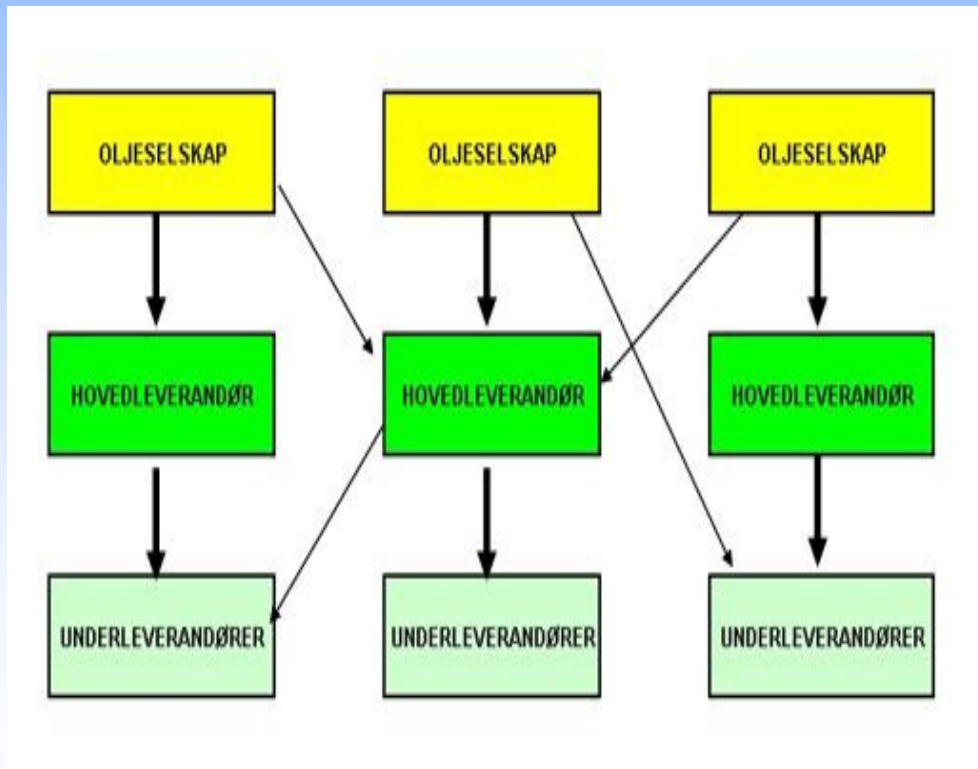
Suggestions for a "shift abroad" strategy:

- ⇒ Leverage problem:
 - ⇒ State should be willing to invest equity if helpful for M&A
 - ⇒ Guarantee general share issue or similar
 - ⇒ Invitation must come from General Meeting
 - ⇒ Conditional on divestment etc at home
- ⇒ No growth at home commitment:
 - ⇒ No major NCS acquisitions unless at least compensated by divestments
 - ⇒ No SDFI hunting
 - ⇒ No major onshore acquisitions or mergers
- ⇒ "3rd World" problem:
 - ⇒ Clarify owner ethics policy
 - ⇒ Relative impact, not "guilt by association"
 - ⇒ Ex: Canadian tar sands, human rights
 - ⇒ Government support (tie-in to aid etc)
- ⇒ Human capital problem:
 - ⇒ Major tax revision for expats in both directions
 - ⇒ Owner acceptance for generous incentives
- ⇒ NCS operatorship problem:
 - ⇒ StatoilHydro commitment to transfer non-critical operatorships
 - ⇒ Area restructuring around other operators
 - ⇒ Exploration, pre-development, tail-end, good partners
 - ⇒ External evaluation
 - ⇒ Reports to the MPE
 - ⇒ Joint program for facilitating transfers

Simulated diversity I

Supplier relations - chains

- ⇒ Clusters must co-operate AND compete
- ⇒ Vertical chains require trust and openness
- ⇒ Inter-chain competition ensure efficiency



- ⇒ Hard to be open with competitor next in line
- ⇒ StatoilHydro says it will maintain multiple chains
- ⇒ Requires separate internal contact teams

Simulated diversity II

Supplier relations – new technology

- ⇒ Norway is good on implementation of new technology
- ⇒ Statoil has been champion for "engineering part"
- ⇒ Hydro has been champion for "efficiency part"
- ⇒ Combined challenge has been good for suppliers
- ⇒ How can tension be maintained in one company?

THESE ARE JUST EXAMPLES. PROBLEM IS BASICALLY THE SAME FOR MANY DIVERSITY ASPECTS:

- ⇒ Simulated diversity conflicts with desire for uniform company culture, normal commercial efficiency and optimal use of human resources
- ⇒ StatoilHydro must still keep its promises and discuss openly how it intends to do so
- ⇒ But we can't and shouldn't expect simulated diversity to last forever.

Cluster policies for innovation

- The more concentration there is on the oil company side, the more important it is to have technological diversity on the supply industry side.
- There are also issues between oil companies and suppliers about intellectual property rights.
- These points support an argument for StatoilHydro focus on primary core competence and extensive outsourcing.
- Also logical for an oil company with international ambitions.
- Statoil has however been extremely important for development of emerging technology firms.
- The Norwegian cluster is still not good enough at anchoring new venture firms or acquiring technology imbedded in foreign firms.
- We can only expect StatoilHydro and very few large suppliers to take on this job.
- We need a continued and perhaps even stronger StatoilHydro presence in these markets, but StatoilHydro should let go of firms and their technology when the time is right.
- This may be suboptimal for StatoilHydro's own interests – one way or the other.
- No obvious solution – dialogue needed

A Social Contract

- ⇒ It would have been preferable to consider StatoilHydro a fully commercial company subject to full competition.
- ⇒ The new dominance makes this impossible.
- ⇒ Certain general policies for the company are already imbedded in established ownership strategy beyond general framework conditions applicable to all
 - ⇒ National anchoring, ethics, remunerations
- ⇒ Diversity and moderation on size should be included.
 - ⇒ Required to include liberal/non-socialist concerns
- ⇒ Several strategies discussed here should be imbedded in a “social contract”
- ⇒ Suggestion: StatoilHydro prepares a candid document about its own place in a diverse cluster; open discussion, Parliament Report, firm commitments by company as well as state, cross-politically acceptable.
- ⇒ Alternative is prolonged political controversies around StatoilHydro.

Petroleum Tax

- ⇒ Unmentionable topic for industry – still important for Norway
- ⇒ Current system too favourable in the high oil price cycle, too poor in the low cycle
- ⇒ The reason is lack of shelter for knowledge rent (materiality) in Special Tax base, hence it has to be recovered from 22% share of assumed resource rent
- ⇒ Resource rent dwindles in poor times, soars in good times
- ⇒ Hard to define knowledge rent, must approximate with bottom shelter defined by objective field properties (similar to GoM royalty)
- ⇒ “One size fits all” impossible under price variability and extreme variability in project challenges
- ⇒ Current tax system causes major risk/uncertainty in the long term, favours short term investment
- ⇒ Incentives for newcomers reinforce this effect. Beneficial, but must be balanced in total system.
- ⇒ Current system discourages majors, frontier exploration, hence tax policy important for diversity.