

The economic environment of the british petroleum



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The British Petroleum p. l. c. is one of the world's largest energy companies and its performance depends on various economic factors as well as the economic environment of the country it is presented in. The reasons and the consequences of the economic conditions effects will be described below.

1) Economic Growth

The economic growth is one of the major factors that influence the performance of a firm, because it reflects the change in the general level of economic activity (Madura, 2004). GDP and aggregate expenditures are the most reliable indicators of the economic growth; however the unemployment level also has a significant effect. Since the head office of BP is placed in the UK and most of the important operations of the corporation are done in this country, the UK economic growth affects the demand for the products of the British Petroleum substantially. To illustrate the effect of GDP on the oil prices in UK it would be useful to learn the world GDP and oil prices, because the price of oil can not be changed significantly by the situation in one particular country.

As can be seen from the graph, the oil growth curve reflects the GDP growth curve. The fall in the GDP growth from about 6% to 1, 5% during the early 1970's resulted in a large decrease in oil prices(from 7% to -4%). From a more general view the graphs are pretty much the same, the growth in GDP results in the growth in oil prices; in contrast the smaller is the GDP growth the lower is the oil demand. The causes of such relation are quiet evident. The growth in GDP means that the economic activity is high and the demand for energy is increasing, thus the high demand results in high prices.

The effect of GDP is more visible during the period from 2008 to 2009. The graphs illustrate that the oil prices fell significantly from nearly 70 pounds per barrel to about 25 during the first half of the 2009, when the GDP diminished by approximately 1%. As a result of low prices, the price of BP's shares fell from about 650 pounds to nearly 350.

2) Income level of the population

However, the GDP may also decrease even if the oil prices remain at a high level, because if the consumers have a smaller income and they cannot reduce oil consumption they will have to cut some other expenditures. This example shows that the income level of population also has its own role in defining the GDP and hence, the oil prices. The graph depicts that the fall of GDP, crude oil prices in 2008 was followed by a decrease in the annualised growth in real household disposable income per head.

3) Interest rate

In order to get extra funding a company can borrow money from banks and financial institutions. The interest rate defines the cost of borrowing such money (Madura, 2004). In the UK the interest rate is defined by the central bank.

The graph F shows that the UK interest rate has been diminishing from the early 90's and now equals 0, 5%. A low interest rate has been set in order to stimulate the economic activity by helping the companies to get favorable loans. Currently, the low interest rate allowed BP to obtain a \$7 billion loan from seven banks in the UK, including Barclays, HSBC and Royal Bank of Scotland in order to plug the oil well under the Gulf of Mexico.

4) Inflation

Inflation indicates the increase in the general level of prices of products and services over a specified period of time (Madura, 2004). High inflation may result in the increase in a firm's operating expenses.

The UK CPI inflation index was increasing from September 2007 to September 2008 reaching the peak level of 5.2 % and after it started to decline. During this period many companies, including BP have witnessed a decline in their ability to immediately pass on increases in input costs when there are short term changes in raw material prices.

5) Fiscal Policy

Fiscal policy of a government defines how the government spends budget money and lays down taxes (Madura, 2004). Fiscal policy of the UK government affects BP's performance significantly, because taxes play a major role in defining price of oil at the world energy market. Corporation tax is a tax levied in the UK on the profits made by companies and on the profits of permanent establishments of non-UK resident companies and associations that trade in the EU (Wikipedia). During 2009 BP has paid 930 million pounds in the UK tax on its profits; every 1 pound from 7 pounds paid in dividends to UK pension funds by FTSE100 companies comes from BP. The total taxes paid by BP in 2009 are equal to 5.8 billion pounds and funded the department for International Development. However, according to the UK budget the corporate tax rate is being cut from 28% in 2008 to 27% in 2011.

Considering the current volume of tax payments made by BP in 2009, the decrease in the corporate tax rate will help the company to save about 58 million pounds.

6) Exchange rates

The fluctuations of the US dollar may also affect the oil prices significantly.

The exchange rate is the rate at which a unit of currency of one country can be exchanged for a unit of currency of another country. Oil is sold for dollars and paid for in dollars, this makes the exchange rate of the US dollar influential. If the dollar value declines against the UK pound, the dollars received by oil exporting companies are worth less. Consequently, the oil producers will try to increase the price of oil in order to keep the purchasing power of the money they earn through selling. The graph I below shows the dependence of prices and exchange rates. As can be seen, the value of the British pound declined in the beginning of 2008, consequently the oil prices fell, because the US dollar increased in value.

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Updated June 9, 2005

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[Accessed 2 November 2011]