The oil and gas industry

Des Plc, one of the largest and world leading drilling companies in the oil and gas sector of Germany. The company was established by Engr. Joe and Mr. Onos in the year 2004 when the German government initiated the Integrated Energy and Climate Programme (IEKP) policy aimed at providing state-of-the-art, secure and climate compatible supply of energy in Germany in order to restrict dependency on imported oil and gas products. Driven by the need to expand, Des Plc has decided to embark on business operations in Nigeria.

The aim of this report is to, as a researcher, advise the CEO of Des Plc as to whether DES Plc should export or go into foreign direct investment (FDI), as its approach in Nigeria. This feasibility study tends to explore and look into the analysis of the national business system and cultural conditions prevalent in Nigeria and Germany while assessing the pattern and trends of trade and investment in both countries within the Oil and gas sector with key emphasis on protection measures against imports and foreign investment in Nigerian oil and gas sector; advise on whether Des Plc should export or go into foreign direct investment, or combine the methods, considering the effect of the exchange rate regime for Germany and Nigeria. And, on the whole, it assesses the level of risk exposure and corporate social responsibility (CSR) issues Des Plc of Germany may encounter in Nigeria as a foreign counterpart in the Nigerian Oil and gas industry.

By the end of this research, the best strategy will have been established for adoption taking into cognizance the recommended approach considered optimal

1. 1 THE OIL AND GAS INDUSTRY

The oil and gas industry is one of the largest and fastest growing industries in the world today. Oil and natural gas products touch our lives in countless ways every day. Together, they account for more than 60 percent of our nation's energy. They fuel our cars, heat our homes and cook our food (EAPI, 2011). It may also be worthwhile to add that Nigeria is the 10th largest oil producer in the world, the third largest in Africa and the most prolific oil producer in Sub-Saharan Africa. And while the Nigerian economy is largely dependent on its oil sector which supplies 95% of its foreign exchange earnings, the German government is trying to lower the level of dependency on the importation of the product (MIS, 2011).

2. 0 AN ANALYSIS OF THE NATIONAL BUSINESS SYSTEM AND CULTURAL CONDITIONS

2. 1 NATIONAL BUSINESS SYSTEM

The national business system approach explains international differences in firm organisation and firm behaviour. The focus is on the coordination of economic activities and on governance issues. National differences in the organisation of firms and markets are explained by differences in culture and in formal institutions. The business systems approach, while originally rooted in sociology, increasingly has become based on economic theory with slight emphasis on legal, political and educational frameworks (Lundvall 1999).

Owing to the implication of the preceding analysis, an emphasis is placed on the following institutional arrangements in the Nigerian political, economic and legal system with the analysis of the national business system in Nigeria in connection with Des Plc of Germany as a prospective entrant to the Nigerian business space- as shown in the table below:

DIMENSIONS

BRIEF OVERVIEW

POLITICAL SYSTEM

IMPACT ON BUSINESS

The Federal Republic of Nigeria is governed in accordance with the provisions of a Constitution. The most recent came into being in May 1999. The new Constitution is based essentially on the report of a Committee which had collated the views expressed by Nigerians in the 1995 constitution. Significantly, the Constitution affirms that Nigeria is one indivisible and indissoluble sovereign state, whose constituent units are bound together by a Federal arrangement. It provides for a presidential system of government in which there is an Executive, a Legislature and a Judiciary, with each acting as a check and balance on the powers of the other two arms. The Constitution further provides for the operation of three tiers of government, at the Federal, State and Local levels. These provisions are binding on all authorities and persons throughout the Federation. This akin to the German political structure in terms of power distribution (TBTIG 2011).

However, this democratic system of government has made the business space so unstable for some years owing to election irregularities and political manoeuvres.

TERRORISM AND NIGERIA'S DEVELOPMENT

THE GOVERNMENT AND BUSINESS

ACTORS IN THE OIL AND GAS SECTOR

Terrorism has been on the increase since 2002 when a sect called Boko Haram started signalling disintegration of the Nigerian economy. Under past leadership, the group demanded that Nigeria become an Islamic state but it is now believed to be made up of several factions, with various demands which distort the political future of the nation (BBC Africa)

The Nigerian government has embarked on robust policies to privatise its sectors in the recent years and as such, has boost efforts to attract foreign investment (TBTIG 2011).

SHELL, TOTAL, CHEVRON are some of the key players in the oil and gas industry of Nigeria. They all have to thrive in the face of ethnic disparities because their major operations are in the remote areas of the notable Niger Delta region where " militancy- oppositions" are prominent. In 2004, Niger Delta activists demanding a greater share of oil income for locals began a campaign of violence against the oil infrastructure, threatening Nigeria's most important economic lifeline (BBC Africa).

DIMENSIONS

BRIEF OVERVIEW

ECONOMIC SYSTEM

IMPACT ON BUSINESS

Nigeria is the most populous country in Africa, with an ethnically and religiously diverse population of 140 million. Nigeria has the second-highest GDP in Africa (US$166. 78 billion in 2007), reflecting the country’s substantial oil reserves. However, oil has proved a mixed blessing for the country (CIA 2011). Nigeria’s economy has much in common with those of China, Brazil, Germany, Malaysia and India; free enterprise is the norm. However, electricity and water continue to be partially government owned and controlled. Outside of transportation and, perhaps, a small section of the industrial sector, the petroleum economy has very little linkage with Nigerian production (Daudu)

The Nigerian government has a policy which is to promote the commercialization, restructuring and privatization of certain government-owned enterprises. Privatization has also been accompanied by deregulation of various economic sectors to encourage private sector participation, notably in telecommunications, power, and downstream petroleum sectors. Most of Nigeria’s economic activity occurs in key metropolitan areas-Lagos, Abuja, Kano, Kaduna, Onitsha and Port Harcourt (online). Although petroleum continues to dominate the public finances and foreign exchange resources of Nigeria, the sector is, in reality, an enclave economy employing less than 100, 000 Nigerians directly in production.

The Nigerian government is restructuring and diversifying the economic base of the economy and reducing the dependence on oil, and as such will have bearing on the industry prominence and strategic posture.

ECONOMIC PERFORMANCE OVER 12 MONTHS

FOREIGN RESERVE

SIGNIFICANT RATES

The strongest performance of Nigeria's non-oil economy allowed the economy to avoid a substantial slowdown in 2009 and it expanded by 4. 9%, compared to the growth rate seen in 2008. In April 2010, the International Monetary Fund (IMF) forecasted growth rate of 7% and 7. 3% for Nigeria in 2010 and 2011 respectively and said that the economy was recovering faster than it had earlier anticipated. These forecasts are predicted on the belief that oil prices will remain relatively stable as the global economy recovers, and on the assumption that the truce with militants in the Niger Delta holds. Attacks by militants on oil infrastructure and kidnappings of oil workers cut exports sharply in previous years (CIA 2011).

Nigeria's foreign exchange reserves had fallen to US$40. 67 billion at the end of March 2010, down from US$42. 4 billion at the end of 2009, and from US$52. 7 billion at the of 2008. Nigeria disbursed about US$3 billion from its oil windfall savings to the three tiers of government in February and March 2010, which contributed to the depletion of its foreign exchange reserves.

Interest rate: 6% (Central bank, April 2010)

GDP growth: 4. 9% (official, 2009)

Unemployment: 4. 9% (2007 est.)

FDI: US$71. 59 billion (December 31, 2009, est)

Nigeria’s economic decline, especially during the last 20 years is illustrated by the fact that per capita income, which was the US $1000 in 1965 had declined to the US $300 by 1998. Within some 18 years, Nigeria had declined from being a low middle-income country and amongst the fifty richest countries in the world to one of the 30 poorest (Daniel 2011).

LEGAL SYSTEM

Nigeria’s legal system is based on English common law, Islamic Shariah law (in 12 northern states), and traditional law

2. 2CULTURAL CONDITIONS

Business is an integral part of society and both influence each other. Social-cultural environment refers to the influence exercised by certain social and cultural factors which are beyond the control of the business unit. Such factors include: attitude to work, family system, religion, languages, habits, preferences, tradition, value system, business ethics etc. Any change in cultural factors like education affects the lifestyle and thinking of the people living in society and thereby bearing on business activities in such society (Jain et al 2009). Managing the problems created by cross -cultural differences increases the transaction costs of conducting international business activities. Consequently, if cultural differences between potential trading partners are large, the economic and/ or strategic benefits of engaging in business activities must be large enough to offset the extra costs of ‘ doing’ business with difference cultures (McDonald and Burton 2002).

However, putting the importance of cultural implications in the business space into consideration, planning to do business in the Nigerian oil and gas industry will require a look into some cultural factors as follows:

Traditions and family system: Oil and gas operations are prominent in the Niger-Delta region of the country as the major oil wells are found in such rural areas of the region. Chevron is the third-largest oil producer in Nigeria and one of its largest investors, spending more than $3 billion annually. Chevron as a core player in the industry enters into serious business negotiations with traditional institutions in host communities before the commencement of oil explorations (Chevron 2011)

Religion: Nigeria has Christianity and Islam as major religions major religions. However, these religions have little or no effect on the consumption of oil and gas products in the country.

Ethnic Groups: Nigeria as Africa’s most populous country, is composed of more than 250 ethnic groups; the following are the most populous and politically influential: Hausa and Fulani 29%, Yoruba 21%, Igbo (Ibo) 18%, Ijaw 10%, Kanuri 4%, Ibibio 3. 5%, Tiv 2. 5% (CIA 2011).

Language: English is the official language in Nigeria. The country is composed of diverse ethnic groups with several languages but three major languages (Hausa, Ibo and Yoruba) are spoken in a general sense. Although, the “ Pidgin English” is prominently used across the nation because it remains the best way in which the uneducated ones communicate. This may constitute a major implication for Des Plc because German is the official language in Germany. So many stakeholders in the Nigerian oil and gas host communities do understand just the “ Pidgin English.”

3. 0 TRADE PATTERN BETWEEN THE TWO COUNTRIES

3. 1 TRADE PATTER IN GERMANY

Germany is one of the constituents of the European Union (EU) and also a member of the WTO. The WTO has a single trade policy and tends to demonstrate the possibility of exploiting the “ Collective” nature of the community’s membership in order to maximize the political pressures brought about by WTO approached sanctions exists and has been noticed the communities trading patterns. However, the ultimate Machiavellian approach might be to target precisely those members’ states that do not benefit from WTO-incompatible measure of the community and are in favour of removing or amending it (Borght 2007).

Developments in Germany’s trade patterns in recent years have generally been conducive to the international use of the Deutsche mark on several accounts. First, Germany has become the world’s largest supplier of exports to the world, surpassing the USA since 1986 and enhancing the potential role of the mark as an invoicing vehicle. The bulk of German imports were raw materials particularly oil and gas from Russia and the bulk of German export were manufactured goods. Second, between 1986 and 1989 the share of specialized manufactured goods (primarily machinery and transport goods) in relation to total exports rose from 38 to 47 percent (ECB 2011).

3. 2 TRADE PATTERN IN NIGERIA

Nigeria has always reinforced commitment to improving her business environment so as to integrate into the global economy. However, oil and gas have been Nigeria’s bulk of export (Iwela 2007). The United States is Nigeria’s largest trading partner after the United Kingdom. Nigeria supplies around 11% of US oil imports and 4. 5% of German Imports. Crude Oil and liquefied natural gas (LNG) account for 98% of exports and around 80% of government revenue (Qfinance 2011).

3. 3 THE PATTERN OF TRADE BETWEEN GERMANY AND NIGERIA

Nigeria and Germany have maintained a consistent trade relationship over the years. Meanwhile, recent trade statistics (2007) showed that Nigeria’s export to Germany amounted to 911, 5 million Euro, a decrease of 35% compared to 2006. Imports to Germany have increased by 10% to 1083, 3 million Euro.

In 2006, the trade figure was in favour of Nigeria, with exports to Germany amounting to 1402, 6 million Euro and imports from Germany worth 973, 9 million Euro. The different trade figure is mainly due to lower oil exports to Germany and higher imports of semi-finished goods (Abah 2011).

3. 4 TRADE IN THE OIL AND GAS INDUSTRY BETWEEN NIGERIA AND GERMANY

Britain was the chief beneficiary of Nigerian oil in the early years of the colony’s oil industry. After gaining independence, Nigeria expanded its export to destinations to include Western European nations, especially Germany and the United States (Levi 2004)

However, the Germany's presence in the Nigerian oil and gas sector has declined over the years. Just as earlier stated that in 2006, the trade figure was in favour of Nigeria, with exports to Germany amounting to 1402. 6 million Euro and imports from Germany worth 973. 9 million Euro. The different trade figure for 2007 is mainly due to lower oil exports to Germany.

3. 5 RESTRICTIONS AND PROTECTIONS ON TRADE IN NIGERIAN

For two decades prior to economic reforms, Nigeria's trade regime was viewed as complex, restrictive, and opaque (WTO, 2005). Following the structural adjustment programme (SAP) in 1988, a seven-year tariff schedule was adopted which significantly reduced tariff averages. However, further tariff revisions were made, often in response to pressures from domestic lobbies. Since 1978, the government had also introduced policies on import prohibitions which banned selected products that were viewed as strategic for the economy or which needed infant industry protection. However, prior to the recent economic reform, Nigeria maintained a complex tariff structure consist of about 19 bands and 5, 146 lines (at the HS-8 digital level), with tariff ranging between 2. 5 and 150 percent. Nigeria liberalized its import tariff regime by adopting the Common External Tariff (CET) of the Economic Community of West African States (ECOWAS) (Iwela 2007).

3. 6 RESTRICTIONS IN THE NIGERIAN OIL AND GAS INDUSTRY

Oil and gas operations commenced in Nigeria effectively in 1956, with the first commercial find in that year by the then Shell D'Arcy. Before this time, that is, from November 1938, almost the entire country was covered by a concession granted to the company to explore for petroleum resources. This dominant role of Shell in the Nigerian oil industry continued for many years, until Nigeria's membership of the Organisation of Petroleum Exporting Countries (OPEC) in 1971, after which the country began to take a firmer control of its oil and gas resources, in line with the practice of the other members of OPEC. This period witnessed the emergence of National Oil Companies (NOCs) across OPEC member countries, with the sole objective of monitoring the stake of the oil-producing countries in the exploitation of the resource. Whereas in some OPEC member countries the NOCs took direct control of production operations, in Nigeria, the Multinational Oil Companies (MNOCs) were allowed to continue with such operations under Joint Operating Agreements (JOA) which clearly specified the respective stakes of the companies and the Government of Nigeria in the ventures (Iwela 2007).

4. 0 EXCHANGE RATE REGIME IN GERMANY AND NIGERIA

Numerous exchange rate regimes are practised globally, ranging from the extreme case of fixed exchange rate system, such as the currency boards and unions to a freely floating regime. In practice, countries tend to adopt an amalgam of regimes such as an adjustable peg, crawling peg, target zone/crawling bands, and managed float, whichever suit their peculiar economic conditions. (McDonald and Burton 2011). The exchange rate regime of Germany and Nigeria are considered as both countries use different currencies (naira and euro) respectively.

4. 1 EXCHANGE RATE REGIME IN NIGERIA

Nigeria has switched between exchange rate systems over the years. During the first phase (1970-1985), Nigeria operated a controlled exchange rate regime where exchange rate of the naira was pegged to the dollar. The second phase of exchange rate history in Nigeria began in 1986. Following the oil glut of the early 80s, it became clear that Nigerian economy which depends on oil was not able to sustain the fixed exchange regime because its foreign reserves not only depleted but foreign debt also mounted. As an integral part of the Structural Adjustment Programme introduced in 1986, the country adopted a flexible exchange rate through the Second tier Foreign Exchange Market (Iwela 2007).

The Nigerian exchange rate. The most critical are the creation of a high propensity to import because an over-valued currency makes import cheaper and promotes a balance of payments deficits. In the quest for a realistic naira 9 exchange rate, the CBN employs the Purchasing Power Parity (PPP) model as a guide to gauge movements in the nominal exchange rate and to determine deviations from the equilibrium exchange rate. Although the PPP as a relative price does not provide clear criteria for choosing a base period and is generally criticized for its insensitivity to short-term policy actions, it nonetheless, provides a reasonable framework for a comparative analysis of trading partners' performances (Iwela 2007).

4. 1 EXCHANGE RATE REGIME IN GERMANY

Germany operates a floating exchange regime system. Germany is much more competitive than its southern counterparts and this biggest economy in the Eurozone relies heavily on net exports and fixed investments while private consumption takes only a second place (ECB 2011).

Growth in the Eurozone will remain sluggish and is expected to underperform the US in 2011. The economy in the 16-nation region is expected to grow +1. 7% in 2011, followed by +1. 8% in 2012, almost half of the growth in the US (ECB 2011).

4. 2 THE EXCHANGE RATE IMPLICATION ON NIGERIAN OIL AND GAS INDUSTRY

The peculiarity of the Nigerian foreign exchange market needs to be highlighted. The country’s foreign exchange earnings are more than 90 per cent dependent on crude oil export receipts. The result is that the volatility of the world oil market prices has a direct impact on the supply of foreign exchange. Moreover, the oil sector contributes more than 80 percent of government revenue (CIA 2011).

4. 2 IMPLICATION FOR DES Plc

Thus, when the world oil price is high, the revenue shared by the three tiers of government rise correspondingly and, as has been observed since the early 1970s, elicited comparable expenditure increases, which had been difficult to bring down when oil prices collapse and revenues fall concomitantly. Indeed, such unsustainable expenditure level had been at the root of high government deficit spending. DES’ performance could, to a large extent, be tied to this economic phenomenon. In addition, the removal of fuel subsidy signaled danger by the Nigerian masses as their standard of living is largely dependent on the oil and gas production and performance.

5. 0 CORPORATE SOCIAL RESPONSIBILITY ISSUES IN THE NIGERIAN OIL AND GAS INDUSTRY

With regard to driving forces for CSR implementation, philanthropy gets a high priority in Africa. This is due to the huge socio-economic needs which have resulted in philanthropy becoming an expected norm in society. According to the theoretical findings, the philanthropic motive has also the highest priority in Nigeria (Helg, 2007). DES Plc cannot over emphasize the issue of CSR in order to consider doing business in the oil sector of Nigeria as many players in the industry have had to put with this situation as much they can (Skjeraseth et al 2004). However, it can be said that CSR is viewed by host communities as ethical and moral obligation of investing companies and as such should not be undermined.

CSR ISSUES IN THE INDUSTRY

OVERVIEW

RESPONSE MEASURE

PLAYERS' EXPERIENCES

While ExxonMobil and TotalFinaElf see their responsibility primarily in terms of providing affordable and environmentally clean fuel and investments in the countries and regions in which they operate, BP aims to be ' a force for good' (BP, 2001), and Shell ' will strive to build a better world' (Shell, 1999)

. Shell, Chevron and other players in the industry have suffered kidnap of expert rates over the years. Militancy has been on the increase in the Niger Delta region where exploration is prominent in Nigeria. The youth regard this approach as the only means to benefit from their natural endowment since there are no other ways.

Provision of employment, construction of roads and employment may be some available measures to keep the potential situation in check for DES Plc.

HUMAN RIGHTS

In Nigeria, CSR is viewed as giving back to society and as such their ultimate right. In Nigeria, philanthropy is more than charitable giving. HIV/Aids is an example where the response by business is essentially philanthropic but clearly, in companies own economic interests.

DES Plc can make provision to partner with human right organizations in order to effectively address potential issues

EMPLOYEES' RIGHT

The Nigerian government has also through its NEEDS strategy (Nigerian National Planning Commission 2004) set the context by defining the private sector role as by stating that " the private sector will be expected to become more proactive in creating productive jobs, enhancing productivity, and improving the quality of life. Nigerians maintain that companies have a responsibility to do more than maximize profits and returns to shareholders? If they do, how far does it extend? Does it include the provision of good wages and working conditions for employees;

DES Plc already has a good reputation for job enhancement and upholding that corporate culture will position it against undue pressure in this regard.

COMMUNITY INVOLVEMENT

Nigerian communities tend to maintain a level of ownership over natural resources and as such never want to part ways with what they consider as stake. There are ” Landlord groups” formed to foster strong opposition against whatever they perceive as injustice in oil exploration

Working on the CSR agenda in Nigeria in partnership with different stakeholders in the society. Involve community leaders in the determination of locations.

ENVIRONMENTAL PROTECTION

Maintenance of the highest environmental standards. Oil spillage and gas flaring have been major issues hosts communities emphasize while maintaining a strong opposition against the investors.

The introduction of local agricultural schemes to appeal to the affected public.

SUPPLIER RELATIONS

Company relations with suppliers and contractors are always questionable and not viewed as a priority (TBTIG 2011).

Multinational companies initiate co-operation with the SMEs in both the formal and informal sector for local supplies. To develop a joint corporate social responsibility (CSR) agenda for Nigerian and non-Nigerian firms. This could be explored by DES Plc while sourcing materials for local use in the region

6. 1 INVESTMENT METHOD

However, Nigeria’s libralised business regime and proactive reform measures are making it easier to do business in the country (TBTIG: 2011). Owing to the preceding issues considered in this report, Foreign Direct investment will be recommended to DES Plc as a measure for expansion and penetrating into the Nigerian oil and gas sector. The Nigerian government has put incentives in place to attract foreign investors. Nigeria’s investment regime has been geared towards encouraging private sector involvement in the country’s economy. The corporate tax rate is 30% in all sectors except petroleum, which is taxed separately under the Petroleum Industry Bill.

According to the World Investment Report 2011, prepared by the UN Conference on Trade and Development, FDI inflows into Nigeria fell from $8. 65bn in 2009 to $6. 09bn in 2011, with the blame placed on delays to the Petroleum Industry Bill (TBTIG: 2011).

6. 2 MODE OF ENTRY

However, The Nigerian government operates a deregulated society which could favour the brownfield approach. DES Plc can adopt this suitable means by merging and acquiring an asset of a firm in the industry owing to the market share core players like Shell, Total, Chevron etc already have in the industry.

7. 0 CONCLUSION

In spite of the corporate social responsibility (CSR) issues identified in the Niger Delta region in recent years, Nigeria’s huge wealth of oil makes it singularly attractive to the multinational majors, most of which are represented in Nigeria.

More recently, multinational oil companies have been focusing their attention on exploration projects. They and their likes promise much for the future of oil industry investment since they allow the oil majors to diversify their investment in the country and bypass the troubles of the Niger Delta region (TBTIG: 2011).

Nigeria's liberalised business regime and proactive reform measures are making it easier to do business in the country. Germany's presence is scanty in the oil exploration space of Nigeria and as such that remains a quick and ample opportunity to be explored by DES Plc taking the aforementioned policies into consideration.

However, owing to the issues discussed in this report it is obvious that the most suitable form of investment is Foreign Direct Investment FDI by merging or acquiring existing firm in the Nigerian oil and gas sector.

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