

# The effects challenges and prospects business essay

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The government's involvement in the ownership and management of refineries and logistics infrastructures is perceived as the cause of numerous problems associated with downstream oil and gas industry in Nigeria. Thus, government economic reforms by way of the deregulation policy were introduced in 2003 to revive the ailing industry. This dissertation seeks " a strategic management perspective and critique of deregulation of downstream oil and gas industry in Nigeria in order to understand the effects, challenges and prospects". The objective of this study is to offer both theoretical and practical insights about the deregulation process in Nigeria from a management viewpoint. This study's theoretical framework is embedded in three aspects of the literature: deregulation, strategic management and competitive forces. These three perspectives are used in order to assess emerging effects, challenges and prospects of deregulation of the industry and the changing strategic landscape arising from the deregulation exercise. The theory of competitive forces provides an understanding of the industry structure and the interactions between competitors, while innovative management is needed in order to assess industry processes and capabilities. Summarising and integrating these viewpoints formed a hypothesised understanding that reflected the effects, challenges and prospects of deregulation. An empirical analysis of the study required a constructed research methodology that is based on quantitative and qualitative methods. A non-probability sample approach with a dichotomous questionnaire (of YES/NO responses) was self-administered in Abuja, Lagos and Port Harcourt to represent three geographical areas in Nigeria; the target population of fifty persons from each state was chosen

using purposive sampling method. Furthermore, an open-ended questionnaire was self-administered on two managers from Forth Oil, one manager from Oando PLC and one manager from Total PLC. The manager's views were sought in order to have an industry professional's opinion on the deregulation of the downstream oil and gas industry. The presentation of result followed a statistical test of hypotheses on the effects, challenges and prospects of the deregulation of the downstream industry. A Porters five forces model was also utilised to analyse the competitive forces in the industry. The analysis performed indicates that respondents are concerned that deregulation could have numerous effects on the country and there are yet many challenges ahead. However, there is an overwhelming consensus that there are great prospects for improvement of the downstream sector as a result of deregulation. Overall, the result shows that many Nigerians are of the opinion that deregulation will deliver positive effects, reduce the challenges in the industry and also create better prospects and opportunities. The study reveals that the previous regulated regime of the downstream oil and gas industry has become more competitive and market driven. Nevertheless, it also indicates that the industry is not fully deregulated to enable the market mechanism to determine product prices; rather the government has been fixing petroleum product prices. The study further revealed that deregulation program is poorly implemented by regulatory agencies. Hence, in view of the lapses revealed, this study recommends that strategic management approach through planning, implementation, evaluation, monitoring and control is required to drive the success of deregulation of the downstream oil and gas industry.

## **CHAPTER ONE**

### **1. 0 INTRODUCTION**

#### **1. 1 Background**

The advent of deregulation reform dates back to 1973 after the first oil shock experience, which led to a decline in the economic growth of most developed economies (Nordhaus, Houthakker and Sachs, 1980; Sachs, 1982) and labour productivity growth (Baily, Gordon, and Solow, 1981). Further to the mid-1970s productivity decline, a wide range of policy responses, including economic deregulation were introduced. The inception of deregulation reform was initiated in the US (Winston, 1998 ; Morgan, 2004), while the UK and other developed economies followed in the early 1980s (Pera, 1988; Healey, 1990; Matthews, Minford, Nickell and Helpman, 1987). The reform was also copied by the new democracies and many developing countries in the 1990s leading to a wide range of labour, capital and product market reforms. This was the scenario that prevailed throughout the early 21st century (Wolfl, Wanner, Kozluk and Nicoletti, 2009) until the global economic and financial crisis which led to the reduction of many countries' economic growth and disruption of deregulation reform. Like many other developing countries that copied the market reform and Nigeria being a growing economy with an increasing demand for petroleum products (Nwokeji, 2007), meeting the supply needs remains a big challenge due to frequent breakdown of the refineries and over-reliance on importation. However, prior to 1960's the downstream oil and gas sector was initially market driven by the mechanism of demand and supply determining product prices (Funsho, 2004). The distribution and marketing of petroleum product were controlled

by the multinational oil and gas companies (Jean, 2012). This was the situation before the government decided to harmonise petroleum products by way of uniform pricing in 1973 to encourage even distribution of products nationwide (Christopher and Adepoju, 2012). In furtherance of the uniform price policy and also to tackle the cost differential problem associated with the delivery of products to every part of the country, the government established the Petroleum Equalization Fund (PEF) (Oluwole, 2004). The participation by government in the downstream oil and gas sector culminated to a regulated regime (Olumide, 2011). The consequence of the policy shift on the economy was characterised by acute product scarcity, hoarding, smuggling, adulteration, long queues, inappropriate pricing, under funding and monopolistic practices. This has been the main features of the supply and distribution process of the downstream oil and gas industry (Funsho, 2004). The unhealthy development degenerated into poor performance of the nation's refineries, which resulted in excessive dependence on imports (Christopher and Adepoju, 2012). Thus, government economic reforms became imperative towards reviving the ailing downstream sector by way of deregulation (Okafor, 2004). The downstream oil and gas deregulation reforms as implemented in 2003 implies removal of restrictions on the establishment of refineries, jetties and depots. It also involves allowing private sector participation in the importation of petroleum products and also allowing the demand and supply mechanism to determine the price (Oluwole, 2004). Furthermore, it is meant to achieve regular supply of petroleum products at reasonable prices, maintaining self-sufficiency in refining, employment generation for Nigerians, growth in foreign investment

and general economic growth (Onyishi, Emeh, and Ikechukwu, 2012). Other major benefits are shown in figure 1 below: Figure : Benefits Of Deregulation Of Downstream Oil and Gas Sector

Removal of subsidy burden  
Government refocus to segment regulator  
Competition on and a level playing field to attract new entrant  
DEREGULATION  
Increased efficiency by service providers  
Eliminate sharp practices that exploit subsidy regime

Source: (Omamofe, 2011). Deregulation 2011 and Beyond. Many years have passed since the deregulation programme started, yet the aforementioned problems still persist while refineries continue to operate below installed capacity (Oladele, 1997). Efficient transport system for product distribution is lacking while pipelines are still being vandalised. The expected private sector investment in establishing new refineries has not materialised. This scenario is in contrast to the objectives of deregulation as commenced in the USA in the 1970's which was to create competition, enhance industry efficiency and guarantee competitive prices (DME , 2007 ; Hicks, 2004). Improving efficiency in the industry implies product availability, proper functioning of the distribution networks and availability of storage facilities and depots to avoid scarcity of products in order to force down prices. However, with the lack of these facilities the intended benefits of deregulation of the downstream oil and gas sector are not realised by the Nigerian populace. The question then is why should the government continue with the deregulation policy? Thus, this dissertation explores a strategic management perspective and critique of deregulation of downstream oil and gas industry, especially the effects, challenges and prospects. The theoretical framework of this study dwells on three aspects of the literature: deregulation, strategic

management and competitive forces. These three perspectives are utilised to assess the emerging effects, challenges and prospects of the deregulation exercise in the oil and gas industry downstream sector. The study analyses the literature from these perspectives, competitive forces and innovation management in the context of deregulation.

## **1. 2 Purpose of the Study**

The purpose of this study is to assess the deregulation programme that was introduced in the Nigerian downstream oil and gas industry. The specific aims of this study are as follows;(1) To examine the implementation of the deregulation policy in the downstream oil and gas sector in order to determine the effects, challenges and prospects.(2) To explore if deregulation has actually yielded the desired result.(3) To use Porter's five forces to analyse the competitive forces in the downstream oil and gas industry in a post deregulated regime.

## **1. 3 Research Questions**

In finding out the effects, challenges and prospects of the deregulation of downstream oil and gas industry in Nigeria, this study answers three questions:(1) What informed government's deregulation of the downstream oil and gas industry and is it the only solution in Nigeria's economic environment? 2) How can the government improve the implementation of the deregulation of the downstream oil and gas industry to achieve the actual policy objective?(3) In what way can government encourage the private sector to fully participate in the downstream oil and gas deregulation exercise?

## **1. 4 Relevance of the Study**

This study is relevant in many ways. Apart from the downstream sector's importance in Nigeria economic stability, other relevance of the study includes the following: The study uses a market structure performance framework to analyse the industry in a deregulated era. It also conducts a survey to know the feelings of Nigerians on the effects, challenges and prospects of the deregulation of the downstream industry. The study also contributes to the existing literature on deregulation thereby providing insight on current developments in the downstream oil and gas industry in Nigeria. The intention is to enhance policy formulation with a view to alleviating the suffering of the masses. Furthermore, the study also serves as an important tool for students, academia, institutions and individuals to consult for knowledge on deregulation of the downstream oil and gas industry in Nigeria.

## **1. 5 Organisation of the Study**

This study contains six chapters. The first chapter is the introduction and background of the study, the purpose of the research, the relevance of the study, the objective of the study and the research questions; the chapter outlines the study. Chapter two presents the literature review of the subject matter. Chapter three gives the theoretical framework of the study. The study methodology is stated in chapter four. Chapter five focuses on the presentation of data, analysis of collected data, findings and discussion of results. The last chapter (chapter six) presents the study conclusion and appropriate recommendations.



## CHAPTER TWO

### 2.0 LITERATURE REVIEW

Many have offered different perspectives and motives for the government deregulation of the oil and gas sector in Nigeria, yielding different opinions and two schools of thought. Those supporting deregulation argue that deregulation of the downstream oil and gas industry would help government to eradicate fuel scarcity and ensure constant fuel supply across the country (Funsho, 2004). Deregulation of the industry would create an inflow of foreign investment while persistent smuggling of petroleum products and inefficiencies in the sector will be eliminated (Oluwole, 2004). They also posit that Nigeria has the lowest price of petroleum products in the world and with deregulation the international market equilibrium would allow government to channel funds to other sectors of the economy. Furthermore, they argue that it would break the monopoly enjoyed by the Nigerian National Petroleum Corporation (NNPC) (Okafor, 2004). Essentially, deregulation would lead to the uninterrupted operation of the refineries and would also guarantee a steady supply by enabling stakeholders and independent marketers to participate in product importation and marketing (Enemoh, 2004). Their view is also that the regulated regime by way of subsidy is a way of the government enriching few petroleum products marketers (Oluwole, 2004). Abu (2012) indicates that Nigerians believe deregulation and privatization will usher in sustainable development and would be a blessing rather than a curse. Odey (2011) recommends the complete deregulation of the downstream sector to reduce corruption, inaccurate record keeping, inefficiency, smuggling and insufficient product supply. Jean (2012) suggests

that making deregulation work involves providing an enabling environment and framework for efficient production, supply and distribution. Bride (2003) recommends that business as usual in NNPC under regulation by way of product importation and distribution is inappropriate because it represents a wrong step for government to continue with; instead the government should fully deregulate the downstream oil and gas sector. The opposing group argues that Nigeria petroleum industry must not be deregulated completely; instead the government should maintain the status quo and restructure the sector to improve efficiency for the overall national interest. They opine that the root cause and clamour for deregulation is because of the massive corruption in the sector and therefore this should be tackled rather than embarking on deregulation. They further argue that deregulation helps increase profit margins for the importers; interestingly this is the position of the labour union and the organised civil society. Furthermore, Amana and Amana (2011) assert that the fair distribution of economic benefits derived from petroleum has proven elusive and therefore predicts same for deregulation. Ibanga (2011) argues that removal of subsidy may cause dislocation to the gas price because of high demand and inadequate supply. Bafor (2001) doubted government sustaining the gain of deregulation due to the undue interference in NNPC's affairs, resulting to near collapse and dismal performances which encouraged the clamour for privatization and deregulation. According to Kikeri and Nellis (2004) deregulation processes and institutions must be combined with appropriate competition policies and regulatory frameworks without which the gains of deregulation can be eroded by the harsh impact on consumers and the overall economy will be

affected due to inadequate product supply. Matthew and Fidelis (2003) opine that the merit of deregulation can only be enjoyed by Nigerians if only there could be genuine attention to eliminating corruption in the sector. Adagba, Ugwu and Eme (2012) posits that government is merely taxing the poor to subsidise the life of the rich. Similarly, Akpanuko and Ayandele (2012) argues that government is not transparent in its drive to transform the economy and suggested reduction in the cost of governance and rehabilitating the refineries as a measure to drive the economy. From a global perspective, the theoretical argument behind the large scale deregulation reforms initiated in the late 1970s is twofold. On one hand, deregulation reduces the rents that regulation creates for workers, incumbent producers, and service providers. This view is popular among academics and policy makers ever since the works by Stigler (1971), Posner (1975) and Peltzman (1976) contributed to the understanding of the political economy of regulation. On the other hand, deregulation allows competition on product, labour and capital markets to determine the winner of rent transfers. Thus, by spurring productivity and efficiency gains (Winston, 1993), economic deregulation ultimately contributes to the overall increase in economic growth. The additional growth from deregulation manifest through increased employment and real wages (Blanchard and Giavazzi, 2003), which impacts both production and consumption and through increased investment (Alesina, Ardagna, Nicoletti and Schiantarelli, 2005). This also affects the capital stock in the economy. However, a need for caution is required on the recent take on the efficiency gains from deregulation in the developing world. The main argument in this new area of

literature is that deregulation reforms influence diverse economies differently, depending on their technology level and their quality of institutions. For example, Acemoglu, Aghion and Zilibotti (2006) claim that certain restrictions on competition may benefit the technologically backward countries, while Estache and Wren-Lewis (2009) argue that the ideal regulatory policies in developed and in developing countries are different because of differences in the overall institutional quality in those countries. In addition, Aghion, Alesina and Trebbi (2007) use industry level data to demonstrate that within each economy, institutional reforms influence different industries differently, and more specifically, industries closer to the technology frontier would be affected more by deregulation and would innovate more than backward industries in order to prevent entry. As a result, countries closer to the technology frontier would benefit more from deregulation. The benefits of economic deregulation in many industries prompted a debate on the growth effects of specific types of reforms on petroleum product downstream deregulation.

## **2. 1 Theories of Deregulation**

Deregulation can be viewed from the angle of different theories. The public interest theory predicts that deregulation would occur if the market deficiency which compelled regulation in the first place were to disappear. An illustration is a change in technology which could eliminate a natural monopoly. The theory also predicts that deregulation would occur if a regulatory regime which had been perceived to be in the public interest was defective. It may turn out that, the cost of the regulatory apparatus is or has become greater than the loss resulting from the market imperfection it was

designed to correct (Posner, 1974). Thus, this may become obvious only with experience that entry restrictions are relatively costly way to enforce standards. Stigler Peltzman advanced the special interest theories, which suggests that a number of factors may give rise to deregulation. First, a reduction in the cost consumers must incur in order to inform them regarding the effect of regulation on them. For example, price comparisons between regulated and non-regulated controls can assist consumers in estimating the effect of regulation on the prices they pay. Secondly, as product substitutes increases between regulated and non-regulated products, this would reduce profits and hence the urge to lobby for regulation induced price increases. Substitution may also occur between regulated and unregulated industries or between regulated and unregulated controls. Thirdly, a change in industry structure can reduce either the incentive or the ability to lobby for regulation. Also, an increase in the number of firms in an industry or a merging of their respective interests may increase the incentive to free ride and make it more costly to organize support for politicians promising regulatory benefits (Stigler, 1974). Noll and Owen (1983) argue that, over time, the beneficiaries of regulation will grow while groups that lose will contract. In view of the interest group structure, alternative for substitutes and information, McCormick et al. (1984) offer two reasons why the incentive to regulate is greater than the incentive to deregulate. The first is that the cost of seeking regulation may be as much as the present value of the anticipated wealth transfer involved, and if this cost is sunk it is not recoverable in the event of deregulation. The question is do these theories of deregulation apply to Nigeria? The public and special

interest theories of deregulation had slightly been criticized for the vagueness regarding transactions in policy frameworks and political markets. In the case of Nigeria the evidence on deregulation supports both the public and special interest theories. The two are in the same range; deregulation is used by government to effect wealth transfers through privatization. These transfers may benefit the highly concentrated special interest groups, such as petroleum product marketers and politicians. They may also benefit larger groups, like in the deregulation of the telecom industry. In the public interest group, government most times come up with reforms and policy framework aimed at benefiting the masses, but this is often hijacked by those who may want to exploit government programme for their own benefit. An example is the issue of oil subsidy; the original government intention was for public interest, but this has been hijacked by special interest groups.

## **2. 2 Deregulation Implementation in Different Countries**

### **2. 2. 1 Argentina**

The Menem administration introduced deregulation in Argentina. The country underwent heavy economic deregulation and privatization and had a fixed exchange rate between 1989–1999. The effects of Argentina's deregulation exercise led to the comparison of Enron with Argentina by (Krugman, 2001) asserting that they were both experiencing an economic collapse due to excessive deregulation. However the claim by Krugman was termed as confusing correlation with causation, as neither the collapse was due to excessive deregulation (Herbert, 2002). He argues that if deregulation of the Argentine economy produced prosperity for years, how could it generate an

economic collapse within few months? The answer is not deregulation but excessive loans.

## **2. 2. 2 Australia**

Deregulation in Australia commenced with the Minimum Effective Regulation in 1986 following the announcement by the Labour Prime Minister Bob Hawke of a wide range of deregulatory policies. The introduction of the policy, which is now familiar requirements for regulatory impact statements, took many years for governmental agencies to comply with. Wider competition policy reforms had commenced during the 1980s trade policy reform which substantially increased competition in the domestic economy (Smith, 2001). In this regard the level of assistance to manufacturing sector was reduced from 25 percent to 15 percent of the value of manufacturing output between 1981-1982 and 1991-1992. There were reductions in import barriers, which exposed many industries to the rigours of international competition, providing increased incentives to improve product quality, costs and innovation.

## **2. 2. 3 Canada**

The deregulation of natural gas in Canada took place in the mid 1980's, with the exception of the Atlantic Provinces, Vancouver Island and Medicine Hat. A price comparison service is operating in some of these jurisdictions, particularly Ontario, Alberta and British Columbia. The other provinces are small markets and have not attracted suppliers (Holly, 1999). Customers have the choice of purchasing from a local distribution company (LDC) or a deregulated supplier. In most provinces the LDC is not allowed to offer a

term contract, just a variable price based on the spot market. LDC prices are changed either monthly or quarterly.

## **2. 2. 4 United Kingdom**

The Conservative government of Margaret Thatcher started a program of deregulation and privatisation in 1979, where the Conservative government criticised many public enterprises, including Central Electricity Generating Board (CEGB), for being too inflexible, bureaucratic and out of political control. As a remedy the government suggested deregulation and privatization (Foster, 1993; Newbery and Green 1996). In response, the policy framework was enacted which included the Express Coach Transport Act 1980, British Telecom 1984, privatization of London Bus Services 1984, Local Bus Services Transport Acts 1985 and the Railways 1993. The common feature of all the privatization was the offering of the shares to the general public. In support of the policy since 1997 the Labour governments of Tony Blair and Gordon Brown developed a programme of better deregulation. This included a general programme for government departments to review, simplify or abolish their existing regulations and introduce approaches to new regulations.

## **2. 2. 5 New Zealand**

The New Zealand government adopted policies of extensive deregulation from 1984 to 1995. Originally initiated by the Fourth Labour Government of New Zealand (Dalziel, 2010). The goal of the policy was liberalizing the economy and had a comprehensive coverage and innovations. The major specific policies included: establishing an independent reserve bank; floating



the exchange rate; public sector finance reform based on accrual accounting; performance contracts for senior civil servants; tax neutrality; subsidy-free agriculture; and industry neutral competition regulation. The introduction led to Economic growth in 1991. New Zealand was changed from a somewhat closed and centrally controlled economy to one of the most open economies in the OECD (Evans, Grimes and Wilkinson, 1996).

## **2. 2. 6 United States**

Many industries in the United States became regulated by the Federal Government in the late 19th and early 20th century (Winston, 1998). Entry to some markets was restricted to stimulate and protect the initial investment of private companies into infrastructure to provide public services, such as water, electric and communications utilities. However in the 1970's among the problems that encouraged deregulation was the way in which the regulated industries often controlled the government regulatory agencies, using them to serve the industries' interests. In the energy industry the Emergency Petroleum Act was a regulating law, consisting of a mix of regulations and deregulation, passed in response to OPEC price hikes and domestic price controls which led to the 1973 oil crisis in the United States. After adoption of this federal legislation, numerous state legislation known as Natural Gas Choice programs sprung up in several states which allow residential and small volume natural gas users to compare the purchase from natural gas suppliers, aside with traditional utility companies.

## 2.3 Concept of Deregulation

Deregulation implies a restrictive use of the state's legal power to direct the conduct of private actors (Stigler, 1971). Deregulation according to Webster dictionary is the withdrawal of government economic interest, reduction of regulation of business and market activity, it is the act or process of removing state regulations. Kimberly (2013) posit that deregulation is the government encouraging more competition in an industry that allows near-monopolies. Ernest and Young (1988) assert that deregulation and privatization are elements of economic reform programs charged with the goal of improving the overall economy in a structured process. From an economic perspective deregulation implies freedom from government control (Innocent and Charles, 2011), while Akinwumi et al. (2005) asserts that deregulation is the removal of government interference in running a system. This implies that the normal regulatory rules and enforcement in managing the operation of a system is replaced by the market forces of demand and supply as a determinant of price (Ajayi and Ekundayo, 2008). Wolak (2005) views deregulation as the removal of control of government on natural monopolies in order to exercise market power. For example in the US, regulation is generally held on natural monopolies to a specified rate of return basis for pricing products (Rothwell and Gomez, 2003). Deregulation introduces free market principles and competition into natural monopolies (Hirsch, 1999 ; Kahn , 2004; Novarro and Shames, 2003; Rassenti, Smith and Wilson, 2002). The deregulation of downstream oil and gas industry is the loosening of government control over the industry. It is a way of breaking the monopoly in NNPC in order to pave way for healthy competition. This implies

the introduction of the free market system, where the forces of demand and supply are allowed to determine the market price of products (PPPRA, 2004). This formula is in contrast to the regulated regime, where government acting on existing law controls and determine retail and wholesale prices of petroleum products. A regulated regime is characterised by a low level of competition and investment leading to distortions in product supply and distribution, scarcity resulting to long queue's, hoarding, smuggling and other bottlenecks such as monopolistic practices, existence of subsidy and poor maintenance of infrastructure (Funsho, 2004). The structural framework of deregulation involves the following phases: (1) Liberalisation (2) Privatization and Commercialization.

### **2. 3. 1 Liberalization**

Liberalization refers to a relaxation of the government previous restrictions, usually in areas of social or economic policy, in most context the process or concept is often, but not always referred to as deregulation (Sullivan, Arthur, Sheffrin and Steven, 2002). It is also the involvement of many participants in the downstream petroleum industry (PPPRA, 2004). Liberalization involves removing monopoly, promoting high competitive culture in the industry, guaranteeing product availability, ensuring fair pricing for consumers, reviving and ensuring the efficiency of the refineries (Oluwole, 2004). Liberalization also ensures the removal of oil subsidy, which robs the poor to pay the rich (PPPRA, 2004). Liberalization is aimed at generating additional revenue, which if properly utilised would address the needs of every one much more than subsidy would provide (Funsho, 2004).

### **2. 3. 2 Privatisation and Commercialization**

Privatization involves the transfer of ownership of the government owned facilities, enterprises to individuals on shareholding basis; it implies state owned companies would be sold to private investors (PPPRA, 2004). In the context of deregulation government facilities, like storage tanks would be opened to private investors on a user fee basis. According to Beim and Calomiris (2001), it is the sale by the government, of a state owned enterprise. Ramanadham (1993) posit that it involves the marketing of enterprise operations which can be carried out through the options of ownership changes, organisational changes and operational changes. The government's intention is to open up the sector for products development and innovations (PPPRA, 2004).

### **2. 4 Government Policy on Deregulation**

The policy framework for the deregulation of downstream oil and gas industry evolved with the inauguration of a 34 member Special Committee by the government on 14 August 2000. The Special Committee to Review Petroleum Products Supply and Distribution (SCRPPSD) members constituted from various stakeholders and other interest groups were charged to review the petroleum products supply and distribution and also other problems of the downstream petroleum sector. On October 2000, the Committee's reports and recommendation were published in the government white paper (Oluwole, 2004). Some of the decisions were:(1) Deregulation and liberalization of the importation of petroleum products by oil marketers and basing prices of products on import parity to encourage the participation of other players other than the NNPC.(2) The privatization of all four

government refineries and encouraging private sector participation in the establishment of private refineries.(3) The establishment of a pipeline management authority for the pipelines, jetties and depots, which will charge private and public users a tariff per throughput litre of products. (4) The immediate setting up of a Petroleum Products Pricing Regulatory Agency (PPPRA) with sufficient autonomy to superintend the various phases of the proposal embodied in the report of (SCRPPSD) especially the deregulation and liberalization of the downstream sector of the petroleum industry. The decision led to the establishment of PPPRA by an Act of the National Assembly in May, 2003 as an agency to monitor deregulation implementation.

## **2. 5 Conclusion**

This chapter highlighted related literatures on deregulation, which reveals the opinion of two schools of thoughts, supporting and opposing groups respectively. The group supporting deregulation feels it will solve the problems in the industry, while the opposing group argue that deregulation of the sector would destroy the nation's economy. The chapter also presented the public interest and special interest theory, which are the bases for the government's introduction of deregulation. The concept and policy framework for deregulation were also revealed, as well as countries where deregulation is already practiced. Generally, this chapter has provided an overview of this study. The theoretical framework of this study is discussed in the next chapter.

## **CHAPTER THREE**

### **3. 0 THEORITICAL FRAMEWORK**

The focus of this study is on the perspective of strategic management. This is because of the essential role strategic management plays in policy implementation, planning, evaluation, monitoring and strategic control. Generally, the impact of these roles would drive the success of the oil and gas industry deregulation reform. The perspective that underlines this concept is innovation management and competitive forces; the broad nature of strategic management and the peculiarity of the industry establishes this perspective as lenses to use in answering the study questions.

#### **3. 1 Strategic Management**

Ensuring the success of deregulation reform in the downstream oil and gas industry requires a strategic approach by the regulatory body. As the deregulation process involves opening the market to drive competition in the industry, the application of strategic management tools becomes very important. However, before proceeding, it is important to understand the meaning of strategic management. According to Ansoff (1965) strategy is a rule for making decisions determined by product/market scope, growth factor, competitive advantage and synergy. Chandler (1962) defined strategy as planning and executing company growth, which consisted of deciding the basic long-term objectives of an enterprise and the resulting adoption of courses of action. It involves a clear awareness of the environmental forces and the way in which they are changing. It is also an appreciation of potential threats, opportunities and the deployment of strategic resources to create new markets (John, 2001). According to <https://assignbuster.com/the-effects-challenges-and-prospects-business-essay/>

Mintzberg (1979) strategy is a mediating force between the organisation and environment, stable patterns in the stream of organisational decisions to deal with the environment. Strategic management is the process by which organisations determine their purpose, objectives and desired levels of attainment, decide on actions for achieving these objectives in an appropriate time scale and frequently in a changing environment (John, 2001). Strategic management consists of managerial decisions and actions that help to ensure that organisations formulate and maintain a beneficial fit within its environment (Wright, Pringle and Kroll, 1994). Consistent with this belief is that strategic management is a process of setting a goal in which the organisations capability is matched to the requirement of its environment (Ralph, 1996). The task as shown in figure 3 defines what the term strategic management implies. Figure : The Five Task Of Strategic Management

Recycle to tasks 1, 2, 3, or 4 as needed  
Improved /change as needed  
Revised as needed  
Revised as needed  
Improve/ change as needed

Task 5: Evaluating performance, Monitoring new developments, and initiating corrective adjustments  
Task 1: Developing a strategic vision and business mission. Task 2: Setting Objectives  
Task 3: Crafting strategy to achieve the objectives  
Task 4: Implementing and executing strategy

Source: Adapted from Thompson and Strickland (2001, p. 7). Strategic management concept and cases. For strategic decisions and implementation to yield good results, it is the responsibility of the policy regulatory team or company's management team to always adjust to tough conditions by undertaking a strategic defence and business approaches that can overcome adversity (Thompson and Strickland , 2001. P. 4-7). The essence of good strategic

decision making and implementation is to build a market position strong enough and capable to produce successful performance and policy changes that will enhance the growth of an industry or company.

### **3. 2 Innovation Management**

Innovation involves the conversion of new knowledge into a new product, process or service and the applying of this new product, process or service into actual use (Trott, 2005). According to (Low and MacMillan, 1988) it is the process of planning, organising, operating, and assuming the risk of a business venture. Innovation is also the ability of firms to recognise opportunities in the market place (Slatter and Narver, 1994 ; Porter, 1980; 1985). Cohen and Levinthal (1990) and Trott (1998) argue that few firms have the ability to scan and search their environment effectively. The focus of innovation management is to allow the organisation to respond to an external or internal opportunity, and use its creative efforts to introduce new ideas, processes or product (Kelly and Kranzburg, 1978). The application of appropriate innovation management tools by the management can trigger creativity to the entire workforce towards continuous improvement of a company (Clark, 1980). Innovation management process can be viewed as an evolutionary integration of technology and market by repeating a series of activities such as search, select, implement and capture (Tidd and Bessant, 2009). Van de Ven (2005) suggests that first movers of technology innovation move faster in order to get optimal benefit. Although this does not mean that innovation has to be technological, it can market innovation as a means to increase barriers of entry Porter (1979).



### 3.3 Competitive Forces

According to Porter (1980) strategic management is the positioning of an organisation or industry, relative to its competitors, in such a way as to gain competitive advantage. Usually, a Porter's five forces framework is utilized to perceive an industry structure and the attractiveness and profitability of the industry (Porter, 1979). It also involves assessing the bargaining power from suppliers and buyers, the threats of new entrants, the threat of substitute products/services, and rivalry amongst existing competitors. The five forces views the industry as a whole and it also considers the firm's capacity.

Therefore to successfully apply strategic management is to understand the industry structure in terms of economic and other technical drivers in order to gain competitive advantage. In view of the deregulation reform, competition in the industry will increase. Teece et al. (1997) suggest that investment decisions based on this model should consist of the following steps:(1) Assess an industry based on its attractiveness; (2) Select an entry strategy based on inferences about competitors rational strategies; (3) if not already possessed, acquire or otherwise obtain the requisite assets to compete in the market. Figure : The Porter five forcesSource: Adapted from Porter (1980). Porter (1980) argue that the five forces can be applied as an approach to determine the profitability of an industry or where an organisational strength is most suitable; however, it's assumed that the forces can be manipulated by marketing innovation with the purpose to increase the barriers for entry, such as brand identification, or to increase the perception of switching costs to embrace loyalty. Porter identifies six major sources of barriers to entry: capital requirement, economies of scale,

product differentiation, access to distribution channels, cost disadvantages and government policy. To defend a position within the industry, Porter (1980) identifies three generic strategies that a firm could use and these are: differentiation, cost leadership and focus. Essentially, Porter (1980) argues that some firms within industries will be more profitable if they are either big with cost leadership strategies or small with differentiation or focus strategies, compared to medium sized firms which are less profitable and regarded as fixed in the middle. This study utilises Porter's five forces model to analyse the competitive forces that can sustain the industry in a deregulated regime.

### **3. 4 Overview of Nigeria Downstream oil and gas Industry**

The downstream oil and gas industry comprises of all the activities from the delivery of crude oil to the processing plants for refining, conversion and value addition into gasoline, diesel, kerosene and petrochemicals, including transportation, storage, marketing of the finished products and associated services (El-Rufia, 2011). The value chain as shown in figure 3 entails the supply of the crude oil to the refineries, primary distribution from refineries to terminals, secondary distribution to depots and distribution to retail outlets for marketing. Petroleum products accounts for a major part of the living cost of Nigerian families like transportation costs, cost of cooking gas or kerosene (El-Rufia, 2011). Figure : The Upstream, Mid-stream and Downstream Value Chain

Distributing and selling refined products  
Converting crude oil into finished products  
Moving oil to the refinery and consumers with pipeline, trucks and tankers  
Bring oil to the surface using technology  
Using technology to find

resourcesMarketingRefiningTransportationProductionExplorationSource:

Adapted from (Bright, 2011). British Petroleum, Corporate Giant in a messAccording to EIA (2011), Nigeria domestic consumption of petroleum was about 286, 000 bbl. / d in 2011 of which about 180, 000 bbl. /d was gasoline. Report from Oil and Gas Journal (OGJ) shows that the combined capacity of four major refineries in the country (Port Harcourt I and II, Warri, and Kaduna) is around 445, 000 bbl. /d. As a result of poor maintenance, theft, and fire, none of these refineries have been fully operational (Funsho, 2004). In 2009 and part of a 2010 low performance of the refinery operation led to the importation of about 85 percent of Nigeria's fuel needs (EIA, 2012). In 2011, the operational capacity at refineries averaged 24 percent, slightly higher than the 22 percent in the previous year.

### **3. 4. 1 Infrastructure**

Oil infrastructure is located across the nation, Port Harcourt refinery was built in 1966 and has a total installed capacity of 35, 000 barrels per day (bpd). The Warri refinery with a total refining capacity of 125, 000 barrels per day was built in 1978. In 1980 Kaduna refinery with a total refining capacity of 110, 000 barrels per day was built. The nation's fourth and last refinery was built in 1989, in Port Harcourt. In order to reduce the cost of transportation, the government constructed pipelines, linking all the depots in the country. By 1979, a total of 3, 001 km of pipelines linking 16 storage depots to the refineries where constructed all over the country. According to EIA (2012), over 5, 000km of pipelines have currently been constructed linking refineries and 21 storage depots nationwide as indicated in figure 5. Figure : Downstream InfrastructureSource: Presentation by Diezani (2012). <https://assignbuster.com/the-effects-challenges-and-prospects-business-essay/>

### **3. 4. 2 Structural Changes**

The introduction of the independent market scheme by the government in 1978 led to the establishment of an Independent Petroleum Marketers Association of Nigeria (IPMAN). In 1988, the Petroleum Inspectorate Department of the NNPC was renamed, the Department of Petroleum Resources (DPR) (EIA, 2012). The department was separated from the NNPC within the same period and merged with the Ministry of Petroleum and Mineral Resources. To ensure the effective management of the pipeline network and overall distribution of petroleum products throughout the country, the government in 1988, established the Pipelines and Products Marketing Company (PPMC). The PPMC does not only manage the petroleum products pipelines and associated depots, but also oversees the overall processes involved in the marketing and distribution of products. The major role of the oil marketers in Nigeria is the distribution of petroleum products around the country, while the major petroleum products they distribute include the following: Premium motor spirit (PMP or Petrol)Automotive Gas Oil (AGO or Diesel)Household Kerosene (HHK)Aviation Turbine Kerosene (ATK or Jet-AI)Industry FuelHigh Pour Fuel Oil (HPFO)Low Pour Fuel Oil (LPFO)Liquefied Petroleum Gas (LPG)BitumenBase Oil

### **3. 4. 3 Operations**

According to PPPRA (2004), the current major oil marketers are namely: Oando, Mobil, Conoil, Total, AP, Agip, Capital Oil, Honeywell oil and gas, Zenon Oil, Eterna oil and gas, Ascon oil, and Texaco. They control a substantial share of the country's oil market in terms of products supply and distribution. The presence of the major oil marketer's is more pronounce in

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the major cities. Similarly, the Depot and Petroleum Products Marketers Association of Nigeria (DAPPMA) play a significant role in products procurement and distribution in the country. Currently, about 5, 000 Independent Petroleum Marketers Association (IPMAN) controls a fairly large share of the oil market EIA (2012). IPMAN operations are felt more in the hinterland compared to the majors who dominate the cities.

### **3. 4. 4 Recent Development**

The Nigeria government removed fuel subsidies on January 1, 2012 on the grounds that it caused market distortions, encumbered investment in the downstream sector, supported economic inequalities as rich oil marketers were the main beneficiaries and have created channels for fraud. Contrary to the government's contention many Nigerians consider fuel subsidy a key benefit of being an oil rich nation. Prior to the subsidy removal, the pump price of fuel was 65 naira (\$0. 40) per litre compared to the actual cost of around 139 Naira per litre. According to the United Nations, the fuel subsidy costs the Nigerian government annually 1, 200 billion Naira (\$7. 6 billion), or 2. 6 percent of the country's GDP. Subsequent to the removal, the government restored a partial subsidy, requiring consumers at the pump to pay 97 naira per litre (\$0. 60), as opposed to the new price of 141 naira per litre. Fuel subsidy is a major challenge and debates continued among government officials, oil marketing associations, unions, and concerned citizens, especially after the review of the sector by the government, which culminated in the full deregulation of the downstream oil sector on 29th September, 2003 (Oluwole, 2004).

### **3. 5 Conclusion**

This chapter highlighted the perspective of strategic management as the main focus of this study. It also explored the concept of competitive forces and innovation as a perspective that underlines this viewpoint. On the whole, an effective strategic management tool for planning, evaluation, implementation, monitoring and control will enhance the success of deregulation. While the concept of innovation and competitive forces will improve industry operators competitive advantage. Chapter four, the research methodology will discuss the philosophy, data collection and analysis method.