Corporate Governance of a Scandinavian MNE in an emerging market - Case study of Statoil ASA in Venezuela -

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Executive summary

Multinational enterprises seek opportunities in areas with a potential great return on investments and future growth. These areas are in some cases emerging markets that are rapid growing and uses economic liberalization as a primary engine for growth. However there are several challenges when entering an emerging market, one of them is the corporate governance issue.

In this context I aim at investigating the presence of Statoil ASA in Venezuela in a corporate governance view, analyzing the different aspects in the joint venture Petrocedeño S.A with Petróleos de Venezuela, S.A (PDVSA).

The thesis is conducted in an exploratory approach, using theoretical tools such as agency theory, institutional theory and resource based view. By using these tools, combined with an overview of existing publications on corporate governance, it allows me to frame the case at hand in a theoretical perspective

Furthermore I use corporate governance framework such as the OECD principles of good corporate governance, national corporate governance codexes for the countries at stake, and reports made by recognized institutions to provide an overview of the differences the companies and countries may have on corporate governance.

Finally I draw conclusions regarding my findings and make recommendations regarding Statoil’s further involvement in Venezuela.
# Table of Contents

1. Introduction .................................................................................................................. 4
   1.1 Background and Research Topic ........................................................................... 4
   1.2 Motivation .................................................................................................................. 5
   1.3 Choice of industry .................................................................................................... 8
   1.4 Research objective and Research questions ........................................................ 8

2. Theories and Methodology .......................................................................................... 9
   2.1 Source criticism ......................................................................................................... 10
   2.2 Limitations ................................................................................................................ 10

3. Presentation of Corporate Governance ...................................................................... 11
   3.1 What is Corporate Governance? ........................................................................... 11
   3.2 Why Corporate Governance? ................................................................................. 13
      3.2.1 Agency theory .................................................................................................... 13
      3.2.2 Corporate Social Responsibility .................................................................... 15
      3.2.3 Institutional Theory .......................................................................................... 16
      3.2.3.1 Rule of Law as an Institution .................................................................... 17
      3.2.4 Resource Based View ....................................................................................... 17
   3.3 International Corporate Governance ....................................................................... 18
      3.3.1 Venezuela and Corporate Governance ............................................................... 19
      3.3.2 Norway and Corporate Governance ................................................................. 21

4. Preface of the analysis section ..................................................................................... 24
   4.1 Why Statoil ASA and Venezuela? .......................................................................... 24
   4.2 Presentation of Statoil ASA .................................................................................... 24
   4.3 Presentation of the Venezuelan Oil Industry ............................................................ 26

5. Analysis .......................................................................................................................... 29
   5.1 Analysis of Corporate Governance in Norway and Statoil ................................. 30
      5.1.1 Shareholders influence on the management ...................................................... 30
      5.1.2 Stakeholder’s role and influence on the company ........................................... 32
      5.1.3 Transparency ................................................................................................... 33
      5.1.4 Governing bodies and their role in the company ............................................. 34
      5.1.5 Risk management and internal control .............................................................. 37
      5.1.6 Remuneration of the board of directors ......................................................... 38
      5.1.7 Overview ........................................................................................................... 39
5.2 Analysis of Corporate Governance in Venezuela and PDVSA .......................................................... 40
  5.2.1 Shareholders influence........................................................................................................ 41
  5.2.2 Stakeholder’s role and influence ...................................................................................... 42
  5.2.3 Transparency .................................................................................................................... 43
  5.2.4 Governing bodies and their role in the Venezuelan market ............................................ 44
  5.2.5 Risk management and internal control ............................................................................. 45
  5.2.6 Remuneration of the board of directors .......................................................................... 46
  5.2.7 Overview ........................................................................................................................ 47

6. Analysis of Statoil ASA in Venezuela ......................................................................................... 49
  6.1 Agency Theory.......................................................................................................................... 49
  6.2 Corporate Social Responsibility ............................................................................................ 51
  6.3 Institutional Theory ................................................................................................................ 52
    6.3.1 Formal Institutions ......................................................................................................... 53
    6.3.2 Informal Constraints ..................................................................................................... 54
    6.3.3 External connections linking executives and key stakeholders ......................................... 54
    6.3.3.1 Rule of Law as an Institution .................................................................................. 55
  6.4 Resource Based View ............................................................................................................ 56

7. Discussion and findings .............................................................................................................. 57

8. Conclusion .................................................................................................................................... 60

9. Recommendations ..................................................................................................................... 61

Bibliography .................................................................................................................................... 62
Sources and Websites: .................................................................................................................. 64
1. Introduction

1.1 Background and Research Topic

While writing my master’s thesis, there have been corporate structural changes within StatoilHydro, these changes are not concerning the company’s financial, operating or ownership structure. From 1. November 2009 StatoilHydro is no longer an existing brand, the new name of the company is now known as Statoil ASA.

Corporate governance is not an incorporated defined and based rule of law in any company. It is more a code of conduct concerning the whole of a company and its people. In the recent years in the business world the corporate governance issue has been more and more debated and discussed due to scandals such as Enron and WorldCom in the U.S and Parmelat in Italy, which again has lead to an enhanced focus on internal corporate control over management. The scandals concerning public traded companies are often due to the fact that management have followed their own strategy for growth and revenue and not considered the shareholders interest. The main idea behind corporate governance is that it is used as a mechanism to protect stakeholders by controlling the management.

The notion of corporate governance is especially interesting considering the involvement of nations with different corporate cultures, legal conditions and development within corporate governance.

In my thesis I will focus on the effect corporate governance has on joint ventures and FDI between a large foreign MNE with strong moral conduct, Statoil ASA, and a country wildly recognized as one of the least economically free countries in the world, Venezuela\(^1\).

By writing this thesis I will determine the differences of corporate governance practices between Scandinavian businesses and Venezuela. Scandinavia has a socialistic view on conducting political reforms and so do Venezuela, however Venezuela have a more radical and aggressive approach. Recently the government, with Hugo Chavez as president, has been nationalizing several companies and facilities to ensure the country’s own natural resources. International

\(^1\) [www.cato.org](http://www.cato.org)
companies such as Halliburton and Schlumberger are two among several oil companies in Venezuela that are at risk of losing their licenses and thereby forced out by the government.\(^2\)

Conducting this thesis, using an exploratory approach, I will explore the risks and threats in a corporate governance view, and try to determine Statoil’s presence in Venezuela are developing in the stakeholder’s interest.

1.2 Motivation

According to J. Dunning (1993) an MNE is:

“A multinational or transnational enterprise is an enterprise that engages in foreign direct investment (FDI) and owns or, in some way, controls value-added activities in more than one country”.

The role of multinational enterprises (MNEs) in emerging economies has become a key aspect in globalization, this due to the fact that FDI might facilitate knowledge transfer, modern values and more efficient management practices to the host country, as it is a major source of capital and technology in emerging economies continuing to accelerate in economic significance.

Statoil ASA, from now referred as Statoil, is by this definition a MNE because of the many expansions in foreign markets, such as Venezuela among many others. Statoil is a Norwegian MNE in the oil and gas industry with presence in more than 40 countries worldwide. Some of the countries experience great political and financial distress, such as problems with corruption, economic challenges, social indifference, economic indifference, political influence by corruption etc. The company is state controlled by the Norwegian government with a controlling share of 67%. The company is listed as a public traded company on the Oslo Stock Exchange and NYSE. Statoil is widely recognized as a company with great ethical and moral conduct in doing business in the globalizing world.

Statoil has been present in Venezuela since the late 1994 and states through its website that the involvement in the country is a long term commitment.

\(^2\) www.reuters.com
Venezuela has in the recent two decades gone through great political, social and economic turmoil. The country is rich on natural resources with one of the largest oil and mineral reserves in Latin America and the Caribbean.\(^3\) The country’s economy is highly dependent on oil export as the revenue from oil export contribute to over half of the government’s revenue. Since the late 1800 foreign MNEs have been present in the Venezuelan oil market, however the political instability regarding the nationalization of companies in the Bolivarian revolution, a program developed by the populist left winger president Hugo Chavez, have made FDI levels drop significantly the recent years.\(^4\)

As Venezuela is an emerging market it is therefore a contradiction when considering the terminology of an emerging economy is stated by Hoskisson et al (2000) as:

“Emerging economies are low-income, rapid-growth countries using economic liberalization as their primary engine of growth”.

The World Bank classifies economies as low-income (GNI $755 or less), middle-income (GNI $756–9,265) and high-income (GNI $9,266 or more). According to Worldbank.org, low-income and middle-income economies are sometimes referred to as developing countries. Venezuela with its GNI per capita of $ 7320 classifies within the middle-economies i.e. an emerging economy.\(^5\)

Venezuela is therefore dependent on attracting FDI to sustain a higher level of GNI per capita and emerge from an emerging economy to a developed economy.

Normally the focus on corporate governance is on a company level i.e looking at corporate management and board of directors in publicly held companies. I will in my thesis expand the stakeholders by including the government in Venezuela, because the main role of the government is to obtain Venezuela and the citizen’s future revenue interests. Most countries have enrolled acts and policies on how to conduct good corporate governance. The Sarbanes-Oxley act of 2002, which is the act used by the U.S government to protect the shareholders interests in publicly held companies, is a widely applied policy in the U.S.

\(^3\)Worldbank.org  
\(^4\) www.fdi.net  
\(^5\) Worldbank.org
Venezuela has made an effort in adapting norms that are applicable to the principles of corporate governance as defined by the OECD, resulting in an agreement of self-regulation by the issuing entities with regard to corporate governance made formal in the Venezuelan official gazette, no: 327286 of 17 February 2005.[6][7]

However this agreement was developed in a context that involved mainly listed companies on the Venezuelan Stock market in Caracas. Companies in Venezuela consist mainly of non-listed companies such as SME and non-listed large companies such as PDVSA. The Venezuelan Petroleum Corporation (Petróleos de Venezuela, S.A.—PDVSA) is the third largest international oil conglomerate and was founded in 1977. PDVSA is state controlled by the Venezuelan government and also the majority shareholder of Petrocedeño S.A, a joint venture between PDVSA, Total and Statoil. PDVSA and its affiliates, in this case Petrocedeño S.A, are therefore not included in the agreement. The well awareness of the government that the market constitutes more than 95 % of companies in the SME sector and over 90 % of the country’s industry is appalling considering that this sector also is the main provider of employment in the country.

The Petrocedeño S.A project, which is the most successful extra-heavy crude project in Venezuela, is a joint venture with Statoil as a minority shareholder with an owner’s interest of 9, 67%. 8 Petrocedeño S.A is controlled by the Venezuelan state with approximately 60% owner’s interest and Total with approximately 30% owner’s interest. The amount invested by Statoil in Venezuela is approximately $ 1 billion and it is stated by Statoil that it is a long term investment. However difficulties have arisen from their original investment in the former Sincor project, now known as Petrocedeño S.A, as Statoil had an owner’s interest of 15% by the end of 2006. Their share in the project is reduced to 9, 67% as mentioned before. I presume that this is a clear violation towards Statoil own goal and ambition in Venezuela, due to the fact, as I described earlier in my thesis, that Statoil has a long term investment commitment.

From Statoil’s homepage the investment in Venezuela is defined as a Greenfield investment with contribution of knowledge and experience both in the Petrocedeño S.A and the offshore participation Plataforma Deltana in the Atlantic Ocean, adjacent to Venezuela’s border with Trinidad & Tobago.

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[8] www.statoil.com
Overall the strategy and goal of Statoil’s presence in Venezuela is aligned with the company’s strategy which is:

- Building and delivering profitable international growth
- Developing profitable midstream and downstream positions

By exploring the corporate governance in Venezuela from Statoil’s point of view I will determine if the presence of Statoil in Venezuela is developing as planned when they first decided to enter the market. Are the goals and ambition developing as planned? If not could the corporate governance issues give an explanation?

1.3 Choice of industry
As the demand for energy resources as oil and gas is ever rising and the resources is ever declining, companies such as Statoil must find and explore markets independent of political, geographical or social awareness for future economic growth. This makes Statoil and similar companies highly vulnerable towards the impact of state government i.e Venezuela, and the global corporate governance issues.

The similarities between the two nations are also important factors, as both nations are highly dependent on their national oil and gas resources.

1.4 Research objective and Research questions
In order to enlighten the interesting aspects of the topics mentioned earlier I have designed following key research objective:

**Research objective:** Analysis of Statoil’s minority share in PDVSA through a corporate governance view with the emphasis on the differences on how to conduct corporate governance in Venezuela and in Norway.

The research objective will be determined using theoretical tools, corporate governance framework and literature on the topic of research.

Subsequently this research objective will raise some underlying research questions:
**RQ 1:** What impact, if any, does a major Scandinavian MNE such as Statoil have on the corporate governance level in emerging markets such as Venezuela?

**RQ 2:** Vice versa, how does the corporate governance practice in Venezuela influence Statoil?

**RQ 3:** What impact does Statoil have on determining the future of Petrocedeño S.A, Plataforma Deltana and Carabobo area?

**RQ 4:** Are the factors on the investment climate in Venezuela indicating a hostile threat on MNEs such as Statoil? And how does it affect future investments?

RQ1 and RQ 2 examine the power structure between Statoil (Norway) and PDVSA (Venezuela) in their joint venture Petrocedeño S.A. Subsequently does RQ3 and RQ4 investigate the possible future for Statoil in Venezuela after the determination of RQ1 and RQ2.

### 2. Theories and Methodology

The research in this paper is build upon three different but interrelated theoretical approaches. When applied, it will provide a founding for conclusions and recommendations regarding the aspects I find most important in the power relation between the Venezuelan government, i.e PDVSA, and Statoil. As the paper consists of these theoretical elements it has a research design that is coherent with what I believe are the main parameters in the process of cooperation between the parties at stake. The paper will conclude on these points of focus and will provide recommendations on further development in the process of cooperation between PDVSA and Statoil in their joint venture Petrocedeño S.A. The complex nature of the theory composition alongside the fact that it is a case study will only conclude on this specific case and only regarding Venezuela, i.e. this paper will not draw conclusions valid for application on other countries than Venezuela. To draw sound conclusions a combination of statistical and qualitative data is explored with the intentions of getting as much information on the questions in focus as possible. Specifically I will use research data from media, official/governmental, organizations such as OECD and company web sites in my data sample. The analyses in the paper will consist of an exploratory approach, in order to process the collected data properly, identifying complexities and problems, creating an overview of (latent) causality between the actual facts
and the problems affecting the cooperation between PDVSA and Statoil. In this regard, the implicit power relationship, referred to as a principal/principal construction, is addressed and analyzed, using a theoretical tool based on the traditional agency theory. Furthermore, the potential obstacles regarding the institutional conditions are addressed and analyzed using the institutional theory. The final aspect of interest, relates to the resource composition of the cooperation, as Statoil may be the provider of advanced technology in the project.

2.1 Source criticism
Information regarding corporate governance principles in PDVSA and Statoil is based on information provided through the companies websites. The information provided is therefore difficult to verify and qualify. However, considering Statoil applies the Norwegian code of conduct and Norway has a strong corporate governance policy, I presume the information provided through Statoil’s website is coherent with international standards.

PDVSA’s web pages are not up to date regarding the current owner situation. Changes that occurred several months ago are not transparent through the web pages of PDVSA. The fact that Venezuela has no corporate governance framework such as “National Code of Practices” for companies such as PDVSA and the joint venture Petrocedeño S.A, this makes it difficult to analyze the entities at stake as there is no corporate governance framework which is applicable for the companies.

2.2 Limitations
The purpose of the thesis is to analyze the differences on how corporate governance is performed in Venezuela and in Norway. Similarities and differences on the issue can therefore only concern the two countries at stake, however the strong resembles between other Latin American countries and Venezuela and vice versa with Norway and Western Europe could give an indication on how the corporate governance is between Latin America and Western Europe.

It could arise some difficulties getting information from Statoil regarding current corporate governance problems in Venezuela due to the vulnerable effect this could have on the stock price of Statoil on the Oslo stock exchange and on the NYSE. In general bad corporate governance could have a negative effect on Statoil. Due to the insecurity on corporate governance agreements
in Venezuela, Statoil would not benefit from publishing any irregularities and aberrations from their own corporate governance practices.

The thesis is based on a single case study of Statoil in Venezuela, with a market analysis of the oil and gas industry in Venezuela. Other markets will not be taking into consideration, so variations from industry to industry will not be highlighted. The findings and conclusion can therefore not give a corporate governance solution to other MNE in other industries. It can only provide a guideline for other MNE’s that are seeking opportunities in the promising oil and gas market in Venezuela.

Also, other MNEs can have different opinions on how the corporate governance should be conducted in Venezuela and they can also have other opinions on how the level of corporate governance is in Venezuela. I solely base my study on how Statoil experiences the corporate governance level in Venezuela and reflect this upon Statoil’s own corporate governance policy. General implications and lessons will be highlighted in chapter 4.3 “Analysis of Statoil ASA in Venezuela”.

3. Presentation of Corporate Governance

3.1 What is Corporate Governance?
Corporate governance is not a protected title i.e meaning that there is no formal guideline on how corporate governance should be practiced. In general it could be explained as the relationship between the board of directors, management and the shareholders in a company where the main function is to control the management and protect the shareholders. Corporate governance is best described as a set of processes and goals companies should strive to accomplish through an ethical business moral, and how the corporate management through its structure and focus should conduct its business in the best suitable way for its shareholders.

Shleifner and Vishny (1997), defines good corporate governance as an assurance for suppliers of finance to companies, to get a return on their investments. Mechanisms in how to get this assurance could be forcing law and regulations on companies to protect owner’s interests.
However there are theories indicating that corporate governance in the long run, without interference of governance reform, could be self implemented through certain market conditions such as competition, this due to the fact that companies are forced to minimize costs and a part of this cost minimization is to adopt rules which includes corporate governance mechanisms, enabling the company to raise external capital at the lowest cost. This would cause an efficient market and a self-regulated economy, where competition is the solution to corporate governance; however it does not guarantee return on capital for investors. The corporate governance mechanisms provide this assurance.

Shleifer and Vishny (1997) also states that in most advanced market economies the problem of corporate governance is partly solved in that they have assured the flows of enormous amounts of capital to firms, and actual repatriation of profits to the providers of finance. The corporate governance mechanisms in most advanced market economies still experience problems and improvements are constantly evolving.

Corporate governance is defined by the glossary of statistical terms in OECD as:

“Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making”.

The OECD definition is a guideline in creating an own set of practices in which a global perspective is at focus.

The definition of corporate governance may vary from nation to nation as several nations have developed their own national corporate governance practices i. e codex such as the Cadbury report in the U.K and the Sarbanes- Oxley act in the U.S.

In order to give an even more precise description of corporate governance, I will further enlighten
the debate on why corporate governance does matter for global presence of businesses. Thus I will describe and explore the origin of corporate governance.

3.2 Why Corporate Governance?
In this section I will focus on why corporate governance in the recent decades has become more and more popular as a topic of great discussion among businesses, news writers and columnists, to mention few.

I will also give an explanation to why corporate governance is of great contribution and importance in countries such as Venezuela, by looking at the country’s history. The challenge in this paper is to prove any anomalous behavior which is also stated by national and international authorities.

The most important aspect in corporate governance is the principal-agency theory. The principal-agent theory defines the management as agents and the owners as the principal, whereby the agents (management) acts on behalf of the owners (principal).

In the following section I will emphasize on The Agency Theory, as this the fundamental factor in corporate governance, Corporate Social Responsibility (CSR) Institutional Theory, both formal and informal, as the social and regulatory aspects of this case are of significance when analyzing firm behavior between the entities at stake, and finally Resource Based View (RBV), as Statoil may possess technological advantage in the power struggle with PDVSA.

3.2.1 Agency theory
The agency theory is defined by M.C Jensen and W.H Meckling (1976) as the relationship between a principal and an agent. The principal engages another party (the agent) to perform services on its behalf which involves delegating decisions making authority to the agent. The essence of the agency problem is concluded by Shleifer and Vishny (1997) as the separation of management and finance, or —in more standard terminology, —of ownership and control, this due to the fact that both parties will try to take advantage of the situation to enhance their own utility, i.e. maximizing current situation. The principal interest is to increase and gain highest possible
return on investment, whereby the agent’s interest is to gain highest possible income through minimum risk and work effort. Problems arise when either the principal or the agent maximizes their own utility by reducing or blocking the other party from maximization. Investors have to assure funds from being expropriated or wasted on unattractive projects. To do so contracts are made to ensure and specify what managers does with the funds.

Type of agency problem could be the one we discussed above, which, by S. Thomsen (2008) is called **Type 1 agency problems**. **Type 2 agency problems** concern the relationship between majority and minority shareholders and occur if there are conflicts of interests between the two groups. Different opinion could occur and jeopardize the relationship between the two parties involved.

**Type 3 agency problems** between shareholders and other stakeholders occur when shareholders make self-interested decisions which influence the welfare of other stakeholders. Example of a situation when this could occur is if the shareholders want to close down a factory to save money which would harm the employees and possible harm the local community.

An important part of agency problems is the information asymmetry, which entitles that the agent has more knowledge and more information concerning the company than the principals. Thus also have more knowledge concerning the company’s financial figures, current competition and investment opportunities. There are two particularly important types of information asymmetry: moral hazard, which I described in the above section, and adverse selection.

If the agent possesses more information and is aware of the information asymmetry, the agent could take actions against the interests of the principals. Actions against the interest of principals are called moral hazard; i. e the management has set aside the shareholders interest. Moral hazard refers to hidden action and adverse selection refers to hidden knowledge, in which the agent withdraws information or hides information for example about own achievements and competence. The principal’s goal is to reduce the conflict of interest between his own goals and the agent’s goals, in order to do so, the principal can use different incentives so that the agent wants to act on the behalf of the principal, thereby aligning their goals and ambitions.
Such incentives could be bonus arrangements, monetary, or the risk of being fired, non-monetary, when acting against the interests of the principal. Another option is to constantly supervise the agent, stopping the agent of misconduct of interest, before an incident has occurred.

Agency costs arise due to the conflict of interests between the principal and the agent. Agency cost could include cost of supervising the agent (internal control) and commitments regarding long term contracts of bonus arrangements in correspondence to the company performance. The principal can supervise the agent by analyzing the company’s budget and financial statements and thereby find any irregularities against his own preferences and interests. The agency theory emphasizes on how the management act and conduct business to preserve and protect the shareholders interests.

Another important agency issue, especially in this case, is the principal- principal goal incongruence, defined by Dharwadkar and Brandes (2000), which is a typical agency problem arising in emerging markets. This problem may lead to expropriation of weak governance as the majority shareholder take control over the company and deprive minority shareholders from appropriate return on investments. As minority shareholders have the same interest as the majority shareholder, they will act as allies to even the odds in a potential clash with the majority shareholder. This situation creates many implications regarding corporate governance and agency theory.

The potential principal- principal goal incongruence between the entities at stake will be analyzed further in section 4.3.

3.2.2 Corporate Social Responsibility
According to McWilliams and Siegel (2001) CSR is defined as actions that appear to further some social good, beyond the interest of the company and that which is required by law. However they argue that CSR means going beyond the law not only abiding the law. Some examples in CSR actions that go beyond legal requirements are: recycling, abating pollution and supporting local businesses.
These actions could be encouraged by shareholders (especially large institutional investor), customers, employees and governments. The CSR policies from a corporate governance view are interesting when considering a joint venture consisting of companies with different ethical and moral issues. This again relates to agency theory as there might be different opinions on how the joint venture should act in a CSR view.

3.2.3 Institutional Theory

The social and regulatory aspects of this case are of significance when analyzing firm behavior. Since ownership concentration and identity are arguably embedded in national institutions these have to be considered when analyzing corporate, and in this case national, strategy. Institutions, by North (1991), are the rules of the game in a society or, more formally, the humanly devised constraints that shape human interaction. In that way, they affect the performance of the economy by affecting the cost of exchange and production. Together with the technology employed, they determine the transaction and transformation (production) costs that make up total costs. (Both formal and informal institutions play a significant role in the strategic choices Statoil and PDVSA make in the emergence of the Petrocedeño S.A project).

By North, institutional frameworks are made up of both formal and informal constraints. Formal institutions include political rules, judicial decisions and economic contracts. Informal institutions include socially sanctioned norms of behavior, which are embedded in culture and ideology. Peng (2001) argues that when formal constraints fail, informal constraints will play a much larger role to reduce uncertainty and provide constancy to organizations. I choose to look at two typical informal constraints:

1. The interpersonal relations among executives.

2. External connections linking these executives and key stakeholders. (Corruption, linkages with government officials).

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9 Foreign and domestic ownership, business groups, and firm performance: Evidence from a large emerging market, Douma, George and Kabir, Strategic Management Journal 2006 p. 4
3.2.3.1 Rule of Law as an Institution
Within political science there is a common belief that the rule of law is a prerequisite for functioning democratic systems, political processes and a social development\textsuperscript{10}.

The rule of law in western society, as we know it is well developed and constitutes a common belief that rule of law is a prerequisite for future economic growth. Laws and justice must be embedded in the national institutions to ensure a legal system that protects and ensures both national and foreign businesses operating in the specific country.

In developing countries, especially in countries in Asia, Africa and Latin America, the rule of law is not fully entrenched in the legal system, creating voids and uncertainty for MNEs seeking business opportunities.

3.2.4 Resource Based View
According to the Resource Based View (RBV), by J.B Barney (1991), a firm’s competitive advantage is based on its tangible and intangible assets. A brief definition on the traditional RBV is “\textit{Firms can earn supra-normal returns if and only if they have superior resources and those resources are protected by some form of isolating mechanism preventing their diffusion throughout industry}”.

The traditional RBV argues that resource related advantages would ultimately result in profit maximization, whereas the gains, as a result of unique resources, in this case will form of strategic alliances opening doors to future operations.

J.B. Barney’s segmentation of resources (Valuable; Rare; Imperfectly Imitable; Non-Substitutable) is a useful tool in the identification of a company’s resources:

\textit{Valuable}: when they enable a firm to conceive or implement strategies that improve its efficiency or effectiveness.

\textit{Rare}: valuable firm resources possessed by large number of competing firms cannot be sources of either a competitive advantage or a sustainable competitive advantage.

\textsuperscript{10}Worldbank.org
*Imperfectly Imitable*: because of (a combination of) 3 reasons; unique historical conditions; causally ambiguous; social complex.

*Non-substitutable*: there must not be strategically equivalent resources that are themselves either not rare or imitable.

These tools (VRIIN-S) will later be analyzed upon when determining the presence of Statoil in the Venezuelan Oil and Gas market.

### 3.3 International Corporate Governance

The international development of corporate governance had its foundations from the U.S (the Sarbanes- Oxley act of 2002) and England (the Cadbury report). Acts and efforts from these two countries have made the foundation of national codexes in several other countries.

However I will emphasize on the OECD principles of good corporate governance, as this is the international codex all countries, despite the differences in national law and regulation, can use as benchmark to good corporate governance performance.

OECD developed their “Principles of Corporate Governance” in 1999, due to the development and experience of OECD member and non members, to give an even broader international scope of the term corporate governance. After the introduction of the principles, they have become the international benchmark for investors, corporations, policy makers and stakeholders worldwide.

The principles however are only recommendations on how to conduct good corporate governance, thus they are not solely binding as law of regulation for companies and countries. Despite that they are only recommendations, OCED’s principles have had a great magnitude in companies and countries in shaping good relations with counterparts.

The OECD Principles of Corporate Governance 1999 was in 22. april of 2004 revised and published, where new development in the area was taken into consideration and empowered.

Differences in economic and cultural behavior from nations to nations were adapted and the principles of 2004 are developed through knowledge and experiences from both OECD members and non OECD-members.
The principles of OECD are intended by OECD to:

“The Principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. The Principles focus on publicly traded companies, both financial and non-financial. However, to the extent they are deemed applicable, they might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state-owned enterprises. The Principles represent a common basis that OECD member countries consider essential for the development of good governance practices. They are intended to be concise, understandable and accessible to the international community. They are not intended to substitute for government, semi-government or private sector initiatives to develop more detailed “best practice” in corporate governance”.

In order to ensure this OECD focus on following key aspects:

I. Ensuring the Basis for an Effective Corporate Governance Framework
II. The Rights of Shareholders and Key Ownership Functions
III. The Equitable Treatment of Shareholders
IV. The Role of Stakeholders in Corporate Governance
V. Disclosure and Transparency
VI. The Responsibilities of the Board

These key aspects will be thoroughly analyzed and described for each of the entities at stake, Statoil and PDVSA in my analysis.

3.3.1 Venezuela and Corporate Governance
With a history of cruel dictatorship, violence by powerful landowners of peasants and workers causing and extreme impoverishment and political uncertainty for decades of a time, Venezuela was left behind the economic and political infrastructure developing in the U.S and Europe at the same time. Venezuela became an economic basket case after the fall of the dictatorships leading
to political instability and financial turmoil. Still Venezuela is by some news agencies, such as the CNN, defined as a “dictatorship” lead by Hugo Chavez as president.

When Hugo Chavez attempted to nationalize the oil production in 2002-03, which amounts to 30% of the gross domestic product, the despotic dictator was met by huge protests and riots not only from the executives and oil workers but from the Venezuelan people in general. As strikes went on and the oil trade from Venezuela stopped, the strike and the nationalization were condemned on both sides from the world press.

The Organization of Petroleum Exporting Countries (OPEC) has some doubts concerning reports published by PDVSA as numbers are not coherent with OPEC’s own reports. A paper by Ramon Espinasa, which explores the outcome of the Venezuelan oil sector from 1997-2008, accounted a gap between the exports numbers recorded by PDVSA and those from EIA (Energy Information Administration), the official energy statistics from the U.S Government. According to the R. Espinasa (2009) the difference between the two reports amounted to 1.24 million bpd (barrels per day), equal to a 42% difference.

In the time period from 2002-2006 PDVSA did not produce any performance assessments, concluding in a relatively poor transparency towards its stakeholders.

As for corporate governance agreements in Venezuela, which in the past were formed through legal mechanisms, are now made formal through an inventory of legal forms created by the The Asociación Venezolana de Ejecutivos (AVE), applicable to corporate governance and constitutes a set of laws that more or less covers the principles of good corporate governance defined by OECD.

The problem in Venezuela and in other emerging markets is that the market consists of a majority of SME and non listed large companies. These companies are in some cases reluctant to adopt good corporate governance due to the possible loss of sensitive corporate information. A large numbers of these SME companies are family owned and transparency of financial statements is not positive welcomed, due to the misunderstanding of the concept of corporate governance. In the case of large- non listed state owned companies such as PDVSA, adopting good corporate governance has much to do with the public policy context and the strategic interest defined for
each sector.\textsuperscript{11} 

As stated by La Porta et al (1999): “the political opposition to such change has proved intense. Governments are often reluctant to introduce laws that surrender to the financiers the regulatory control they currently have over large corporations. Important objections to reform also come from the families that control large corporations. From the point of view of these families, an improvement in the rights of outside investors is first and foremost a reduction in the value of control due to the deterioration of expropriation opportunities”.

Through legal reforms these companies may increase their total value, as expropriation declines and investors finance new projects on more attractive terms; however the effect would be tax on the insiders (management and controlling shareholders) for the benefit of minority shareholders and creditors. What the reformers see as protection of investors, the founding families call “expropriation of entrepreneurs”.

In the case of PDVSA, the company is not included to follow and adopt the corporate governance agreement in Venezuela.

In order to implement good corporate governance in Venezuela, it is a necessity that a large state owned company becomes a frontrunner in adopting and following the agreement conducted by AVE. For other businesses to follow, it makes a more statuary example when a large company leads the way and successes from it.

\textbf{3.3.2 Norway and Corporate Governance}

As legal families derive from a few common branches such as the English (common law), the French and the German laws, which both derive from Roman Law, the Scandinavian countries have developed their own legal structure. These “families” have spread throughout the world, due to conquest, colonization and voluntary adoption. The legal family of the French law extends to former Spanish colonies such as Venezuela and Latin America.

According to La Porta et al (1999), the legal rules to protect outside investors, varies systematically across legal origins. Common law countries such as Great Britain and its former colonies i.e the U.S and Australia have the strongest protection of outside investors, both

\textsuperscript{11} Corporate Governance of Non-Listed Companies in Emerging Markets, OECD, 2006 p.8
shareholders and creditors.

The French civil law countries, including in this context Venezuela, have the weakest protection, whereas the German law and the Scandinavian countries fall in between, although comparatively by the studies performed by La Porta et al they have a stronger protection of creditors, especially secured creditors. Through their studies they also found that the generally richer Scandinavian and German legal origin countries receive the best score on the efficiency of the judicial system. These legal families again appear to shape legal rules, which in turn influence the financial markets.

As a comparison to these statements in regards of corruption and transparency, Scandinavia and the Nordic region are ranked as the least corrupt nations in the world by the latest corruption list from Transparency International.

The Norwegian Code of Practice for Corporate Governance is a code of practice which is annually revised, if necessary due to recent development and experience, to align with recent development in the field of corporate governance nationally and internationally. The purpose of the “Code of Practice” from 1.oct.2009 is that companies listed on regulated markets in Norway, such as Oslo Stock Exchange and Oslo Axcess, will practice corporate governance that regulates the divisions or roles between shareholders, the board of directors and executive management more comprehensively than what is required by legislation. The code of practice is influenced by Norwegian legislation, the EU and international organizations such as the OECD principles of corporate governance. Norway and Norwegian companies have a recognized set of standards which is widely known internationally by companies and countries. Transparency of financial figures, such as annual reports, from SMEs and listed companies are made public through an official organization named Brønnøysund registeret. This state owned organization assembles data and information from all Norwegian companies and provides it to the public.

As for Statoil, a Norwegian Oslo Stock Exchange and NYSEC stock listed company, has to follow the Norwegian, the Sarbanes- Oxley act of 2002 and OECD principles of good corporate governance when conducting business. These entities does not prevent situation where personal

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12 www.brreg.no
interests or behavior interferers with company policy.
The challenge is to discover and prevent the conflict of interest from an early stage in process.

I will later in this thesis discuss the importance of the OECD Principles of Corporate Governance related to the two countries and companies at stake.
I have covered in this first section of my paper an introduction of the importance of good corporate governance practices. These practices are influenced by the state and the internal company control over the management.
4. Preface of the analysis section

4.1 Why Statoil ASA and Venezuela?

The thesis emphasizes on corporate governance in emerging markets from a Scandinavian MNE’s point of view. Through my thesis I will investigate and highlight common corporate governance problems that may be present for Scandinavian MNE’s in emerging markets such as Venezuela. The findings may give a guideline for other Scandinavian MNE’s that wants to invest in the promising oil and gas market in Venezuela.

As mentioned before in the introduction section Statoil is the largest Norwegian MNE and has invested heavily in FDI all over the world. Statoil is widely recognized for their corporate governance policy and is by many other large MNEs used as a benchmark for their own corporate governance performance.

As the majority of Statoil’s public stock is owned by the Norwegian State with a share interest of 67%, it is highly relevant to look at the effect and bargaining power between the two states in question. It is also interesting to compare the two state controlled companies, PDVSA and Statoil, to find any resemblance on how they incorporate good corporate governance within the companies. These findings will eventually reflect in the joint venture Petrocedeño S.A project.

4.2 Presentation of Statoil ASA

My primary focus is on Statoil and their presence in the Venezuelan market and how they interact with the Venezuelan government regarding corporate governance.

In this section I will give a brief presentation of Statoil with focus on company history and the current situation, this to provide a wider understanding of the company, before I explore the current corporate governance practice.

The history of Statoil started as a merger between Statoil ASA and the oil and gas section of
Norsk Hydro ASA in October 2007. Both companies have been central in developing the oil industry in Norway since the early 1970s.\textsuperscript{13}

Hydro’s history began 2nd December 1905, by its founding partners: Sam Eyde, Kristian Birkeland and Marcus Wallenberg. Their business idea was based upon industrial production of a nitrogen-based mineral fertilizer. The idea later on gave the foundation to be one of the largest industrial enterprises in Norway within a broad specter of production. The nitrogen-base mineral fertilizer provided opportunities of such a magnitude never seen in the Norwegian industry, providing new jobs and a better knowledge in exploring and exploiting the use of waterfalls as an energy source. This later revolutionized and pioneered Norway as a frontrunner in renewable water energy. After the Second World War complex issues such as ownership and restructuring of the company led to a state intervention of 46\% of the issued shares of Hydro. Heavy investments were made and expansion within other fields of industry such as metal and aluminum made Hydro a cornerstone in the Norwegian industry in the 1950s until present day. In the late 1960s Hydro entered the promising oil and gas industry in Norway through the exploration and participation of the “Ekofisk” field in the North Sea. At the time of the merger Hydro was operator of 13 oil and gas field on the Norwegian continental shelf.

In 1972 the Norwegian State Oil Company, Statoil, was formed. As I previous discussed Hydro’s role in the exploration and participation of the Ekofisk field, new discoveries of oil and gas fields were made as the Norwegian continental shelf contained large amount of undiscovered energy resources. In 1974 the Statfjord field was discovered and commenced production of the field in 1979. In 1982 Statoil was the first Norwegian company to be given operator responsibility for a field, at Gullfaks in the North Sea. Previous large foreign MNEs such as Phillips Petroleum were the main operator on the Norwegian continental shelf, however the entry of a Norwegian company stated a new era of involvement in the global oil and gas industry. At the time of the merger, Statoil was operator for over 39 oil and gas fields on the Norwegian continental shelf. In October 2007 the companies decided to join forces and became StatoilHydro ASA. Later in 2009 the company was renamed to Statoil ASA.

\textsuperscript{13} www.statoil.com
Today Statoil is the world’s largest operator in waters more than 100 meters deep, world leader in the use of deepwater technology and world leader in carbon capture and storage.

It is essential in Statoil’s social responsibility policy to practice and conduct good corporate ethics by:

- Making decisions based on how they affect Statoil’s interests and the interests of the societies around the company.
- Ensuring transparency, anti-corruption, respect for human rights and labour standards.
- Generating positive spin-offs from the company’s core activities to help and aspire the societies in which it operates.

These ground values is further described in Statoil’s “Internal book of good corporate principles”, which concerns all businesses, people and entities that perform on behalf of Statoil.

4.3 Presentation of the Venezuelan Oil Industry

Venezuela has since the late 19th century and the early beginning of the 20th century been extracting oil from their large oil reserves. Foreign MNEs possessed the much needed technology and up until 1918 oil companies only paid the regular taxes corresponding to any other economic activity; they did not pay for the right to exploit the resources.

The Regulatory Act of Coal, Petroleum and Similar Substances issued in October 1918, stipulated royalty rates to range from 8% to 15%. The act also established, for the first time, that once the concession for the foreign MNE was over, the facilities must revert to the Venezuelan State, including all buildings, machinery and production facilities without any payment by the government. Venezuela has a long history of being an oil nation; the country contains about 7% of the world’s oil reserves and was for about 4 decades (1928-1970) the largest oil exporter in the world. Through the late 1980 and into the early 1990s the country enjoyed the highest standard of living in the Latin American countries with a GDP of roughly $ 3.100 per capita.

Despite its large natural resources of oil, aluminum, steel and petrochemicals, the country has experienced large social indifferences, making a small elite of the population to benefit from the masses. The causing effects of this social equilibrium, was and is, due to the political patronage,
corruption and poor economic management.

The government created PDVSA as a holding company with the purpose of being an umbrella company for four major petroleum–producing affiliates. This process consolidated holdings of fourteen foreign companies and one national company into four competing and largely autonomous subsidiaries. Lagoven which was the largest subsidiary consisted of facilities previously operated by the U.S oil company Exxon. From the holdings of British and Dutch Shell, a subsidiary named Maraven was created. Four smaller U.S oil companies became Meneven. Finally, from six smaller foreign companies and the state owned company, PDVSA consolidated into Corpoven. Later on after several internal restructuring, the existing company was reduced into three big functional business enterprises consolidated in the corporation: PDVSA Gas oil; PDVSA Exploration and Production; PDVSA Manufacture and Marketing and PDVSA Services, all of them responsible for carrying out the oil related activities. They began operating on January 1st 1998.

Through the 1975 law to nationalize the oil industry, the Venezuelan government could go through with the consolidations from foreign companies. The new law of 1975 had a controversial element, Article 5, which gave the government the authority to contract out to multinational firms for various technical services and marketing. This act provided technical expertise that proved crucial to the industry's smooth transition to state control beginning in January 1, 1976. Although the act was heavily criticized by foreign MNEs at the time, despite their compensation packages which exceeded the profits they would have obtained if operations commenced until 1983, the scheduled expiration date considered by the respective previous laws. The law gave Venezuela a foothold in the future oil industry, taking control over its own resources.

From the late 1980s to the late 1990s the Venezuelan oil market experienced a large entry from foreign MNEs, resulting in a setback in the nationalization process of the oil and gas industry. Due to the lack of experience and technology, PDVSA was forced to seek help to fully take potential of their resources by outsourcing some of their services. PDVSA itself argues that the outsourcing of essential services to foreign MNEs was not a necessity as it had the technological
experience and capability to fully develop the company. During this time, named the oil Apertura, PDVSA proved the theory of Vickers and Yarrow (1988), that management rarely implements good corporate governance practices. As a state controlled company PDVSA management made poor decisions and investment choices on behalf of the Venezuelan government and its people. This lead to a loss, both financially and technologically, never seen before, that drove the company from the national effectiveness of managing the oil industry into the hands of foreign enterprises. Due to the ongoing privatization of the oil industry in the country, the government had to make some decisions to fully ensure their resources and control over the industry.

The New PDVSA was born after the damaging national strike instigated by forces opposed to the elected government.

“The New PDVSA is a national Venezuelan state-owned corporation, committed to serving the interests of the Venezuelan public; constitutionally, the rightful owner of the country’s oil reserves”.

The information regarding Statoil and PDVSA provided in this section are from the companies websites, any abbreviation from other literature or articles are therefore not accounted for.

The section is meant as information in regards on how Statoil and the Venezuelan oil industry have developed from their early beginning until present time.

The history of Venezuela may explain why the country currently is nationalizing companies and resources; this will be further explored in the analysis section of the Venezuelan oil industry.

Statoil and its history in the oil and gas industry is not that extensive as for PDVSA and Venezuela, which have been in the oil industry since the early 19th century.

Due to the oil Apertura in the 80s and 90s, where outsourcing of services to foreign MNEs was heavily criticized, there are doubts in how PDVSA can benefit from collaboration with Statoil. I will analyze the RBV with this in mind and draw (if any) conclusions regarding the potential bargaining power Statoil has in the joint venture Petrocedeño S.A.
5. Analysis

As described in my methodology section, I will analyze the above aspects in an exploratory approach using agency theory, institutional theory and resource based view (RBV).

By analyzing Statoil and the Venezuelan Oil & Gas industry separately, focusing on corporate governance practices and the agency theory, I will find and highlight the differences and similarities and combine them in the final analysis together with the above mentioned frameworks to give an overall impression of Statoil in Venezuela and their joint venture Petrocedeño S.A. Based on this, I will highlight the strengths and weaknesses possessed by Statoil and conclude whether Statoil should continue its operations in Venezuela, or pull out in order to secure the interests of the shareholders, which primarily is the Norwegian government. The analysis is solely based on a corporate governance view. Financial information regarding historical and potential revenue and earnings will not be taken into consideration or analyzed.
5.1 Analysis of Corporate Governance in Norway and Statoil

In the analysis of Statoil I will focus on the overall corporate governance practices, including corporate segments within Statoil and draw parallels towards Venezuela in the final analysis.

Corporate governance in Statoil is based on openness and equal treatment. The corporate group is run in a justifiable and profitable manner to benefit employees, shareholders and society.

I will emphasize on the following segments:

- Shareholders influence on the management
- Stakeholder’s role and influence on the company e.g suppliers, partners, politicians etc.
- Transparency
- Governing bodies and their role in the company
- Risk management and internal control
- Remuneration of the board of directors
- Overview

5.1.1 Shareholders influence on the management

Before the merger between Statoil ASA and Norsk Hydro ASA, the Norwegian state had an ownership share of 70.9% in Statoil ASA and 43.8% in Norsk Hydro ASA. After the merger the Norwegian state had an ownership share of 62.5%. The Norwegian state will over time increase their ownership to at least 67%, this to ensure and protect that the company retains a firm Norwegian base. The state’s ownership is also crucial for implementing the sales and marketing arrangement for state-owned oil and gas production and ensuring industrial competence and development. By March 2009 the government announced that they had reached an ownership share of 67%. There is no indication in the near future that they will strengthen their ownership position.

It is defined by the Norwegian Code of Practice that the board of directors and the management conduct their practices in the interest of the company’s shareholders. This implies that the
shareholders are responsible for the board of directors and the management conducting their day to day business in both the long term and short term perspective, in line with the resources within the company. In order to ensure equal interest and good communication between shareholders, board of directors and the management, Statoil has enhanced the communication and transparency regarding company information through websites, annual/quarterly reports and general meetings.

A type 1 agency problem would be imminent if the management at Statoil did not act in the best interest of its owners (The Norwegian state, institutional investors and private investors, both domestic and foreign). The current situation with the Norwegian state as a majority owner solves the type 1 agency problem to a large extent. Nevertheless, before the merger, both Statoil ASA and Norsk Hydro ASA had experienced scandals concerning managers acting on behalf of themselves and not in the interest of the company: this was seen in the scandal of Statoil ASA 2002/03 regarding the misconduct and corruption scandal with a consultancy firm in Iran and the misconduct by Norsk Hydro ASA where managers had gained access to Libyan licenses for the hire of a “suspect” consultancy with ties to the regime of Muhamar Ghadafî in 1999. The result of this was that the new chairman of Statoil and former CEO of Norsk Hydro ASA resigned only three days after the merger in 2007.

I believe however that the risk for similar situations in Statoil is minor. This is partly because the Norwegian state has a function as an additional “watchdog”, but also based on improvements in corporate governance policies in Statoil due to the previous scandals. However, since both Statoil ASA and Norsk Hydro ASA have a history of a corruptive behavior it is important to be aware of this potential problem, which not only would harm the company but also the reputation of the Norwegian state as majority shareholder.

Another important factor on the principal-agent theory is the use of remuneration of executive management. In Statoil the remuneration of executive management is based on performance and determined by an own remuneration committee appointed by the board of directors. It is requested by law that the board should provide guidelines for the remuneration of executive

14 www.scandoil.com
The board of directors in Statoil has provided extensive information regarding guidelines explaining the remuneration of top management and all other employees on the company’s website. The board of directors has to ensure that the remuneration is competitive, while at the same time protect the best interest of the shareholders. This is solved to some degree through a share program for employees, where 5% of the salary is used in purchasing of stocks in the parent company. Performance remuneration of top management is based on performance of a group of company peers. Further information regarding remuneration packages for management and employees is stated each year in the annual report.

As for minority shareholders influence on management and the relationship between majority and minority shareholders, type 2 agency problems, the minority shareholders has to be aware of the power structure before investing in the company. The company has a voting structure in line with the shareholder posts where one share equals one vote. The minority shareholders do not have any voting interest or power, and are dependent on how the company is run through its majority shareholder interest. In Norway there is a large amount of companies listed on the stock exchange with one controlling shareholder. Through its years on the stock exchange in both Oslo Stock Exchange and the NYSEC, the company has experienced a great increase in the stock price, which has benefitted both the minority shareholders and the Norwegian state.

### 5.1.2 Stakeholder’s role and influence on the company

As the majority shareholder is the Norwegian state, the company is highly influenced by political factors, media coverage, customers and social responsibility. In keeping the best interest for its stakeholders on a corporate social responsibility level, Statoil has developed and implemented a strong code of ethics within the company. Statoil uses the different aspects in the internal code of ethics i.e corporate value, corporate commitments and the company’s methods.

To ensure the interest of all stakeholders is an almost impossible achievement. Statoil has invested billions in research and development in projects that encourages sustainable natural energy resources such as wind and wave power. Concerning these investments, there is a clear dilemma on which investment to prioritize as the company has a responsibility to ensure financial

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15 The Norwegian Code of Practice for Corporate Governance 21 October 2009 p 46
revenue for its shareholders. Financial returns in other energy segments such as wind and wave power is limited within the available technology. The issue becomes more aware when investments exceed budget limits and affects potential return on investments for shareholders.

All in all Statoil has a well functioned corporate system which emphasizes on strong corporate ethics, moral, environmental and social responsibility for all its stakeholders. This is also viewed through sustainability reports which are published annually.

5.1.3 Transparency

Norway and Scandinavia are one of the least corrupt nations/regions in the world and has a high rating when it comes to transparency to all its stakeholders. Statoil has developed and maintained a high level of corporate actions to implement good corporate governance practices, which also includes high level of corporate ethics and values.

This is shown through the company’s website, which is very easy to use in order to find relevant information such as quarterly reports/annual reports, financial information regarding its shareholders, corporate value and ethics, countries it operates in etc. The use of the Internet as a communication tool towards the public is well implemented in Statoil; the website reflects this by continually updating and refreshing relevant information.

Statoil has an own corporate division to ensure good communication level between the company and its shareholders. The division consists of seven employees, five in Norway and two in the U.S, which have the corporate responsibility with regards to investor relations. Annual reports from 1996 until 2008 are also available for downloading on the website, including quarterly reports from 2004 until 2009. The reports are available in pdf, wmv (streaming) and mp3, both in English and Norwegian. Corporate governance policy and company policy are also transparent on the website, including corporate guidelines for all parties included in the day to day business. Statoil has through its policy regarding transparency incorporated additional information to its annual reports. This includes sustainability reports, which describes the affect Statoil has on environmental, economic and social relations in the countries they operate in. The global effect oil and gas have on the environment are also issues which are addressed through these rapportst.
All in all it can be concluded that Statoil has a high level of transparency to all its stakeholders and its practices are conducted as recommended by the Norwegian Code of Practice.

5.1.4 Governing bodies and their role in the company
In essence the role of the board of directors is to ensure and protect equal interests of shareholders while taken into the consideration the interest of all stakeholders. Further, the duties of the board of directors are stipulated by the Public Companies Act, which states that the board has the ultimate responsibility for the management at the company and for supervising its day- to- day management activities in general. This includes responsibility for ensuring that the activities are soundly organized, drawing up plans and budgets for the activities of the company, keeping itself informed of the company’s financial position and ensuring that its activities, accounts and asset management are subject to adequate control.\footnote{16 The Norwegian Code of Practice for Corporate Governance 21 October 2009}

The corporate executive committee, which consists of the executive management, is responsible for the day- to- day operations and reports to the board of directors that has the ultimate responsibility and supervision of the company. According to the Norwegian Code of Practice, the board of directors should also lead the company’s strategic planning and make decisions that form the basis for the executive management to prepare for and implement investments and structural measures.

In short the main duties of the board of the directors are:

- Determine objectives, strategy and implementation of the company, this should be reviewed on an annual basis.
- Assure that the financial reporting is in accordance with the actual situation of the company and that it is accepted by general accounting practices.
- Appoint and supervise the management.
- Ensure the interest of all stakeholders relative to the company.
Statoil’s board of directors must continuously keep up-to-date on relevant information concerning the company and its activities. Statoil’s board of directors has two sub-committees which act as preparatory bodies: the board’s audit committee and the board’s remuneration committee.

The role of the audit committee according to Statoil website: “to assist in the exercise of the board’s management and control responsibilities and to ensure that the group has an independent and effective external and internal auditing system”.

Jointly the role of the remuneration committee defined by Statoil is: “to assist the board in its work on terms and conditions of employment for the chief executive, and on the philosophy, principles and strategy for the compensation of leading executives in Statoil”.

There is no cross relation regarding the board structure, i.e a member of the audit committee cannot be a member of the remuneration committee. There is no executive management represented in the board of directors, although there are members representing the employees in the board of directors, in accordance with to the Code of Practice which states that:

*In any company with more than 30 employees, the employees have the right to be represented on the board of directors. If a company has more than 200 employees but has not elected a corporate assembly, employees must be represented on the board*.”

The structure of the governing bodies is described below:
The role of the board of directors can be related to the agency theory (section 2.2.1). According to theory, the board of directors is responsible for solving the agency problem as best as possible and supervise the management. This can be seen in Statoil’s own corporate policy, which states that the board of directors is responsible for supervising the management and the company’s activities on a day-to-day basis. The statutory report includes the different roles of each governing body, including the external auditor annual report. The statutory report describes the specific governing bodies and states that they each act according to the Norwegian Code of Practice. The board of directors annually prepare a director’s report, a main section of the statutory report, which includes financial information regarding group profit and loss analysis, dividends to shareholders, business development in the recent year, cash flows, liquidity and capital resources, revenue on average capital employed, R&D, risks, group outlook, people and the organization, health, safety and the environment, environment and climate, society and board developments. These different segments of the group’s operations and activities secure that the board of director’s is up dated regarding information on a day-to-day basis. In the statutory report the corporate governance practices and values are included and confirmed by the board of directors. The report is based on board meetings and in 2008 the board held 13 meetings with an attendance of 97%. These meetings make the premises for the report and secure that the board is up to date on the groups operation and activities.
Companies that follow the Norwegian Code of Practice should have a nomination committee, and the general meeting should elect the chairperson and members of the committee and also determine the remuneration of the committee. The majority of the nomination committee should be independent of the board of directors and the executive management.

“The nomination committee is expected to monitor the need for any changes in the composition of the board of directors and to maintain contacts with shareholder groups, members of the corporate assembly and board and with the company’s executive personnel”.

The nomination committee in Statoil consists of four persons, which all have relevant and long experience in different managing roles in the Norwegian industry.

The information is easily accessible through the corporate website, and the values regarding corporate governance are thoroughly described and compared with the guidelines of the Norwegian Code of Practice.

5.1.5 Risk management and internal control
According to the Norwegian Code of Practice the board is responsible for risk management and internal control.

In Statoil, risk management is divided into three categories:

- **Insurable risks**
  
  Are managed by a captive insurance company operating in the Norwegian and international insurance markets.

- **Tactical risks**
  
  Are short-term trading risks based on underlying exposures, are managed by a principle business segment line managers.

- **Strategic risks**.
  
  Are long-term fundamental risks, and which are monitored by the company's corporate risk committee, which gives advice and makes recommendations to the corporate executive committee.

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17 The Norwegian Code of Practice for Corporate Governance 21 October 2009 p 29
This is according to the Norwegian Code of Practice which also states three categories, although formulated differently. Statoil has personified these categories in accordance with its own corporate values and ethics, which in my opinion makes it easier to understand and relate to other corporate governance factors within the company. Statoil has a separate corporate risk committee which is chaired by the chief financial officer. The committee, stated in the annual report of 2008, considers and adopts strategies for risk management. The management, with the chief executive officer and chief financial officer as supervisors, is responsible for establishing and maintaining adequate internal control of financial reporting.

The reporting must be in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The accounting policies applied by the company must also comply with IFRS as issued by the International Accounting Standards Board (IASB). In the annual report of 2008 Statoil states that it complies with these policies.

According to The Norwegian Code of Practice for Corporate Governance:

“The objective for risk management and internal control is to manage, rather than eliminate, exposure to risks related to the successful conduct of the company’s business and to support the quality of its financial reporting.

Effective risk management and good internal control contribute to securing shareholders’ investment in the company and the company’s assets”.

From the reporting and supervising of the management the board of directors must, by information presented by the management, decide and form its own opinion on the company’s internal control.

5.1.6 Remuneration of the board of directors

According to the Norwegian code of practice the remuneration of the board of directors should reflect the board’s responsibility, expertise, time commitment and the complexity of the company’s activities. The remuneration should not be linked to the company’s performance nor should the company grant share options to members of its board.\textsuperscript{18}

\textsuperscript{18}The Norwegian Code of Practice for Corporate Governance 21 October 2009 p 44
The remuneration of the board of directors is decided in the annual general meeting. Although Statoil has its own incentives scheme for its employees and executive management, the board of directors can’t take part in any incentive or share option plan, as this could weaken the board’s independence. However it is encouraged that members of the board own shares in the company.

From the corporate website one can gather information regarding share post of the board members, their education and experience, independency towards the company, family relations toward other board members and employees (including executive management) and other matters concerning the company and its activities. One can also find the remuneration of each board member by searching in listings provided by the Norwegian tax authority annually, which include payment, wealth and different corporate roles. Norway is probably the only country in the world that provides this information regarding personal and sensitive information. The list includes every citizen in Norway and is of public display through websites and newspapers.

5.1.7 Overview
Based on this internal corporate governance analysis of Statoil, the company acts accordingly to the Norwegian Code of Practice and within Norwegian corporate law, which the code of practice is stipulated from.

When analyzing the different aspects regarding the company’s profile towards corporate governance, it becomes imminent that Statoil is very much concerned with how it is portrayed and recognized by all its stakeholders. The well awareness of this is shown in the extensive information available on the website and the strong bond between the company and the Norwegian state. How the company is run and all its activities will ultimately reflect on the Norwegian state and it is therefore of great importance that the corporate governance policy in Statoil reflects and acts in accordance with the Norwegian Code of Practice. Relating this to the agency theory, conflicts of interest may occur despite thoroughly and descriptive set of guidelines provided by the company. The interesting aspect is how the company solves the internal problems. I believe Statoil has developed a sustainable system in detecting and preventing internal potential conflicts that can be defined as type 1 or 2 agency problems. However, type 3

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19 The Norwegian Code of Practice for Corporate Governance 21 October 2009 p. 45
relates to problems that occur outside the company, these includes financial crisis, environmental scandals that affect the oil and gas market, labor policies etc. at the stake of stakeholders such as employees.

Statoil’s a high set of standards concerning ethics and moral is reflected in their operations and it relates to both formal and informal constraints as defined by the institutional theory. These high standards are embedded in Norwegian law and the Norwegian culture and ideology. The company also provides a book of guidelines to ensure a successful implementation of ground rules based on Norwegian Law, culture and ideology to the employees.

5.2 Analysis of Corporate Governance in Venezuela and PDVSA

In my analysis of the Venezuelan oil and gas industry I will use the same structure as in the analysis of Statoil, in order to detect potential equal or different factors to be used in the final analysis of Statoil in Venezuela.

Through participation in meetings with policy makers in the Latin American countries, Venezuela has been involved in designing the White Paper of Corporate Governance in Latin America (White Paper). The White Paper is based on the OECD Principles of good corporate governance in Latin America and the objective is to improve common guidelines to ensure good corporate governance. Although the White Paper is a non-binding consultative document, it provides guidelines suited for Latin American companies. The paper is developed on a consensual basis by an informal, but highly influential group of policy makers, regulators, market participants and other experts.

The Venezuelan Association of Executives (AVE) represents Venezuela at the Roundtable meetings. Through Roundtable meetings and national research, AVE has developed a report (Non-listed Companies in Venezuela Tendencies, legal frameworks, promotion of Corporate Governance, by Sonia De Paola de Gathmann General Manager Venezuelan Association of Executives AVE 2006), describing the legal regulations in force and applicable to corporate governance in the country which constitutes a group of principles which are structured and organized according to the OECD’s Principles of Corporate Governance.
As in my analysis of Norway and Statoil, I will link PDVSA’s own corporate governance practices, ethics and moral to the principles of the White Paper and to the report; *Non-listed Companies in Venezuela*.

5.2.1 Shareholders influence

The majority part of businesses in Venezuela consists of non-listed companies such as small and medium sized companies, large-non listed companies and state owned companies. The small and medium sized companies represent 95% of the Venezuelan market. By De Paola de Gathmann (2006), this sector is one of the main generators of employment and job opportunities in the country.

As non-listed companies represent the majority of the Venezuelan market they have a great influence on implementing and developing good corporate governance throughout the Venezuelan market. Since the non-listed companies consists of company’s held by families and often with one majority owner, the strong linkage towards the management and the shareholders influence on management is highly present.

De Paola de Gathmann describes several challenges for implementing good corporate governance in these companies. The reluctance the companies may have against corporate governance are: resistance regarding the promotion of information disclosure, resistance related to lack of information and incomprehension about the benefits, and the perception that the adoption of Corporate Governance practices may be expensive. The problem occurs when small-medium business and large-non listed companies seek strategic cooperation with foreign MNEs through joint ventures. Through joint ventures it becomes evident that disclosure of financial information, transparency within its administration and board members are important and necessary mechanisms to secure the interests of the foreign MNEs. Being aware of the possible gain of good corporate governance and implementing this at an early stage, certain companies in promising business sectors could get a first mover advantage in attracting FDI to increase its market share. In the long run the cost of implementing good corporate governance could be a successful investment.
As for PDVSA which is a state owned company, the type 2 agency problem between majority shareholders versus minority shareholders, is not present due to the fact that there are no minority shareholders.

Because of the close ties between PDVSA and the Venezuelan government, the impact of control and supervision of management by majority shareholder are of great importance and certainty of priority, as PDVSA controls the majority of the country’s oil and gas reserves.

5.2.2 Stakeholder’s role and influence

Stakeholders are in general all parties that are involved and influenced by the company on all levels, stakeholders are employees, financial institutions i.e banks, customers and the society in general.

There is an ongoing concern regarding corporate governance in Venezuela especially in the banking sector. The lack of transparency of financial figures makes it difficult for financial institutions to issue the necessary financial advice and/or loans to provide the ongoing growth of companies in Venezuela. Venezuela has a history of strong and powerful families with great financial reserves. The great difference between rich and poor makes it difficult for new entrepreneurs to expand their business without cash reserves. An open and easy corporate governance policy could enhance the current situation in Venezuela for small and medium companies, but it could also enhance further global expansion for larger companies, whether they are family owned or state owned such as PDVSA. Attracting FDI should therefore be a priority for all business segments in the country. However, due to political instability, FDI has been reduced the last decade.20

PDVSA recognize their stakeholders including the above mentioned parties and emphasizes on securing its interest for the sake of the Venezuelan people. From the company’s website its corporate actions must follow the Ministry of Energy and Petroleum’s guidelines, plans and strategy, as well as the norms issued by the National Development Plans for the hydrocarbon sector. PDVSA emphasizes on sovereignty of national energy resources and promotions of

20 www.fdi.net
technological independence to ensure creation and innovation of Venezuela-made technologies, so as to generate quality jobs, economic growth and the creation of wealth and welfare for the Venezuelan people. In order to do so they focus on transparency, clear control of accounts and visible communication from the management to the public and to encourage social audit. Although it’s not explained how and when the company evaluates its board of directors, executive team and employees, it states that in general the performance is evaluated to ensure the company’s principle of honest and moderate administration of corporation resources. Also, the company states different principles of guidelines, however there are no published documents on how the company performs its evaluation. The transparency of financial figures is well stipulated and thoroughly described for each company within the PDVSA Group but there are neither national nor international corporate governance principles stipulated in the financial reports or on the corporate website. (International stakeholders may find this alarming when conducting business with PDVSA) This implies that there is no other framework than the legal framework depending on which country the company operates in. Political pressure, both domestic and abroad, emphasizes the Venezuelan government to follow international corporate governance practices, this is shown through public demonstrations and several Latin Round tables meetings.

An incorporated framework should be implemented from the board of directors to the company’s workforce, so that there are common guidelines to follow in corporate actions.

5.2.3 Transparency
PDVSA practice their own guidelines regarding disclosure of annual financial information, however their website is not fully developed nor updated in regards of for example their ownership share in the joint venture Petrocedeño S.A project (former known as Sincor).

Through its website the company is still a minority shareholder in the project with 38%, Statoil with 15% and Total with the remaining 47%. This information is incorrect as PDVSA now controls the project not only through legal state control, which it had all along, but also through ownership share. Currently PDVSA controls the joint venture with an ownership share of 60%, Total with 30, 33% and Statoil with the remaining 9, 67%. The credibility regarding relevant information on the website is confusing and incomplete.
PDVSA own core values regarding transparency is not reflected through its website. Although the recent developments in strategic associations are discussed and stated in annual financial reports, the accessibility and visibility should also be updated on its side bars on the main page.

The lack of transparency regarding corporate governance including code of ethics, board of directors and executive management compensation, national and international corporate governance guidelines, controls and procedures, should all be accounted for and addressed upon

5.2.4 Governing bodies and their role in the Venezuelan market
The sovereignty of national law is, as in most countries, the first and foremost legal entity to protect and ensure equal rights for all stakeholders. Venezuela has a well established and well implemented legal system that protects its stakeholders from corporate abuse. However in some cases the legal foundation is overruled by the country’s president Hugo Chavez, leading the government to be the governing body of the Venezuelan market. There are several examples indicating that the government lead by Hugo Chavez has interfered with the market situation for example when the “new” PDVSA was established through a military coup d’état in 2002 and Hugo Chavez promoted the top management in PDVSA. The management was accused of misuse of financial investments leading its shareholder, the Venezuelan state, to intervene and take control over the company.

Although a set of principles and guidelines are stipulated in the Latin White Paper and by AVE, state owned companies such as PDVSA does not follow these guidelines. This means that the governing body of the board of directors does not have a national or international framework on how to conduct good corporate governance within the company. The set of corporate principles which are stipulated on their webpage emphasizes strong corporate moral and ethics for all employees and executive management, including the board of directors. The structure of the board of directors is a mix of top executive management within PDVSA and external directors that hold other government positions. The close ties between the Venezuelan government and PDVSA are evident through the personal connections between the board of directors and the government. For instance, the current board president, Rafael Ramíres is also the minister of Energy and Petroleum in Venezuela. Rafael Ramíres was sworn in as board president to act on
behalf of the republics president Hugo Chavez. The individuality and independency of the board and the government can therefore be questioned.

The close ties between the board of directors and the government ensures ultimate shareholder protection; the possible threat could be if the government and the board of directors act on behalf of personal interest rather than the public’s interest. Furthermore, as stated in the annual report of 2008, the management and board of the directors, as representatives of the Venezuelan state and government, has the responsibility to ensure that corporate practices, such as financial reporting and internal control, are in accordance with International Financial Reporting Standards. The independent auditing is provided by KMPG which solely states that the internal accounting and financial figures are based upon the internal auditing by the company. Although financial reports are provided through the company website, including key figures, dividend policy, financial performance, strategic alliances etc, I have not been able to find any annual reports which include the corporate governance policy. Nonetheless it is stated, on the corporate website that the new PDVSA, will focus on good governance and transparent accountability. It does not state how they will proceed to do so, as one would expect would be outlined through annual reports or through its website.

5.2.5 Risk management and internal control
According to the Latin White paper on corporate governance, risk management and risk assessments are of critical interest, not only for investors in public securities market but also for banks, private equity operations and specialized financial institutions. In the banking sector risk assessments and the accessibility of relevant financial information from companies is of great importance to avoid potential banking crisis.
Furthermore the White Paper requires that companies with a stock value greater than U.S $ 45 million must have an audit committee composed of, preferably, independent directors.
Although the White Paper is a recommended guideline for companies in Latin America, PDVSA has acknowledged the guideline of transparency and financial accountability regarding their financial information. As stated in their consolidated financial statements of 2007:
“The Board of Directors of PDVSA is responsible for establishing and oversight of the Company’s risk management framework. When developing the strategic plan and budget for the Company, business risks are analyzed to gain an understanding of their impact on the Company”.

Prior to the above mentioned, risk management policies are established to identify and analyze the risks faced by PDVSA. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the company’s activities.

PDVSA emphasizes on three financial risks:

- Credit risk
- Liquidity risk
- Market risk

The three potential risks are thoroughly described and gives an overview over the risk related to PDVSA’s domestic and foreign operations.

The transparency of financial figures is in accordance with International Financial Reporting Standards and is according to PDVSA’s own internal policy of transparent accountability. Based on the opinion of the company’s external auditor, KPMG, the company’s financial statements are in accordance with International Financial Reporting.

5.2.6 Remuneration of the board of directors

According to PDVSA financial statement from 2008, compensation to the directors in form of salaries and social security were approximately $1.69 million and $1.53 million, respectively. In addition to salaries and social security compensations, PDVSA have also granted non-monetary, contractual and postretirement benefits to its directors. According to terms of collective agreement, the directors have the same rights as the rest of the employees. These include eligibility for retirement plan and postretirement benefits other than pension plan.

It is not explained how this is reflected by the company’s performance during 2008 and 2007 nor does it explain the time commitment by the board of directors. Remuneration schemes
concerning share options or incentive plans are not discussed. If there were any incentive schemes concerning share options, this again could undermine the performance of the board of directors and may influence the independence of the board. However there are some remarks concerning the influence of the board, as already mentioned, several directors have key positions in other related entities, and some of their powers include influencing the operating and financial policies of such companies.

From an institutional point of view, these linkages from board of directors to other related entities, could effect and over time damage the Venezuelan market. Risk related to entering and expanding in the Venezuelan market could therefore depend on the personal interest of the board member.

5.2.7 Overview

As stated by La Porta et al (1999) and discussed in my section: 2. Presentation of Corporate Governance. There is a clear similarity to what La Porta et al discusses concerning implementation of laws and framework for corporate governance, and to the Venezuelan businesses in general.

The implementation of corporate governance in the country is relative poor and is mostly related to the misunderstanding of the mechanisms corporate governance provides. However recent development in the past decade indicates that the country is showing evidence of awareness to the field of corporate governance. The organization AVE has provided important analyses and guidelines which they promote to government and businesses. The participation in several Latin Round tables meetings also indicates that the country is taking the corporate governance issue seriously.

As for PDVSA, improvements have been made concerning the availability and transparency of financial annual statements. Although the statements only include financial figures and does not explain different aspects such as corporate governance and corporate sustainability, the transparency of these figures indicates an improvement regarding corporate information to the
However the general impression is that Venezuela is underdeveloped concerning developing and implementing a good corporate governance framework. As for PDVSA, the company is on the right path of being a frontrunner for Venezuelan businesses but the company itself must acknowledge and implement a national corporate governance framework to ensure that other businesses will follow.
6. Analysis of Statoil ASA in Venezuela

In my final analysis I will emphasize on the relationship between Statoil ASA and PDVSA. Conducting an analysis of the relationship between the two companies, emphasizing on agency theory, institutional theory and resource based view, will provide me with an overview on how Statoil ASA affects the Venezuelan market concerning corporate governance and vice versa. The findings in my two previous sections make it easier to highlight the relevant aspects and implement them in my final analysis.

6.1 Agency Theory

As my thesis explores two large state controlled companies, PDVSA and Statoil in their Joint Venture Petrocedeño S.A project, the fundamental agency problem argued by Shleifner and Vishny, is the conflict between outside investors i.e minority shareholders and controlling shareholders who have nearly full control over the managers. This is interesting when looking at the owner structure of both companies, where the controlling shareholder is the respective governments. Potential conflict of interest may include the governments, Venezuela and Norway, and thereby affecting the joint venture. The fundamental agency problem also affects Statoil as they have several minority investors. If the joint venture has a substantial short term risk affecting the company as a whole and its stock price, this may conflict with the interest of minority investors that may not have a long time perspective with their investment in the company, and thereby does not see the future potential revenue.

A type 1 agency problem would be imminent if the management at Petrocedeño S.A did not act in the best interest of its owners (PDVSA, Total and Statoil). The current situation with PDVSA as a majority owner solves the type 1 agency problem to a large extent. Nevertheless, PDVSA with its strong linkages towards the Venezuelan government could be affected by government acts towards foreign MNEs like the case of Haliburton and Schlumberger.\(^{21}\) I believe that the risk for similar situations is present. This is based on the previous changes in ownership structure, which made PDVSA as a controlling partner of the joint venture.

Petrocedeño S.A will be characterized by the typical agency problem arising in emerging market companies; this is the mentioned principal-principal goal incongruence by Dharwadkar and

\(^{21}\) www.reuters.com
Brandes (2000). This problem may lead to expropriation of weak governance, and thus that the majority shareholder (PDVSA) takes control over Petrocedeño S.A and deprive Statoil from appropriate return on investments. Total and Statoil will arguably have the same interests in a potential situation as described above. In this sense they may act as allies, evening the odds in a potential clash with PDVSA (In the case of Statoil as a minority shareholder and the weaker principal in Petrocedeño S.A, the stronger principal is PDVSA and thus the Venezuelan government). The PDVSA-Government relation implies that there is an absence of an independent legal authority. ConocoPhillips and Exxon Mobile were forced out by the Venezuelan regime in 2007, due to nationalization acts and the 2001 Hydrocarbon Law. A similar expropriation of assets could become a situation for Statoil operating in Petrocedeño S.A, this as a part of Venezuela’s campaign to increase control over the national energy industry. As a minority shareholder in Petrocedeño S.A, Statoil will have little protection from persuasion of PDVSA (Venezuelan) manager’s interests at Statoil’s expense. There could be cases of goal incongruence in the future as Hugo Chavez has indicated strengthened control and expropriation of national energy reserves, especially in the Orinoco belt where Petrocedeño S.A is operating. The different role of the board members in PDVSA and their linkage towards the government could also restrain Statoil in future development in other areas of oil and gas production in Venezuela. PDVSA and Venezuela has a significant bargaining power as PDVSA’s president also is the Venezuelan minister of Energy and Mines.

Because of the minority share in the joint venture, Statoil has little influence on the managers in Petrocedeño S.A beyond the one board position Statoil has in the Joint Venture. Thus would the agency theory fail to apply for Statoil as the company is highly affected by any outcome determined by PDVSA.

From PDVSA’s point of view the involvement of Statoil and Total is a question of how to organize their vertical boundaries (upstream). It is a trade-off between the technical efficiency and agency efficiency known as economizing. A kind of make or buy decision where it has proved necessary to “buy” the technology and knowledge from Statoil and Total. The price is the respective share the two get in the project.

22 www.reuters.com
As analyzed upon in my two previous sections, there are some fundamental differences concerning corporate governance in the respective countries and companies. Norway, who has developed a code of practice based on international standards from OEDC, has a clear and straightforward corporate governance framework for businesses listed on the Norwegian stock exchange and Norwegian businesses in general. These companies are also responsible for conducting their business in line with both national and international guidelines. Venezuela and PDVSA has neither national nor international corporate governance framework they commit themselves to follow. This is a fundamental difference between the two entities at stake. Without any common framework, there is no common belief on how to conduct good corporate governance. Disagreements, misunderstandings and different business opinions are possible situations that could harm the joint venture and cause great distress for the parties involved. As one of my research questions concerns on how Norway and Norwegian corporate governance practices can affect Venezuelan corporate practices, I believe the influence in short term is relative small to almost nothing. However in a long term perspective, I believe Norway, depending on strong ties between the companies and government, could have a positive effect on Venezuelan corporate governance.

6.2 Corporate Social Responsibility

Statoil must account for western practices in regards of CSR policies by setting the standard in terms of social thresholds. As a minority shareholder Statoil is highly dependent on PDVSA CSR policies. Since PDVSA can be considered a part of the Department Energy and Petroleum in Venezuela there could be serious implications in these matters in terms of CSR, and general politics. Statoil has a CSR responsibility beyond its shareholders, including representing the Norwegian state, its customers and employees. When conducting business with a government, which by some is defined as a dictatorship, Statoil’s reputation is therefore highly vulnerable and could affect entities outside Statoil if a negative CSR situation would appear.

Both PDVSA and Statoil however have a focus on CSR and are separately involved in different types of CSR projects in the Venezuela. As both Norway and Venezuela have a social aspect of contributing to the common welfare of citizens, a lot of the profits are invested in social
responsibility programs to secure the future of the Venezuelan people. Statoil has developed programs in areas of education, environment, HIV-Aids prevention, local community development and technology transfer.

Similar to Statoil, PDVSA has developed social responsibility programs that promote the elimination of the social inequalities in Venezuela. PDVSA also promotes FONDESPA (The Fund for Social and Economical Development), which has the task of promoting social development through a transparent and fair distribution of oil revenues.

As it is one of PDVSA policies to contribute to social welfare for the Venezuelan citizens through profit sharing, Statoil must be aware of and adjust to PDVSA policies concerning profit sharing also through subsidiaries such as Petrocedeño S.A.

### 6.3 Institutional Theory

The social and regulatory aspect of this case is of significance when analyzing firm behavior. I have briefly mentioned the role of the state earlier. Since ownership concentration and identity are arguably embedded in national institutions these have to be considered when analyzing corporate, and in this case national, strategy\(^{23}\). This is because national interests are dominating both for PDVSA and Statoil.

It is evident that an era of what is typically called “Statization” has evolved since Hugo Chavez was elected President of The Republic of Venezuela in 1999.\(^ {24} \) Several large companies have undergone changes in owner structure, making the Venezuelan State as majority or sole owner.

It has been stated by Vickers and Yarrow (1988) that in state owned companies:

*The board of directors rarely implements good corporate governance practices, and management turnover obeys political rather than market forces*”

This statement is highly relevant for the companies at stake, especially PDVSA which is fully controlled by the Venezuelan Government. This is also relevant for Petrocedeño S.A, as PDVSA has the majority of shares in the company and thereby the controlling votes. Political factors, for example bad relations between Venezuela and other countries, may affect Statoil and its presence in Venezuela.

\(^ {23} \) Foreign and domestic ownership, business groups, and firm performance: Evidence from a large emerging market, Douma, George and Kabir, Strategic Management Journal 2006 p. 4

\(^ {24} \) http://news.bbc.co.uk/2/hi/americas/3517106.stm
Additional features typical for emerging economies including Venezuela are imperfections in capital, products and managerial talent markets. Such institutional voids create both opportunities and constraints/threats for Statoil. Statoil’s ability to raise capital, their talent base and market access may prove advantageous. On the downside these institutional voids lead to ineffective protection of minority shareholders (Statoil) and more entrenchment by controlling shareholders (PDVSA). This environment is ideally suited for expropriation of Statoil. Both formal and informal institutions play a significant role in the strategic choices Statoil and PDVSA make in the emergence of the joint venture Petrocedeño S.A. First I examine the formal institutions according to Peng (2001):

6.3.1 Formal Institutions

Corporate governance mechanisms should be effective in order to protect the interests of shareholders and other stakeholders in business ventures. If Statoil as minority shareholder is to be sufficiently protected against opportunism, the law and enforcement of institutions in Venezuela must be in place. In the national constitution, article 301, it is stated that national and foreign companies are granted the same business conditions which is a relatively liberal framework for FDI considering Venezuelan politics. However in the hydrocarbon sector, i.e oil and gas, the Venezuelan state or Venezuelan nationals must be majority owners.

Decree 2095 of 1992 establishes the legal framework for foreign investment in Venezuela. Article 13 of the decree explicitly guarantees foreign investors the same rights and imposes the same obligations as applied to national investors "except as provided for in special laws and limitations contained in this Decree." Decree 2095 also guarantees foreign investors the right to repatriate 100 percent of profits and capital, including proceeds from the sale of shares or liquidation of a company, and allows for unrestricted reinvestment of profits. Statoil is highly dependent on obtaining the desired level of information from PDVSA, if not this could affect Statoil negatively if the company does not receive correct or adequate information and details concerning the operations.

25 www.conapri.org
26 www.conapri.org
Venezuela is performing well below average compared to the rest of the emerging economies when it comes to the effectiveness of mechanisms supporting corporate governance legal actions. By the Belgian Export Credit Agency (ONDD), that specializes on helping companies managing risks, when either exporting or investing abroad, the political risk, commercial risk, war risk, risk of expropriation and government action, and transfer risk in Venezuela, all score high in risk assessments of the country. Venezuela has well structured laws, but the implementation is poor. The laws are not alone enough to give Statoil good protection against potential abusive behavior from PDVSA. Because of weaknesses in the formal institutions, informal constraints rise to play a larger role as argued by Peng.

As mentioned in my preface section: Theory and Methodology, where formal constraints fail, informal constraints will play a much larger role.

6.3.2 Informal Constraints

Good transparency within the project Petrocedeño S.A is crucial for good cooperation. The allocation of powerful positions and board structure determines what the possible constraints will be. Statoil has fewer rights in the company management bodies than Total and PDVSA, this is relative to the ownership share. Bad interpersonal communication will ultimately harm the joint venture, and keep it from function optimally. If the strategy from Statoil and PDVSA differs in regards to the goal of Petrocedeño S.A, there can be a case of prisoner’s dilemma. PDVSA will dominate the executive positions in the joint venture and potentially selectively choose the channels of information. This will harm Petrocedeño S.A and Statoil. These are examples of informal constraints that could cause reasons for concern about Statoil’s participation in the joint venture.

6.3.3 External connections linking executives and key stakeholders (Corruption, linkages with government officials)

If Statoil’s representatives are not properly integrated in the project (the first constraint), it could lead to misuse of power. The external connections linking these executives and key stakeholders, in this case the state and government officials could cause abuse of minority shareholders. This

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27 plato.stanford.edu- prisoner-dilemma
may occur in two possible scenarios: One scenario is that PDVSA channels information so that the power balance moves in favor of PDVSA. The other scenario is if Petrocedeño S.A gets involved in a corruption scandal, this again could harm Statoil. PDVSA’s linkage with government officials and ownership of the state, its history and culture, indicates a far greater chance of corruption in Venezuela than in Norway. As minority shareholder, Statoil could in the end suffer under this informal constraint as corruption in Venezuela is far more embedded in the Venezuelan economy.

6.3.3.1 Rule of Law as an Institution
In my presentation of corporate governance section 2.0, I explained that there is, within political science, a common belief that the rule of law is a prerequisite for functioning democratic systems, political processes and a social development. In this perspective Venezuela has several challenges. Legislations to increase state control over television and radio broadcasting, threatens press freedom and free access to information. Threats to put journalists and broadcasters of television and radio, up to four years imprisonment, whose writing divulge information against "the stability of the institutions of the state." is just one of many bad laws legislated in Venezuela.

These bad legislated laws are reflected in the worldbank.org rule of law governance indicator. As Venezuela score in the lower section in the ranking, 0-10%, Norway is at the opposite end scoring 100% when it comes to the empowerment of rule of law in the country.

These aspects relate to the institutional risk faced by Statoil when engaging in Venezuelan commerce.

Independent organizations such as the Fraser Institute, which both analyze and publish surveys on the economic liberty in 141 countries, conclude that Venezuela is among the five jurisdictions in the petroleum sector, with the greatest barriers to invest in. (The other countries among the five jurisdictions are: Bolivia, Ecuador, Russia and Iran). Among all the 10 jurisdictions with the greatest investment barriers, concluded by the Frasier Institute, Statoil is currently involved in 6 of these countries.

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28 www.worldbank.org
29 www.huffingtonpost.com
30 The University of Chicago Law School Faculty blog.
6.4 Resource Based View

The traditional RBV argues that resource related advantages would ultimately result in profit maximization, whereas the gains, as a result of unique resources, in this case will form of strategic alliances opening doors to future operations. The theory has been modified slightly displaying a static picture of the structure and resource related power balance between PDVSA and Statoil. The competitive advantage that Statoil possesses seems to have a life cycle. This is why a long term forecast will be applied according to which the nature of the competitive advantage will alter over time. As Statoil possess both tangible and intangible assets, complying of everything surrounding the technology, including experience (know how) and expertise, it constitutes a significant competitive advantage. It comes evident that the Norwegian “package” of technology and knowledge is an essential step in the process of developing the Venezuelan oil field. J.B. Barney’s segmentation of resources (VRIIN-S) framework is a useful tool in the identification of a company’s resources. Relating to the rare characteristics of the resources it goes that very few (if any) Venezuelan competitors posses the resources in question (in the case of Statoil it comes obvious that the resources possessed are of a rare and a non-Substitutable nature), for which reason Statoil has the benefit of being the sole supplier (when the third party; Total is excluded from the equation). As the experience and technology represents the main asset for Statoil, it automatically creates a relationship of power that benefits Statoil. Statoil provides a service that is not fully developed in the Venezuelan energy sector, and uses this advantage strategically to get access to the projects both onshore and offshore in the Caribbean Sea. The power relationship is mounted in the fact that PDVSA holds the rights over the oil field through its subsidiary and Statoil and Total possesses the technological tools to extract the oil. As for Statoil’s and Totals assets they are difficult to imitate and/or substitute in the short term for which reason PDVSA is dependent on Statoil and Total to develop Petrocedeño S.A. Simultaneously Statoil’s assets are the vital element of bargaining power. If alterations in the nature of these assets will change the power structure over time will be analyzed upon subsequently. As it is agreed upon that Statoil’s engagement in the project is long term, they consider the project as a first move in order to gain foothold in the promising Venezuelan energy sector. In this sense it is unlikely that Statoil will take a short-term financial advantage of the project. Statoil has a long-term perspective on its involvement in Venezuela and has announced through its website that the company has spent more than 1 billion USD since late 1994. This also indicates that it is a long-
term strategic move, which is coherent with the fact that Statoil is experiencing a decrease of natural resources in terms of oil and gas fields in Norway, and is increasingly orienting towards new fields outside the Norwegian shelf. The strategy seems somehow necessary for Statoil, since as RBV theory states, attainable resources are not sustainable. In other words; due to the long term learnable nature of Statoil’s resources it has to get a foothold in future projects in Venezuela. To put it a bit dramatically Statoil’s strength is their weakness, so if they do not manage to adapt their scope to the situation at hand, they will, over time, become excess.

7. Discussion and findings

Through my analysis of Statoil and the Norwegian corporate governance and PDVSA and Venezuelan corporate governance, I have found that the national and international implementation of corporate governance in Norway is much stronger than in Venezuela. Norwegian businesses in general and Statoil have a strong fundamental corporate governance framework, which is reflected in their international corporate affairs.

Findings relating to the poor implementation of corporate governance in Venezuela are reflected in the country’s business demographic, which mainly consist of SME, large family owned enterprises and state owned enterprises.

The reluctance regarding implementing of a framework and national code of practice is reflected through the misunderstanding of good corporate governance mechanisms.

Recent years, financial reports are made available to the public through PDVSA’s webpage, including salary and compensation of the board of directors. This is a good indication that the company and the government are aware of the transparency required for a state owned company such as PDVSA.

The Norwegian Code of Practice is a well defined corporate governance framework, which include the essential mechanisms that must be in order in an international business environment. Statoil apply the Norwegian Code of Practice in their business both in national and international ventures as the code of practice is well incorporated in the business culture and ethics.

However these mechanisms fail to apply when conducting business in countries with non-exiting or underdeveloped corporate governance practices, such as Venezuela.

How management conducts business depends on how well the corporate governance codes are interpreted and communicated. For managers in Statoil the challenge is, as a minority shareholder in Petrocedeño S.A, to be consistent with Statoil’s code of conduct. The 2008 Report on Revenue
Transparency of Oil and Gas Companies ranks Statoil among the top performers in anti-corruption and transparency of financial figures. PDVSA is among the low performers, and the report states that the disclosure of National Oil Companies is relatively absent in the areas of payments and anticorruption initiatives. Improvement for this group involves increased reporting on every aspect of revenue transparency at all levels of implementation. The report is coherent with my analysis of PDVSA and the transparency of PDVSA’s financial figures and corporate governance.

The political factors in Venezuela are of great impact for future FDI flow into the Venezuelan economy. The recent decade has shown a remarkable decline in FDI, this can to some degree relate to the political conditions with Hugo Chavez as president. The nationalization process of large enterprises, referred to as “Statization” earlier in my analysis, has increased during the years of Hugo Chavez and indications show further actions of nationalization processes. In the analysis section of Venezuela and PDVSA, I have mentioned some of the many laws relevant for FDI and MNEs. My findings concerning Venezuelan law, is that especially in the hydrocarbon sector, there are “special laws” which affects and regulates the business environment. Legislations like the 2001 Hydrocarbons Law, reserves the state the exploration, production, gathering and initial transportation, and storage of petroleum and associated natural gas. This means that the primary activities must be carried out directly by the state, by a 100 percent state-owned company such as PDVSA or by a joint venture company with more than 50 percent of the shares held by the state. Any arbitration proceedings carried out by the companies involved will therefore be in domestic not international venues.  

Changes made during the last decade in royalty, tax policies, and contracts has made foreign MNEs uncertain concerning their investments in the country, which is also be reflected in the previous mentioned drop of FDI inflow in the country.

The 2001 Hydrocarbon Law is the main reason why companies such as ConocoPhillips and ExxonMobil refused to reduce their investment stakes, and thereby were “forced” out from the Venezuelan market.

31 U.S Department of State
This law is highly relevant for Statoil’s future involvement in the promising Venezuelan oil and gas sector as it indicates that Statoil never will have a majority ownership share in projects concerning exploration and production, business fields that are Statoil’s primary services. Another important and highly relevant factor for Statoil is the repatriation of investments made in Venezuela concerning the Venezuelan currency.

The Law Governing the Foreign Exchange System (Gazette No. 4897 of 1995) permits the government to intervene in the foreign exchange market: "when national interests so dictate." President Chavez used this law to create the Commission for the Administration of Foreign Exchange (CADI VI) in February 2003 to regulate the purchase and sale of foreign currency. According to the US department of State, in March 2005 the official exchange rate was adjusted to 2,150 bolivars to the dollar. In 2008 the government introduced a redenominated bolivar, “bolivar fuerte” and the official rate was adjusted to 2.15 bolivar fuerte to the dollar. In this time period from 2005 to 2008 the inflation rate was over 102, 3 percent, which again indicates that the exchange rate is overvalued.

Foreign companies wishing to repatriate capital, dividends, or profits at the official rate have to get authorization from CADI VI. Whether this affects Statoil and the joint venture negatively is uncertain, however it shows clearly an unstable currency and economic policy which in time may cause great financial distress for Venezuela and thereby affecting the controlling party in the joint venture PDVSA. It also indicates that PDVSA and Venezuelan government controls the joint venture as the different roles are mixed. If Statoil where to pull out of the joint venture because of disagreements with PDVSA, it has to get authorization from CADI VI, which again is controlled by the government.

Concerning institutional theory, this situation can cause a “prisoners dilemma” for Statoil (if goal incongruence occurred), Statoil in fear of losing its investment, would remain a silent partner and not affect the joint venture. This is inconsistence with what Statoil has announced through its website and annual reports that clearly states that Statoil will have an active role and a significant influence in the joint venture.
8. Conclusion

Based on my analysis of Statoil and Norway, PDVSA and Venezuelan and the common joint venture Petrocedeño S.A, I have estimated that in the period of 25 years, which is the duration of the joint venture, Statoil will partly lose their bargaining power and technological advantages, as latent spill-over’s are realistic. When taking institutional and agency related factors into account, the power balance in the joint venture is in favor of PDVSA. Statoil’s bargaining power is the technological advantage it possesses compared to PDVSA. If Statoil does not keep the competitive knowledge at a glance and constantly improve its technology level compared to PDVSA, it will in time be excess. Statoil also need to maneuver in the institutional environment in a sustainable way, and handle the analyzed agency problems.

It is clear that Statoil must focus on being included in future projects and developing its own knowledge based resources alongside focusing on enhancing its technology. Building on my analyses this is also possible, PDVSA did choose Statoil as partner for the project, and this was partly due to the technological advanced activities undertaken by Statoil.

Since it is stated that implementation of the law and enforcement of institutions is not sufficient in Venezuela, the question is if Statoil can see through the informal practices of the Venezuelan business environment. The institutional analysis showed that the quantity of Venezuelan laws is adequate, but it is not clear if the quality in terms of experience and competence is sufficient.

This could become a critical point of importance, as it is crucial for Statoil to be able to asses both the actual actions, but also the information passed on by Venezuela through formal and informal channels.

The fact that Venezuela owns more than the two other parties, indicates that Statoil has to be aware of the risk that PDVSA might try to capitalize on rights and decisions in Petrocedeño S.A.

To sum up the ownership structure and corporate traditions of Venezuelan companies, in terms of informal institutions taken into account, it could be a very big challenge for Statoil to asses and manage the project, depending on how PDVSA chooses to play in Petrocedeño S.A. One of the questions that remain unanswered at this point is if the two (three) companies can develop a sustainable cooperation, avoiding obstacles and corporate governance related scandals along the way.
As it becomes evident that PDVSA is the controlling entity in Petrocedeño S.A, Statoil is highly influenced on how PDVSA conduct its corporate governance practices. As mentioned before, I believe that Statoil in the long run, combined with external market forces, could contribute with great knowledge in how to implement good corporate governance practices in PDVSA and Venezuela. However this is dependent on several important factors for instance politics, economic conditions and external market forces. The potential risk in short terms is of great magnitude and manifests an uncertainty for Statoil in Venezuela.

9. Recommendations
Based on my analysis, findings and conclusion it is my overall recommendation that Statoil should remain in the promising Venezuelan oil and gas market. This due to the heavy competition in the market and mostly because I believe Statoil possesses knowledge PDVSA and Venezuela needs to exploit their natural resources. I also have the impression that over time, Statoil has the possibility to affect and influence the Venezuelan corporate governance. Statoil should use their technological advantage as a bargaining tool against Venezuela and PDVSA for implementing a corporate governance framework. This however, depends on Statoil’s ability to constantly improve and develop existing and new technology so that the company maintains its competitive advantage in the joint venture.

The fact that Venezuelan and PDVSA have no international corporate governance framework based on OECD principles of Corporate Governance is a potential large risk for Statoil. My recommendation is that Statoil, together with Total, should enforce a framework towards PDVSA and Venezuela.
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