Corporate Governance in Algeria

Case study on the joint ventures between British Petroleum, Statoil and Sonatrach

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Executive Summary

Multinational oil and gas enterprises often try to find opportunities in countries with large proven reserves and promises of future economic growth. However, these countries often find themselves lacking proper formal institutions and accordingly the environmental volatilities are high. As a result, this brings with it many challenges for international investors, including corporate governance issues pertaining to cross-national joint ventures.

We have conducted a case study on the joint ventures between British Petroleum, Statoil and Sonatrach, located in southern Algeria. We have attempted to map the nature of these joint ventures and how they play into a broader context by using a corporate governance view. The thesis has been conducted with an inductive approach, using an explanatory strategy. The aim has been to explore the role of local corporate governance in a developing country and how it affects the ventures of international investors. This has led us to the following research question: “How does the institutional environment in Algeria impact the corporate governance in the joint ventures between British Petroleum, Statoil and Sonatrach and how can the foreign investors best protect their assets?”

While the three companies have very different domestic cultures, they have certain cultural drivers that make them able to cooperate. However, the success of this teamwork depends on several other things. Our research has uncovered that Sonatrach and Algeria has the biggest influence in both joint ventures, even though British Petroleum and Statoil are acting as important resources from their position as international shareholders. In addition, these two foreign investors are accepting great financial and political risks when choosing to invest in Algeria. These risks emerge as a consequence of Algeria being a rentier state and consequently the country suffers from great institutional voids. These voids are one of the major reasons of why the country has yet to make the leap towards becoming a well functioning democracy. In addition to challenges related to weak institutions, they are also expected to suffer from agency problems pertaining to local workers and their Algerian management. The investment environment in Algeria is hostile towards foreign investors and foreigners are almost without exception only allowed to invest in the hydrocarbon industry. The reasons for accepting these risks and the hostility towards FDI is grounded in a potentially great return on investments as the industry in question is highly lucrative.
Acknowledgements

This master thesis concludes our two-year long master study at Copenhagen Business School. It has been particularly educational and informative months in which we have gained a deeper insight in cross-cultural joint ventures and good corporate governance. We hope that this thesis highlights the importance of partner characteristics and host country institutions when choosing a country to invest in.

We would like to thank our supervisor, Peter Gammeltoft, for his guidance and help throughout this thesis.

Gabriella Ann Wells Klev & Christian Sennesvik
### Abbreviation list

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>BOD</td>
<td>Board of Directors</td>
</tr>
<tr>
<td>BP</td>
<td>British Petroleum</td>
</tr>
<tr>
<td>CACI</td>
<td>Chambre Algérienne de Commerce et d’Industrie</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<tr>
<td>EITI</td>
<td>Extractive Industries Transparency Initiative</td>
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<tr>
<td>EPRA</td>
<td>Early-phase risk assessment tool</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>HSE</td>
<td>Health, Safety &amp; Environment</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labour Organization</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IOC</td>
<td>Privately Owned International Oil Companies</td>
</tr>
<tr>
<td>LNG</td>
<td>Liquefied Natural Gas</td>
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<tr>
<td>LPG</td>
<td>Liquefied Petroleum Gas</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
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<tr>
<td>MNE</td>
<td>Multinational Enterprises</td>
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<tr>
<td>NEC</td>
<td>National Energy Committee</td>
</tr>
<tr>
<td>NOC</td>
<td>National Oil Company</td>
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<tr>
<td>NGO</td>
<td>Non-Governmental Organization</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organization of the petroleum exporting countries</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
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Fig. 1: Structure Of The Thesis

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- Methodology

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- Institutions
- Rentier States
- Shareholders
- Agents and Principals

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- In Salah

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1.0 Introduction

In this thesis we will focus on host country corporate governance and the effect it has on large joint ventures. This especially when the joint venture is made up of foreign multinational enterprises (MNEs) with strong moral conduct operating in some of the least economically free countries in the world. In this study we will look upon the differences of corporate governance practices between British Petroleum (BP), Statoil and Sonatrach and the dynamics of their business relationship in Algeria.

The thesis will be a case study of BP and Statoil in Algeria, including an analysis of the hydrocarbon industry in said country. We will not be looking at other markets, so variations from industry to industry will not be explored. Our findings in this thesis cannot give a corporate governance solution to other MNEs in other industries. It can only provide a guideline for other MNEs that are seeking opportunities in the hydrocarbon sector in Algeria and countries with a similar corporate governance context and a similar level of formal institutions and informal constraints. Throughout the thesis we will investigate the risks and threats in a corporate governance view, using an exploratory approach and simultaneously attempt to establish whether or not the joint ventures In Amenas Gas Project and In Salah Gas Project in Algeria are developing in the interest of all shareholders.

We want to look at the differences of western and Algerian corporate governance practices. On “paper” all three countries have a socialistic society and should in this way be a good match for each other in a joint venture. However, when looking further into each society, great differences appear, especially when comparing Algeria to Norway and the United Kingdom. Thus, the joint venture may not operate as effectively as first perceived, despite their apparent similarity. The ownership structure of both Statoil and Sonatrach is a bit similar as both companies have the government as its majority owner. Having a conflict within the joint ventures therefore has the potential of being an international dispute between the two governments, both giants within the hydrocarbon sector. Aside from this, Algeria’s troubled history since their independence in 1962 provides several uncertainties for foreign investors. Algeria has built their current industry on nationalized companies and the current legal system is very protective of their national oil and gas resources. Algeria has been financially
dependent on their oil and gas industry ever since their independence and is accordingly governing its national oil and gas company, Sonatrach, with a forceful political hand towards their own subjective goals.

Some market-oriented efforts have been attempted throughout the years, but the government has never fully endorsed any of these attempts. These market-oriented labours are therefore yet to undermine the Algerian imperatives when it comes to their hydrocarbon strategy. All of this is in spite of international pressures to restructure the socialist system. The government has strong ties with Sonatrach and high government officials and their counterparts in the national oil company exchange positions regularly. Although the names have changed, been reshuffled, or eliminated all together, those in charge of the national hydrocarbon sector have remained key actors in the management and the direction of Sonatrach. The government officials in Sonatrach are put there to maintain close political scrutiny of the industry and to make sure that the national oil and gas company moves in the direction sought after by these bureaucrats¹.

Corporate governance mechanisms are both legal and economical institutions, which sometimes can be altered for the better through the political process. However, the democratic drivers in Algeria have always been weak. Attempting to restructure the socialist system may furthermore prove difficult when you are perceived to be forever condemned as a rentier state. Breaking away from such stigma is not easy and may prove to be very time consuming and costly. Also, as the Algerian population in reality fail to make any real democratic demands, because of their social contract with the government, the only incentive to change their ways comes from MNEs looking to invest in the country. Many claim that the product market competition itself will better these mechanisms, through the minimization of costs and adoption of rules, enabling them to increase external capital at the lowest cost². However, when a state-owned company enjoys full monopoly in their domestic market, there will be no product market competition. Only when crossing national boarders and expanding operations to other countries will such product market competition mechanisms emerge. How serious you take them is another matter. So far, nothing seems to motivate the Algerian government

¹ Entelis, 1999
² Shleifer & Vishny, 1996
to fully restructure their political system, democratising the rentier state and improving the formal institutions. Accordingly adopting international rules and regulations will slowly improve the domestic corporate governance mechanisms.

1.1 Problem Statement

**Research objective:** We want to conduct an analysis of BP and Statoil’s joint ventures with Sonatrach through a corporate governance view with the emphasis on the challenges of operating in Algeria. We want to examine how environmental volatilities affect a multiple partner joint venture. We also want to look at what makes a good partner match when cooperating across national borders.

The research objective can be formulated into one research question:

“How does the institutional environment in Algeria impact the corporate governance in the joint ventures between British Petroleum, Statoil and Sonatrach and how can the foreign investors best protect their assets?”

1.2 Structure of the Thesis

The first part of this thesis is an introduction to the case study and also a presentation of the problem statement. The second chapter outlines the research design and explains the methodology chosen to answer the research question. Chapter three introduces theoretical concepts such as corporate governance, joint venture theory, institutional theory, rentier theory, resource-based view and agency theory. Chapter four gives an case overview with a small profile on each company, in addition to a profile on Algeria and the two gas fields in which the joint ventures takes place. Chapter five goes deeper into each company and Algeria, individually analysing corporate governance determinants. Following this, chapter six analyses the joint ventures as whole, considering all previous facts and theoretical notions in order to answer our research question. Chapter seven draws concluding remarks, as well as recommendations and limitations pertaining to the thesis.
2.0 Methodology and Research Design

In this section we will outline our research philosophy and lay out the methodological terms for the paper. We will also give answers to the questions concerning the reliability and validity of the case study, in addition to reasons for choosing to use only secondary data. We will so present our multi-theoretical perspective and account for the reasoning behind it.

2.1 Research Philosophy

Realism is a branch of epistemology that is similar to positivism in the way it undertakes a scientific approach to the development of knowledge. This assumption supports the way positivism accumulates and understands its data. According to Saunders et. al. (2009), the philosophy of realism is that there is a reality quite independent of the human mind and the objects thus exist independently of the mind. There is two types of realism; Direct and critical. We will be concerning ourselves with the latter, as it points out that what we experience are images of the things in the real world, not the things directly. Thus our senses can be deceiving. The argument is accordingly that we cannot understand what is going on in the social world if we are not able to understand the social structures that have given rise to the phenomena we are trying to understand3. We are thus, as mentioned before, interested in researching the social structures in the joint venture, such as the industry environments, in order for us to fully understand the phenomena of the corporate governance we are studying.

2.2 Research Approach

There are two main approaches to a research project; deductive and inductive. A deductive approach is concerned with scientific principles, the collection of quantitative data, the operationalization of concepts and the need to explain causal relationships. However, induction emphasizes gaining a understanding of the meanings humans attach to events, the collection of qualitative data, a close understanding of the research context and less of a concern with the need to generalise. Accordingly, when moving on, we will use the latter approach.

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3 Saunders et. al., 2009
2.3 Research Method

When deciding what method one will use there is two options. The quantitative data collection method is predominantly used as a synonym for any data collection or analysis that generates or uses numerical data. In contrast, the qualitative data collection method is predominantly described as the generation or usage of non-numerical data. While our thesis will mainly be qualitative, we will use a semi-what mixed-model method. This will combine the quantitative and qualitative data collection techniques and analysis procedures. This will also allow for the combination of approaches at other phases of the research. Mainly, in this thesis, this will allow us to use quantitative data, such as graphs and tables, in order to qualitize it in the analysis.

2.4 Research Strategy

In this thesis we are planning to conduct explanatory research. Within explanatory research the emphasis is on studying a situation or a problem in terms of being able to explain the relationships between the studied variables\(^4\). As for a research strategy we have in this thesis chosen to conduct a case study. A case study is "a strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence"\(^5\). Yin (2009) also emphasizes the meaning of context. Within the case study, where the context cannot be controlled, the boundaries between the phenomenon and the context within which it is being studied are not clearly evident. The case study is thus of particular interest when one wants to gain a more detailed understanding of the context of the research and the processes being enacted. According to Yin (2009), this thesis will be especially fitting for a case study. This is because our research question consists of a “how” question. The latter does not require control of behavioural events and has a focus on contemporary events\(^6\). While “what” questions tend to favour survey methods, “how” questions are much more explanatory and thus favour methods such as case studies. This is because of a need to trace operational links over time and not just have a mere focus on frequencies or incidents.

\(^4\) Saunders et. al., 2009  
\(^5\) Robson, 2002; 178  
\(^6\) Yin, 2009
We will perform a multiple case study. We have chosen BP and Statoil for a literal replication and Sonatrach for a theoretical replication. We believe that BP and Statoil have similar results when it comes to their corporate governance and we expect Sonatrach’s corporate governance to be contradicting with the two aforementioned companies. Choosing Sonatrach also allows us to look closer at how the Algerian context influences the company. We will first look at the three companies separately and then analyse the effect they have on each other, one by one and combined, leading us to conduct a holistic case study.

2.5 Collecting Data

Only secondary data, meaning data originally collected and published by others, will be used in this thesis. A downfall of this is that the level of subjectivity will increase in the data collection. While primary data, such as first-hand statements from company executives, would have added a richer base to the study, negotiating access was beyond the limit for this thesis. Still, both documentary and multiple source data will be used. Primary, secondary and tertiary literature along the lines of company reports, books and indexes will be drawn upon.

The study will be mainly cross-sectional, as it will examine the impacts of the industry environment in Algeria at the time of the data extraction. However, data is not only collected from the presence, it is also gathered by tracing steps back over time. This gives the study a small temporal aspect.

2.6 Reliability

According to Saunders et. al. (2009) reliability refers to the extent to which data collection techniques and analysis procedures will yield consistent findings. The authors further state that reliability can be evaluated through three matters of inquiry. Firstly whether the measures would yield the same result on other occasions. Secondly, if similar observations will be reached by others and lastly if there is transparency in how the observers made sense of the raw data.

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7 Yin, 2009
Since the data we will be using in the case study is secondary and includes no subjective variables, it is plausible to assume that the same results should be reached on all occasions, giving us a high level of reliability. However, much of the data will be collected directly from the companies themselves, leaving room for company subjectivity. On the other hand, because of all the data being secondary, it is safe to assume that other researchers would reach similar conclusions. This because no contextual factors, such as the circumstances under which data were collected, influenced the information gathered. However, as we have chosen to conduct our study in this particular way, others might opt to do it differently. We will try to describe all choices as thoroughly as possible in the text, making it easy for others to backtrack our steps. We will try to stay as unbiased as possible all throughout the study. Thus choosing three companies in which neither author has a personal connection to helps the objectivity of the study.

2.7 Validity

Validity refers to whether the findings are actually about what they appear to be about\(^8\). Yin gives us three types of tests in order to check the quality of the case study; construct validity, internal validity and external validity. In order for us to secure validity in the first test we will use multiple sources of evidence and attempt to establish a clear chain of evidence. In order for us to secure validity in the second test we will try to match the detectable patterns, in addition to relying on theoretical propositions. We will give a case description and we will also use quantitative data and make it qualitative, using both methods in order to make the study more valid. In order for us to secure validity in the third test we will use replication logic. By choosing to look at three companies it gives us the possibility to estimate whether the findings can be applicable to other cases, at least more than if we were to choose a single case study, giving the study greater external validity\(^9\).

However, the analysis in the case study only uses secondary data. Initially, this data was collected and published for a different purpose than the one they are applied to in this thesis. This may result in the misinterpretation of the realities to be examined and may compromise

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\(^8\) Saunders et. al., 2009  
\(^9\) Yin, 2009
the validity of the findings. Moreover, the requirements for secondary data limit the case examples to very large companies. The results do not reflect how context affects smaller companies in other joint ventures.

2.7.1 Traditional Prejudices towards Case Studies

Sometimes case studies are seen as a less desirable form of inquiries, with interviews, surveys and experiments being the frontrunners. The first concern is their lack of rigor. We are thus trying to be as focused and systematic as possible in order to maintain the integrity of this case study. We will also try to keep ambiguous evidence and biased views to a minimum so that it will not influence the directions of the findings and conclusions. Secondly, a concern for case studies is that they provide little basis for scientific generalization. However, one cannot generalize from a single experiment either. The short answer is that “case studies, like experiments, are generalizable to theoretical propositions and not to populations and universes”\(^\text{10}\). With this in mind we proceed to the third concern, which is that case studies take too long and result in massive unreadable documents. We will attempt to keep this study as short and “to the point” as believed possible. Lastly, the fourth objection concerns itself with the fact that case studies seemingly have emerged with the renewed emphasis on “true experiments”. Such studies seek to establish causal relationships. However, like other types of non-experimental methods, case studies are not capable of directly addressing such issues. It is important to remember that case studies can offer important evidence to complement experiments. As experiments may be limited in their explanation of “how” and “why” we thus wish to provide our case study as a supplement to existing field theory. More research will have to be conducted, before general statements about how context and partner characteristics affect joint ventures as a whole can be made.

\(^{10}\text{Yin, 2009; 15}\)
2.8 Multi-Theoretic Perspective

In order to fully research this topic we will use a multi-theoretic perspective when writing this case study to obtain the most comprehensive answer to our research question. We think that good corporate governance is made up with more than one or two elements, thus proving that a theoretical overview is needed.

The joint venture theory will create the fundamental basis for our paper by looking at the factors that affect a joint venture. The theory explains the company’s behaviour and performance based on different factors in the joint venture, as well as the host country. Therefore, joint venture theory will be the core of our thesis by looking at the different structures and partner characteristics pertaining to cross-country collaboration. The institutional theory will build on this foundation with a closer look at how companies lean towards compliance with predominant customs and traditions. Thus, a successful company is the company that achieve support and legitimacy by meeting the requirements of social pressure. Rentier theory will supplement our thesis by looking closely on the different consequences of working with a state mostly financed by oil revenue. This theory will

Fig. 2: Multi-theoretic approach in explaining the governance – performance relationship amongst companies in an emerging economy context

Source: Adapted from Douma, George & Kabir, 2006
enlighten us on how the Algerian regime is built and how this is affecting the country, its companies and foreign investors. Both institutional and rentier theory explain why country context matters in the making of corporate governance. While motives may be directed by particular organizational needs, certain shareholders may also play a part in the decisions. The importance of such shareholders is highlighted in resource-based theory. The basic premise of the resource-based view is, in order for a company to drive strategy and performance, to gain a competitive advantage through its unique and valuable resources that cannot be copied. From this theory we will only be using the resource of shareholders and their impact on the company. While all resources are valuable, we feel that we only need to highlight this particular resource in order to answer our research question. Also, the motives the different agents have for making these decisions will vary considerably depending on organizational culture and traditions. The essence of agency theory is the separation of management and finance, or in other words, of ownership and control. A successful joint venture will be the one that compels managers to distribute profits correctly and also gives investors legal protection in order to exercise their own power over the management.

Each of the theories has strengths and weaknesses; therefore it makes sense to apply a multi-theoretical perspective to the paper to gain the most knowledge in order to answer our research question. For instance, highly productive resources, such as valuable shareholders, will be of limited value and use if there is no organizational will or political support to deploy them and with no management to orderly distribute the profits. Also, Douma, George and Kabir (2006) argue that while agency theory and the resource-based theory may be important tools when proving the effect of ownership on company performance, they claim that these theories suffer great limitations as neither perspective examine the social context within which the company’s activities are embedded. We thus believe that the theories we will introduce in this paper, in combination with each other, will offer us the most comprehensive framework to answer our research question.

11 Oliver, 1997
12 Shleifer & Vishny, 1996
13 Oliver, 1997
3.0 Theoretical Framework

In this third chapter of our case study we will outline the theories we have chosen. We feel that the upcoming theoretical framework will give us enough material to analyze our research question. From first to last we will present joint venture theory, institutional theory, rentier theory, resource based view and agency theory in a structured and separate manner.

3.1 Corporate Governance

According to Shleifer and Vishny (1996) corporate governance handles the ways in which the corporation’s financial suppliers assure themselves a return of investment. As it follows from this definition the two authors are focused on the financial aspect of governance, albeit corporate governance can be much more. There is no single, accepted definition of corporate governance, as the definitions vary greatly according to which country is considered. Thomsen and Conyon (2012) defines corporate governance as “the control and direction of companies by ownership, boards, incentives, company law and other mechanisms”\(^{14}\), based on and further developed from the widely known Cadbury definition. In other words, corporate governance refers to the set of systems, principles and processes that provide the guidelines as to how the company can be directed or controlled, in order to fulfil its goals and objectives in a manner that adds long term value to the company. Solomon (2010) follows this way of thinking and define corporate governance as: “the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activities”\(^{15}\). She states that in today’s society, a stakeholder-oriented approach to corporate governance is important. Stakeholders in this case would include everyone ranging from the board of directors, shareholders and management to customers, employees and the society in general.

In developed countries, such as the UK, corporate governance is a common and well-developed tool for corporations. The United States, Germany, Japan and the UK have some of the best corporate governance systems in the world. Thus, the differences between them are

\(^{14}\) Thomsen & Conyon, 2012; 4
\(^{15}\) Solomon, 2010; 6
likely to be small compared to how they differ from other countries. On that same note, in less developed countries, including some of the transition economies, the mechanisms within corporate governance are basically non-existent\textsuperscript{16}. For instance, in Russia, large diversion of assets by managers of many privatized companies is set off by the weakness of corporate governance mechanisms. This leads to the virtual non-existence of FDI to such companies\textsuperscript{17}.

### 3.2 Joint Venture Theory

Joint ventures “involve two or more legally distinct organizations (the parents), each of which actively participates, beyond a mere investment role, in the decision-making activities of the jointly-owned entity”\textsuperscript{18}. International joint ventures are a key drive-force of global expansion for MNEs. While it is easy to assume that these joint ventures involve only two parent companies, one has to account for several parents in the venture-mix, as literature suggests that a considerable amount of joint ventures have three or more parent companies\textsuperscript{19}.

#### 3.2.1 Multiple Parents

From a resource-based perspective, a bigger pool of parents might entail more and better matched resources that can be put together in a common joint venture. However, in order to be useful to the joint venture, these resources have to be coordinated and incorporated. Thus, further resources may perhaps not serve in the best interest for the joint ventures performance, as cost and coordination difficulties might increase. The equation is quite easy, the greater the number of parents, the higher the transaction cost. This is for the reason that opportunism, free riding and defection becomes more probable with having more interested parties fighting for the bone. Also, multi-parent joint ventures are bound to be more conflict prone, more difficult to manage and more prone to greater diversity and leading to higher communication costs. As the number of partners increases, governance complexity increases. This particularly comes to light in international joint ventures, where behavioural gaps in cultural, legal, political, economic and ideological beliefs are difficult to bridge\textsuperscript{20}.

\begin{itemize}
  \item \textsuperscript{16} Shleifer & Vishny, 1996
  \item \textsuperscript{17} Boycko, Shleifer & Vishny, 1995
  \item \textsuperscript{18} Geringer 1991; 41
  \item \textsuperscript{19} Gong et. al, 2007
  \item \textsuperscript{20} Gong et. al., 2007
\end{itemize}
In order to manage this situation as best as possible, the need for complete contracts become more and more evident. Contract completeness has to do with "the extent to which relevant clauses or issues pertaining to building and managing a joint venture are clearly specified and codified in a venture’s contract"\(^{21}\). Accordingly, increased diversity of goals, behaviours and capabilities extend the contingencies that must be enclosed in a contract. However, this diversity also increases the likelihood of overlooking these contingencies during the contract negotiation. Moreover, the higher the number of parents, the harder partner cooperation is to achieve. This, not only because of diversity, but also because of an increase in parents will give fewer opportunities to interact with each other and ascertain more meaningful relations. A complete contract spells out the joint venture’s goals and scope. While it specifies the decision-making rules and procedures for the joint venture, it also stipulates the rights and obligations of each partner. All of this with the intention of resolving disputes and avoiding conflicts. Additionally, a complete contract regulates each party’s behaviour, commitment and responsibility while at the same time safeguarding the interests of each party\(^{22}\).

\(^{21}\) Gong et. al., 2007  
\(^{22}\) Gong et. al., 2007
Thus, while joint ventures may well be utilized to reduce transaction costs and environmental volatility, one might want to reflect on the number of parents involved in the joint venture in order to achieve this wanted utilization. Gong et. al. (2007) found that the number of parents is in general negatively related to collective returns and that a company should always strive to forge alliances with a smaller number of partners. Sometimes however, additional partners are needed, in case one needs an intermediary to bridge cultural distances or because critical resources are unavailable from a single partner. Therefore, if the number of partners must be more than two, these partners should, in cooperation, set up a more complete contract early on in the relationship. Since strains on cooperation will be greater than in two-partner ventures, the more detailed contracts one achieves, the more relationship-constrains one is able to fight of 23.

3.2.2 Partner Characteristics

Inter-company cooperation is a crucial component of the pursuit of global competitive advantage. In general, the criteria’s used for a partner selection will determine the joint venture’s skills mix, knowledge, procedures, structures, vulnerability and its overall competitive viability. Therefore, finding a good partner match is essential for the joint venture’s successes 24. In 1993, Arvind Parkhe found that the linkage between structure and performance varies by the nationalities of partners. He therefore stressed the need for a systematic assessment of salient characteristics of potential international partners. He also stated that the logic of the prisoner’s dilemma would explain why this was needed. Like the prisoner’s dilemma, the anticipated structure-performance relationship leans on certain fundamental behavioural and environmental assumptions. However, each of these assumptions becomes questionable when faced with sharp differences in the actor’s cultural, national and organizational backgrounds. Thus, in order to find a trustworthy “partner in crime”, homework has to be done. For example, the propensity for trust is likely to vary significantly among nationalities. In oriental cultures, trust is a vital supplement to contractual arrangements, and it may even take their place while American managers tend to rely on formal contracts and binding arbitration to resolve areas of conflict. Furthermore, some countries may use competition and efficiency as benchmarks of performance measurement,

23 Gong et. al., 2007
24 Roy & Oliver, 2009
while other countries may use stability and social justice as the preferred evaluation criteria. However, organizational-level dimensions are also crucial in alliances. Such dimensions include corporate culture, strategic direction and management practices. These fundamental differences might also be found in problem solving, goal setting and other crucial areas of joint ventures. This diversity in societal cultures may as a result engender incongruent perceptions about the criteria for utility maximization. Chen, Peng and Saparito (2002) find that collectivists have a higher opportunistic propensity in inter-group transactions. They mention that when negotiating with out-group others, while individualists make an effort to seek common ground with both in- and out-groups, collectivists have a propensity to first lay down what is not negotiable. Furthermore, inter-group transactions present “a most vigorous test for collectivists to demonstrate their willingness to self-sacrifice for the preservation of their in-group's interest.” Collectivists are therefore, compared to individualists, much more prone to be loyal agents of their in-groups. Accordingly, collectivists will not only be more inclined to give precedence to the interests of their in-group, they will also be more willing to fight on behalf of their in-group against the out-group. This leading them to employ all possible means including guileful ones like opportunism, a concept we will return to later.

When choosing an appropriate partner it is possible to use both "task-related" and "partner-related" criteria. Whereas the first concerns itself with facilities, raw materials and regulatory permits, the latter concerns itself with trustworthiness, commitment, transparency reputation and goals. Roy and Oliver (2009) assert that companies will be more likely to choose partners based on partner-related criteria than task-related criteria. This because the potential for opportunism and increased coordination costs are more likely to be aggravated by the lack of a partner’s trustworthiness and transparency, compared to the partner’s physical assets. Roy and Oliver (2009) also find that the legal aspect of the institutional environment in the host country is an extremely important factor in determining partner selection. Control of corruption also seems to be especially important when influencing the MNEs decision-making. Thus, when faced with a host country with poor rule of law and control of corruption, the "partner-related" criteria should outweigh the perks of "task-related" criteria. Added up,

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25 Parkhe, 1993
26 Chen, Peng & Saparito, 2002:575
27 Chen, Peng & Saparito, 2002
28 Roy & Oliver, 2009
the host country’s institutional environment holds much power over the MNEs actions and will shape their joint ventures and their entry mode. The institutional host country environment will be discussed in more detail further on in this theory chapter.

### 3.2.3 Opportunism

An emerging economy is defined as “an economy that grows rapidly with structurally changing industries, promising but volatile markets, weak legal protection systems, and a regulatory framework that undergoes drastic transformations”\(^{29}\). As we have discussed previously, institutional environment in the host country is particularly important when selecting partners. However, this is not only key for the overall skill mix, but also for the prevention of opportunism.

![Fig. 4: A model of opportunism in emerging market-based joint ventures](source: Luo, 2007)

Opportunistic behaviour is to conduct yourself in a sly and devious manner in order to seek out self-interest while disclosing incomplete or distorted information. Opportunism often occurs in the process of developing a joint venture and disrupts the joint venture outcome. Hence, looking at environmental influences is important because opportunism is said to be a function of uncertainty and accordingly, uncertainty is, at least to some degree, a function of environmental volatility. Industry structural instability, information unverifiability and law unenforceability are three interrelated, but distinct constructs that mutually make out an emerging market’s environmental volatility. Structural instability concerns itself with the

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\(^{29}\) Luo, 2007; 42
extent to which an industry’s key structural attributes, such as profit, sales and output growth is unstable or fluctuates. While structural instability does not seem to affect opportunistic behaviour, information unverifiability and law unenforceability does. The fact that structural instability does not seem to impact opportunism may imply that market opportunities in a structurally volatile industry may be large enough to cancel out volatility-related threats. Investors are “rational” enough to tolerate a greater degree of environmental uncertainty when joint ventures participate in a more rapidly growing industry\textsuperscript{30}.

When it is possible to disregard the importance of structural instability whilst forming a joint venture, both information unverifiability and law unenforceability are not to be overlooked. Also, Luo (2007) argues that the positive correlation between opportunism and information unverifiability and law unenforceability will be even stronger when a joint venture depends more on the environment in the host country. Information unverifiability refers to which degree true information about macro- and micro-business environments is difficult to verify for individual businesses. In addition to help foster opportunism, information unverifiability also makes it difficult to formulate and implement strategic plans. For example, while some joint ventures have penetration of the local market as their main focus, others may consider the host country as merely a production platform for exports. This second kind of market orientation affects the company’s dependence on the host country’s market and resources to a great extent. This also affects how the company perceives the environmental volatility in the host country. In addition, exit costs and sunk costs are also considerably higher when the joint ventures are more reliant on the local environment\textsuperscript{31}.

When it comes to law unenforceability, the weaker the local partner’s connections with the local judiciary and governmental authorities, the higher the law unenforceability is perceived to be. In developing countries, “people”, rather than the law itself, take a considerable part in determining commercial activities. Even though both legislative and governmental institutions in developing countries have started to enact more commercial laws, because of different political, institutional, socio-cultural and historic reasons, these laws are by large not sternly enforced. Especially in emerging markets, international joint ventures are created in

\textsuperscript{30} Luo, 2007
\textsuperscript{31} Luo, 2007
order to share risk and costs. Thus, if law unenforceability inhibits the investing parties from seeing this prospect of reduced risk, the parties are more likely to behave opportunistically\(^{32}\).

### 3.3 Institutional Theory

When analysing company and national behaviour and performance it is important to examine the social and regulatory aspects. “Institutional theory emphasizes the influence of socio-cultural norms, beliefs, and values, regulatory and judicial systems on organizational structure and behaviour”\(^{33}\). In other words, institutions influence the economy by affecting the cost of exchange and production, forming the incentive structures in a society by being the determinants of economic performance\(^{34}\). These institutions, which include the regulatory structures, governmental agencies, laws and courts, have been found to be an exceptionally vital driver of strategic choices\(^{35}\). The political institutions determine the tax rates and tariffs, investment regulations, restrictions on foreign ownership, government protection and foreign exchange controls. The political institutions also enforce the rule of law. The lack of transparency of laws, or weak enforcement of the laws, results in weak protection of intellectual property rights and increase corruption. Poor protection of property rights discourages companies from pursuing innovation. Increasing use of corruption can threaten the ability of companies to gain fair rents from their operations, as they have to waste resources on unproductive behaviour\(^{36}\).

#### 3.3.1 Host Country’s Environment

Significant variation may exist along each of the partner’s larger context in an international alliance. As a result, the company’s “national context” will naturally also vary significantly across country lines, hence impacting the company’s ability to enter and operate the joint venture. Accordingly, institutional structures and governmental laws and regulations all come into play in the nations local context, impacting the joint venture in different ways\(^{37}\).

\(^{32}\) Luo, 2007  
\(^{33}\) Douma, George & Kabir, 2006; 641  
\(^{34}\) North, 1994  
\(^{35}\) Roy & Oliver, 2009  
\(^{36}\) Chan, Isobe & Makino, 2008  
\(^{37}\) Parkhe, 1993
Chan, Isobe and Makino (2008) found that the host country’s national contextual factors influence company behaviour and economic performance and they name three supporting infrastructures. Physical infrastructure is the basic facilities and installations needed for the local economy to function. Human infrastructure is the skilled labour and the networks where companies acquire new knowledge. Technological infrastructure is a home base for technological development, where companies create their competitive advantage. Together, these three supporting infrastructures create operations efficiency, knowledge acquisition and technological development. Foreign affiliates that operate in countries with weak developed institutions are likely to be involved in more costly market transactions and less efficient transformation. Countries with highly developed institutions are more favourable for foreign affiliates, as they provide a safer institutional context that gives a positive effect on the profitability. The performance of foreign affiliates is influenced by the institutional context of the host country, because the institutions affect the costs of doing business. The performance of foreign affiliates varies a lot in countries with weak institutions because they differ in what strategic actions they take in response to the level of development of the institutions. They also differ in their ability to manage the institutional idiosyncrasies of the host country. This implies that the choice of host country is at least as important as choosing the industry, in determining the foreign affiliates performance\textsuperscript{38}.

### 3.3.2 Constraints

North (1991) defines institutions as “\textit{the humanly devised constraints that structure political, economic and social interaction}”\textsuperscript{39}. These constraints are divided into formal rules and informal restraints. Formal rules are the constitution, laws, rights and political rules that are formally in place. Informal restraints are the customs, sanctions and code of conduct based on the traditions of the country. Together they define the incentive structure of the economy. Institutions have historically been developed to create order and reduce uncertainty in exchange. The institutions are constantly evolving, connecting the past with the present and future. North (1990) describes the evolving institutions as strategic choices that are made by organizations influenced by the institutional framework, that in turn influences how the institutional framework evolves. The institutional framework interacts with organizations by

\textsuperscript{38} Chan, Isobe and Makino, 2008

\textsuperscript{39} North, 1991; 97
signalling what choices are acceptable. The formal rules, like law and justice systems, are often well developed and embedded into national institutions in western societies. The formal rules aim to ensure a fair legal system that protects national and foreign businesses operating within the country. In developing countries, the formal institutions are not always as capable as in the western society, creating uncertainty for MNEs looking to invest.

When everything works smoothly in developed countries the market-supporting institutions are almost invisible. However, McMillian (2007) argues that when markets work poorly in emerging economies, the absence of strong and formal institutions is striking. Strategic choices are not only driven by industry conditions and company capabilities, but are also a reflection of the formal and informal constraints present in the environment of the company. Institutions are directly influencing what tools a company has when formulating and implementing strategy and creating a competitive advantage.

The level of institutional development in emerging economies is generally low, because of institutional rules being absent or poorly enforced. North (1990) argues that a lack of institutions, predictable government action and efficient bureaucracy creates an institutional void. These voids are often caused by imperfections in the market, poor management and flawed products. These voids make transactions and transformation costs bigger for the company. Transaction costs are higher as foreign companies need to protect their assets from expropriation. Transformation costs increase because weak institutions mean a higher risk of insecure property rights and unenforceable contracts. However, Douma, George and Kabir (2006) argue that business groups are especially well suited to address such institutional voids as they have a superior ability to raise capital, train and rotate management and use common brand names in the marketing of products.

Still, Peng (2002) claims that when the formal constraints fail, the informal constraints will come into play to reduce uncertainty and provide consistency for organizations. He names three main sources of informal constraints. The first informal constraint is the external

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40 Peng, 2002
41 North, 1991
43 Chan, Isobe & Makino, 2008
44 Douma, George & Kabir, 2006
connections linking executives and key stakeholders. There is often a need to have greater contact with government officials for companies in unstable environments. Bribes, gifts and other corrupt practices may be a part of working with bureaucracies. The second informal constraint is the reputation of companies as a strong signalling device to reduce uncertainty for customers and investors. The last informal constraint is the interpersonal relations that exist between executives. By engaging in mutually supportive networking, managers from diversified companies are able to reduce uncertainty in their decision-making\textsuperscript{45}.

### 3.3.3 Deinstitutionalization

Institutional theory gives a comprehensive explanation for both individual and organizational action. However, deinstitutionalization is an equally important phenomenon in which can be described as the processes that weaken institutions and ultimately makes them disappear. There are many sources or drivers of change and Oliver (1992) identified three key sources of pressure that affected institutional norms or practices: functional, political and social sources. Firstly, functional pressures for deinstitutionalization are those that take place from the perceived usefulness linked with institutional practices or perceived problems in the levels of institutional performance. These changes may for example be caused by changes in the environment, like increased resource competition. Secondly, political pressures are first and foremost an outcome of shifting interests and underlying power distributions. These shifts may cause existing institutional arrangements to lose their support and legitimacy. Such alterations to interests and power distributions may be caused by an emergent crisis or environmental changes. Thirdly, the sources of change may also be influenced by social pressure related with differentiation of groups or changes in laws, social expectations and organizational structure and governance\textsuperscript{46}.

### 3.4 Rentier Theory

A “rentier state” is a country that acquires a considerable amount of its income from natural resources, often originating from sales of oil and gas resources. The oil industry is capital intensive, employs few workers and lacks sizeable linkages with the economy at large.

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\textsuperscript{45} Peng, 2002  
\textsuperscript{46} Dacin, Goodstein & Scott, 2002
Because of the volatility of international petroleum markets, reliance on petroleum revenues can lead to governmental overspending, debt and fiscal crises\(^47\). Sandbakken (2006) argues that oil rentier states have certain features that make them unlikely to become consolidated democracies. She uses three features to confine the rentier state framework. Because of the oil, rentier states are freed from democratic obligations to their taxpayers and do not rely on taxation for income, enabling the government to make decisions on their own without being pressured by the public. Secondly, Sandbakken states that the state spends oil revenues on placating and repressing its population. The oil rents accumulate directly to the state, leaving the state in the position to buy off or repress political opposition. Lastly, she states that there is little room for democratic opposition in the social structure in rentier states because oil wealth creates social structures that are not favourable to democracy\(^48\). This way of governing evolves around a social contract in which the citizens make rather few political demands, as long as the state provides many services without charging taxes to them.

### 3.4.1 Democracy in Algeria

Rentier states, if not forever damned by their oil wealth, has quite a few failings stemming from their waste of tax extractive capacity, or rather the waste of it. As rentier states seldom consolidate democracy, the state becomes isolated from social forces. This leaves the state with few plausible institutions when in need to work out peaceful conflict resolutions in the aftermath of economic shocks\(^49\).

Sandbakken (2006) compares three African rentier states, namely Nigeria, Algeria and Libya. In all of these cases the government spending on repression and welfare has helped diminish the pressures for democratization. This social structure argument seems especially valid for Algeria. During several years the Algerian government managed to maintain a wide-ranging welfare system. This included free health care, free education, retirement benefits and consumer and agriculture subsidies. All of this was financed through the states oil revenues. The political system in Algeria has been motivated by a socialist ideology throughout the modern time, although never actually being accomplished through democratic means. While some sort of election has chosen the regime, this has not been an uncensored and democratic

\(^{47}\) Losman, 2010  
\(^{48}\) Sandbakken, 2006  
\(^{49}\) Henry, 2004
process. One might even find such voting conditions working to consolidate the theory on rentier states.

Algeria has been a rentier state for the majority of the period since they became independent in 1962. They have experienced some democratic transition, albeit never seen democracy fully consolidated. This shows that rentier state theory can be applied to African rentier states\textsuperscript{50}. Henry (2004) argues that Algeria indisputably will continue to be a rentier state, as it still depends on oil and gas revenues to finance a significant part of the government budget. In spite of this, he also states that Algeria is not forever condemned for its exploitation of “black gold”, but is instead able to turn things around with taming political Islam and removing the military from the political arena. He also states that a resurrection of Algeria’s short-lived democratic trial in 1989 to 1991, could overcome the legacy of the authoritarian bunker state of the past. Algeria’s bunker state still monopolizes oil rents, but has revised the implied social contract that offers welfare and security to the population in exchange for allegiance. If invested wisely through the government’s economic recovery program, some of the surplus from the oil rents could help, rather than hinder, the democracy in Algeria\textsuperscript{51}.

\subsection*{3.4.2 Distribution of Rents and NOCs}

As mentioned earlier, rentier states operate with great independence from their citizens because they are in no need to collect taxes and consequently invoke a sort of social contract with its population. Because of this social contract, the public has been “bought off” and consequently the rentier state has little need to develop mechanisms of fiscal accountability\textsuperscript{52}.

On the basis of this, the rentier state’s main economic function is to distribute the rents, thus naming the national oil companies (NOCs) extremely important for the state, as they are the ones supplying the regime with the funds to distribute these oil rents. Furthermore, it is important to recognize that privately owned international oil companies (IOCs) and NOCs have distinctively different objectives and thus serve different functions. The latter often operates as flagship enterprises for rentier states and accordingly being providers of public

\textsuperscript{50} Sandbakken, 2006
\textsuperscript{51} Henry, 2004
\textsuperscript{52} Losman, 2010
services, such as education, social welfare and transportation. Consequently, their business objectives are more reflecting of government goals than of profit-maximizing behaviour. Compared with the IOCs, the NOCs operational characteristics and degrees of efficiency bear far different performance indicators and different resource allocations. The IOCs, while wanting to maximize their profits over the long run, has in the recent decades been highly influenced by the financial markets and increased the relative importance of short-run results. On the other hand, the NOCs are in theory free from these short-term financial pressures and their greatest asset is their unique long-term perspective. However, this theoretical advantage fades away when facing the political and bureaucratic realities. Firstly, it’s predisposed to be nullified by the pervasive risk-aversion of most NOC officials. Their biases often lead to investments directed at more easily calculable, and thus more justifiable, short-run projects. Secondly, while stock prices play an important role for the IOCs, the bureaucratic and political pressures in rentier states operates as the most coercive force for the NOCs.

As a result of the political process within rentier states, the NOCs become repeatedly constrained by the government and their incoherent goals. Accordingly, incoherent goals impede the NOCs operations and increase its costs. Not surprisingly, NOCs tend to be larger and the processes more bureaucratic than in the IOCs. The NOCs’ managers usually consist of governmental employees or appointees and available positions are often handed to regime friends, rather that to people with managerial or technical expertise. Engrossing somewhat large numbers of inexperienced personnel almost always lowers efficiency for a prolonged period of time. This may well result in slow decision-making, with poor decisions to show for. The organizational structures in NOCs are often developed to facilitate the retention of capital and not as a mean for minimizing costs. Rentier states are also often predisposed to a high degree of corruption.

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53 Losman, 2010
54 Losman, 2010
When it comes to capital expenditures, the NOCs frequently show a bias against investments. This leads their profits to be far lower than for IOCs and accordingly reducing funds available for investment\textsuperscript{55}. The table above shows upstream capital expenditures, such as exploration, development, and production, by the top ten companies. Private oil companies, eight of which account for 75 percent of the money invested upstream, dominate the listing. These investment findings prove the NOCs’ bias toward the short-term, as well as having significantly less profit to “play with”. The latter plays an important role in this negative circle. NOCs could easily borrow from the international market to found additional investments, but because of their inefficiency in turning oil into revenues, they are very likely to receive unfavourable terms from the international capital market\textsuperscript{56}.

\begin{table}[h]
\centering
\begin{tabular}{|l|l|l|}
\hline
\textbf{Rank} & \textbf{Company} & \textbf{Capital Expenditures} \\
\hline
1 & Exxon Mobil & 14,470 \\
\hline
2 & Shell & 12,046 \\
\hline
3 & BP & 10,237 \\
\hline
4 & PetroChina & 10,160 \\
\hline
5 & Total SA & 10,040 \\
\hline
6 & Conoco Phillips & 8,844 \\
\hline
7 & Chevron & 8,389 \\
\hline
8 & Petrobras (Brazil, 68% privately-owned) & 7,194 \\
\hline
9 & EnCana (Canada/US, privately owned) & 6,650 \\
\hline
10 & Statoil (Norway, 70.9% state-owned) & 6,423 \\
\hline
\end{tabular}
\caption{Top companies for upstream capital expenditures (billion of dollars), 2006}
\label{tab:capital_expenditures}
\end{table}

\textit{Source: Sandbakken, 2006}

\textsuperscript{55} Losman, 2010

\textsuperscript{56} Losman, 2010
3.5 Resource Based View

A company’s resources consist of all assets that enable the company to implement strategies that improve efficiency (Porter, 1981). According to the resource-based theory, a company’s competitive advantage stems from the possession of tangible and intangible resources, which also are costly or difficult for other competitors to get a hold of57. There are three types of company resources: physical capital resources, human capital resources and organizational capital resources. Barney (1991) claims that it is the company specific differences that drive strategy and performance58. As mentioned in the last chapter will we only be looking at the shareholder resource and its impact on the company.

3.5.1 Shareholders

As mentioned, a company’s competitive advantage stems from the ownership of touchable and untouchable resources. Shareholders are one of these resources. For emerging economy companies, the differences within shareholders arise from them being either domestic or foreign and strategically or financial. The shareholders impact on the company’s performance is expected to differ as a consequence of this heterogeneity in resources and organizational capabilities. Normally there are four categories of various shareholders; financial-foreign, financial-domestic, strategic-foreign and strategic-domestic. The first two categories of shareholders often have a negative impact on the company. While financial-foreign shareholders often hold good monitoring skills, they are often unwilling to commit to a long-term relationship with the company and cherish exit strategies. Financial-domestic shareholders possess characteristics that represent the worst of both worlds. Their focus on financial profit tends to lead to short-term behaviour and their domestic affiliation often leads to a complex maze of business relationships59.

However, there are also some positive shareholder effects. The strategic-foreign shareholders use their ownership to foster their strategic interests. This includes securing access to new markets, location-specific resources and low-cost production facilities. Strategic-domestic

57 Douma, George & Kabir, 2006
58 Barney, 1991
59 Douma, George & Kabir, 2006
shareholders regulate competition between companies, they underwrite relational contracts and they secure new markets, in order to pursue their own strategic interests\textsuperscript{60}.

3.5.2 Foreign vs. Domestic Ownership

Douma, George and Kabir (2006) state that ownership concentration and identity must to be taken into account for corporate performance, as they are deeply embedded in national institutions. They also pose that foreign corporate ownership positively affects a company’s performance in many ways. Using a resource-based view, one finds that the extent of a foreign company’s control over a domestic company is positively associated with the degree of resource commitment to technology transfer. Though, the sustainability of such advantages is often linked to an institutional context. When experiencing imperfections in capital, labour and technological markets, foreign shareholders are in a much better position to use their relative advantages to achieve a positive performance, compared to domestic shareholders. Accordingly, countries are in a position to attract higher level of foreign capital if they have a strong judicial system, obtain strong shareholder rights and pursue economic development. Domestic governments can also attract foreign investments by providing different incentives appealing to such shareholders\textsuperscript{61}.

However, the study also shows that domestic corporate ownership can positively affect a company’s performance. Domestic corporations are likely to have both the incentives and the skills to act as good monitors. They are likely to have a long investment horizon and abilities to cut monitoring costs. Also, with domestic shareholders, the threshold for acquiring stakes in other companies as a way of strengthening their core competences is significantly low. Albeit, domestic corporate governance must not be confused with domestic financial institutional ownership, as the latter negatively affects the company’s performance. The latter includes banks, insurance companies and mutual funds and the downside is that they often are predominantly government owned. Government ownership is often weighed down with multiple problems, which in turn significantly reduce their monitoring potential. Firstly, the government’s board nominees are often bureaucrats with minimal expertise in corporate matters. Secondly, the board members may not have the best incentives to do a good

\textsuperscript{60} Douma, George & Kabir, 2006
\textsuperscript{61} Douma, George & Kabir, 2006
monitoring job, as their tenure and career prospects rarely affected by the performance of the company they serve as board members for. Thirdly, governments in developing countries may be less profit driven and less vigilant in their monitoring role as they promote significant social welfare objectives. They may be forced to buy stocks from underperforming companies to bail them out of financial crisis\(^{62}\).

While the study shows that domestic corporations positively influence a company’s performance, the influence is not as noteworthy as by foreign corporations.

### 3.6 Agency Theory

One of the most important aspects in corporate governance is the principal-agent theory. This theory defines the owners as the principals and the management as agents. The essence of the agency problem is the separation of management and finances, or in other words, of ownership and control\(^{63}\). Ross (1973) describes agency theory as a relationship between two or more parties where one, designated as the agent, acts for or on behalf of the other, designated the principal, in a particular domain of decision problems. The principle contracts the agent to make decisions on behalf of the principal\(^{64}\).

#### 3.6.1 Agency Problems

Agency theory is concerned with problems that one may encounter when there is a conflict between the wishes of the principal and the agent. It also occurs when it is expensive or difficult for the principal to confirm what the agent really is doing\(^{65}\). According to Thomsen and Conyon (2012) there are three main types of agency problems. The type 1 agency problem arises when the agents are not acting in the interest of the shareholders. This occurs when there is a separation between management and finance. The problem arises when maximizing interests only is achievable by the one party blocking the other party’s interests. The principal’s interest is to gain the highest possible return on their investments, versus the agents interest is to get the maximum achievable income with minimum risk and work

\(^{62}\) Douma, George & Kabir, 2006  
\(^{63}\) Shleifer & Vishny, 1996  
\(^{64}\) Ross, 1973  
\(^{65}\) Douma, George & Kabir, 2006
effort. Williamson (1991) argues that enforcement of property rights is key to effective governance. In emerging economies new owners may use relatives or friends as managers to decrease monitoring need and costs, and therefore minimize type 1 agency problems between principal and agent. Albeit, these agents can also further the majority investor’s needs and wishes by neglecting the interests of minority investors.

As mentioned before, contract completeness is very handy in a joint venture. In the case of agency problems, having a detailed contract and control over the agent can minimize many of the problems associated with owner-management agency problem. Conversely, in many situations, managers are often given the most control rights. The problem here is that managerial investment decisions may reflect their personal interests rather that those of the investors. For example, incentive contracts, along the lines of share ownership, stock options and threats of dismissal, may create enormous opportunities for self-dealing for the managers. Also, manager discretion and corruption might become a problem. A well-drafted contract detailing who has the right to make what decisions could solve problems, but is in itself hard to achieve, as it is quite difficult to foresee every problem that might occur. Complete contracts are therefore practically infeasible. Also, if one party is given the complete sovereign rights to make all decisions, it might not have the qualifications and enough information to excel in all cases.

Type 2 agency problems exist between majority and minority investors and occur if there are conflicts of interest between the two groups. The majority investors, who are effectively in charge of decisions, are the agents who act on behalf of the minority investors. These in turn are the principals. The problem often lies in the legal protection of the investors. Receiving control rights is the major reason for why investors provide external financing. However, much of the differences in corporate governance systems around the world stem from differences in how to interpret legal obligations. There are also differences to be found in the courts as to how they interpret and enforce these obligations.

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66 Thomsen & Conyon, 2012  
67 Dharwadkar, George & Brandes, 2000  
68 Shleifer & Vishny, 1996  
69 Shleifer & Vishny, 1996  
70 Thomsen & Conyon, 2012  
71 Shleifer & Vishny, 1996
Type 3 agency problems are between shareholders and stakeholders and occur when shareholders make self-interested decisions that influence the welfare of stakeholders. Shareholders may decide to close down a factory, thus harming the welfare of the employees, suppliers, local government and perhaps customers. Type 3 problems are under the broad category of corporate social responsibility (CSR) and we will not be elaborating further on this subject.  

### 3.6.2 Information Asymmetry

There are two important types of information asymmetry, adverse selection and moral hazard. Adverse selection tends to occur before the principal makes a decision, and moral hazard usually happens after the decision is made. Adverse selection, or hidden knowledge, is when there is some important information known to the agent but not the principal. By withholding such information, the agent can persuade the board to act in a way they may not have done if they knew all information. Moral hazard is the hidden action where the principal cannot observe the activity of the agent and the shareholders have limited knowledge of what the agent is doing.

To counter these information problems there exists a trade-off between risk and incentives. If you insure people against risk they also lose the incentive to do anything about it. The goal of the principal is to align the goals and reduce the conflict of interest between their own goal and the goal of the agents. To do so they have to provide incentives so that the agent will work towards the same goals. With type 1 problems between shareholders and managers, managers can be given incentives like bonuses or stock options if specific goals are reached. Then the agent will share some of the risk and have the incentive to act in the shareholders interest. Monitoring is also a strategy. Having annual company and management performance reports will spot non-performance in the company and give the agents incentives to perform well.
3.6.3 Weak Governance

Agency problems can be resolved through optimizing risk-bearing properties of principals and agents, increasing incentive alignment between the principal and the agent or by effective monitoring. These agency solutions rely on an efficient governance context that already exists in most developed economies. The traditional solutions that work in strong governance context of developed economies are not necessarily effective in weaker governance contexts of emerging economies. Scholars have identified two categories of control mechanisms concerning effective governance systems, namely the internal and external control mechanisms. Internal control mechanisms are organization-based and include monitoring done by the board of directors (BODs) and by mutual monitoring done by the management. External control mechanisms are market-based and include hostile takeovers, buyouts, proxy contests and legal protection of minority shareholders.

Dharwadkar, George and Brandes (2000) make a case of companies in emerging economies being particularly exposed to a unique agency problem. Instead of the problems arising from just the traditional principal-agent goal incongruence, this special problem stems from principal-principal goal incongruence. This occurs when weak governance systems allow large or majority owners to assume control of the company and deny minority owners the right to appropriate returns of investment. In countries with weaker legal systems, shareholder voting-rights are violated more frequently. For example, managers might threaten employee-shareholders with layoffs unless they vote with the management, try to prevent hostile takeovers or fail to notify shareholders about annual meetings. The figure below gives an illustration of how weak internal and external governance gives favourable conditions to traditional and unique agency problems.

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75 Walsh & Seward, 1990
Needless to say, agency problems may be especially hard in such legal conditions. A possible solution to such problems may be to invest in bulks. If legal protection does not give enough control rights to small investors, they can get more effective control rights by being large. Large shareholders play an active role in corporate governance and so a concentration of ownership leverages up legal protection. However, the effectiveness of large shareholders is strongly tied to their ability to defend their rights and they must be acquainted with the most effective tools to fight off bad management and whatever dirty tricks they have up their sleeves. In these cases, domestic investors often have more mechanisms of their own to protect their power. This also includes better access to other shareholders, to courts and in some cases to physical force.  

Thus, the weakened governance context of emerging economies creates another agency type 2 problem between large and minority shareholders. This agency problem occurs when majority owners assume control of the company and deprive the minority owners the right to

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76 Shleifer & Vishny, 1996
appropriate return on their investments. The traditional principal-agent alignment problems in developed economies are replaced by principal-principal alignment problems in weaker governance context economies\textsuperscript{77}.

### 3.6.4 State ownership

Shleifer and Vishny (1996) situate that to achieve a good corporate governance system, both legal protection of investors and some type of concentrated ownership are essential, thus referring to the institutional context in which the company is embedded. A good legal system is essential if large investors are to compel managers to distribute profits equally. The investors do this by exercising their power over the management with tools such as voting rights and the supremacy to withdraw security. Accordingly, if a good legal system is in place, it also protects smaller investors that are otherwise unable or unwilling to join forces in order to concentrate ownership. In an effective corporate governance system large investors and legal protection are complementary to each other\textsuperscript{78}.

When it comes to the notion of concentrated ownership there has been many previous arguments among scholars that state-owned companies are a better fix to the agency problem than private companies. Privatizing, both in developed and emerging economies, results in an increase of agency problems of managerial perquisite consumption and entrenchment when transferring ownership from the state to new owners. Perquisite consumption is the short run cost activities managers use to increase non-salary income. Entrenchment is the management actions that reduce the effectiveness of control mechanisms that are in place to regulate managerial behaviour\textsuperscript{79}. Because their single-minded focus on profit, private companies might underprovide quality or otherwise give the company less than what is expected or deserved. Private profit-maximizing companies may also fail to address concerns such as monopoly power, externalities or distribution issues. On the other hand, a politician motivated by the public’s welfare can control the decision of given companies and thus improve efficiency. The traditional case for state ownership is fetched from such welfare arguments. In addition to

\textsuperscript{77} Dharwadkar, George & Brandes, 2000  
\textsuperscript{78} Shleifer & Vishny, 1996  
\textsuperscript{79} Dharwadkar, George & Brandes, 2000
prisons, schools, healthcare, railroads and electricity, versions of these arguments are used to justify state-owned industrial companies as well⁸⁰.

However, Shleifer and Vishny (1996) argue that the reality of state ownership is largely inconsistent with this efficiency argument, albeit with a few exceptions such as police and prisons. Firstly, the state does not seem to serve the public interests better than private companies. For example, pollution problems are far more severe in former communist countries that were dominated by state companies. Secondly, state companies are characteristically inefficient and often relies on their country’s treasuries to bail them out. The behaviour of state owned companies could be explained by the fact that the real control rights belong to bureaucrats and not to qualified leaders. They almost have complete power to direct the companies in the political way they so desire. These bureaucrats often have very different goals than the goals of the social welfare. Because company profits enter the government budget, it gives the bureaucrats controlling the company few incentives concerning profit. This again gives them objectives far from the social interest⁸¹.

⁸⁰ Shleifer & Vishny, 1996
⁸¹ Shleifer & Vishny, 1996
4.0 Company Profiles: History and Governance

In this section we will give a detailed background of the three different companies in order to gain a complete overview of the case. We will also give a description of the political and industrial environment in Algeria, in addition to the two gas and oil fields in question.

4.1 British Petroleum

British Petroleum plc is a British multinational oil and gas company with its headquarters in London, the United Kingdom. The British company has around 85,700 employees and operates in over 80 countries. Forbes Magazine (2013) ranks BP by revenue as the 18th biggest public company in the world and the 6th biggest in the oil and gas sector, amongst both public and private companies.

The origins of BP date back the founding of Anglo-Persian Oil Company in 1909. The company was established as a subsidiary of Burmah Oil Company in order to explore the oilfields of Persia, now Iran. As follows, in 1935 they became the Anglo-Iranian Oil Company and finally in 1954 they became the British Petroleum Company, or more commonly known, BP. In the years to come they found oil in Alaska and found the Forties field in the North Sea, which could produce 400,000 barrels of crude oil a day. In 1978 they also acquired majority control of Standard Oil of Ohio.

Under the reign of Margaret Thatcher the British government started to privatize the state-owned companies during the 1980s. Thatcher sold off the commanding heights of the British economy, with BP as one example. The sale dramatically reduced the government's ownership of the company and by the time they entered the 1990s, the British government sold off all their remaining shares, making BP fully privatized. In 1998, after strong

83 http://www.forbes.com/pictures/mef45gkei/6-bp-4-1-million-barrels-per-day-2/
88 http://www.econlib.org/library/Enc/Privatization.html
competition in the energy industry, BP merged with Amoco and acquired ARCO and Burma Castrol in 2000. Later, Castrol’s motor oils and Aral’s distinctive European operation would also join the group\textsuperscript{89}.

As of 2012, 38 percent of BP shares were held by American investors and 35 percent by British investors, the remaining shares were held by investors from other countries. As of February 2013 the major institutional shareholders include BlackRock Investment Management Ltd with 5.39 percent, Legal & General Investment Management Ltd. with 3.82 percent and Capital Research & Management Co. with 2.33 percent\textsuperscript{80}. Bob Dudley is BP’s group chief executive. He was appointed as executive director on 6 April 2009\textsuperscript{91}.

4.2 Statoil ASA

Statoil is a Norwegian multinational oil and gas company with its headquarters in Stavanger, Norway. However, the company’s office in Bærum has corporate functions and leads all the international operations. The company has about 23,028 employees. The Norwegian company operates in 34 countries and Forbes Magazine (2013) ranks Statoil by revenue as the 38\textsuperscript{th} biggest public company in the world\textsuperscript{92} and the 20\textsuperscript{th} biggest oil company in world amongst both public and private corporations\textsuperscript{93}. The oil and gas company is publically listed on the stock exchange in Oslo and New York.

Statoil was originally formed in order to ensure the Norwegian governments business interest in the oil and gas sector. The company started its production in 1979 in the Statfjord area. In 1985 a new system was introduced with direct government ownership in the oil and gas fields, but this did not hinder the operating conditions. The difference was now that Statoil’s ownership interest in most of the productions licenses on the Norwegian continental Shelf was divided into one economic share for Statoil and one economic share to the government\textsuperscript{94}.

\textsuperscript{90} http://markets.ft.com/research/Markets/Tearsheets/Business-profile?s=BP.:LSE
\textsuperscript{93} http://www.forbes.com/pictures/meff45gkei/20-statoil-2-1-million-barrels-per-day-2/
\textsuperscript{94} http://snl.no/SDOE
In 2007 Statoil merged with the oil and gas company Norsk Hydro. This had been recommended by both boards and the government in order to get the size and strength to master the comprehensive international effort. Statoil’s shareholders got two thirds and Hydro’s shareholders got one third of the shares in the new company, which as of October 2007 was named StatoilHydro. However, the 1st of November 2009, the name was changed back to Statoil and the company introduced a brand new logo95.

The Norwegian state is the biggest shareholder of Statoil. When it became a public limited company in 2001, Statoil was partially privatized and listed on the stock exchange. After the initial offering, the government retained 81,7 percent of the Statoil shares. Pursuant to the agreed exchange ratio, as part of the merger with Hydro’s oil and gas activities, the State’s ownership interest in Statoil was 62,5 percent as of October 2007. In accordance with the government’s decision concerning a minimum state shareholding of two-thirds in Statoil, the government intended, over time, to increase its shares in the company to 67 percent. This was reached March 2009. The ownership interest is managed by the Ministry of Petroleum and Energy96. Helge Lund is the CEO of Statoil and has been since 2004.

![Diagram: Governing Bodies of Statoil](http://www.statoil.com/en/about/corporategovernance/governingbodies/Pages/GoverningBodies.aspx)

**Source:** [www.statoil.com](http://www.statoil.com)

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95 http://snl.no/Statoil_ASA
97 http://www.statoil.com/en/about/corporategovernance/governingbodies/Pages/GoverningBodies.aspx
4.3 Sonatrach

Sonatrach is an Algerian oil and gas company formed as the “National Company for the Transportation and Marketing of Hydrocarbons”. Sonatrach is currently the largest oil and gas company in Africa. The company operates in exploration, pipeline transportation, production and marketing of hydrocarbons and by-products. In 2010 they almost reached a $56,1 billion turnover\textsuperscript{98}. The company operates several places outside of Algeria: Africa (Mali, Niger, Libya, Egypt), Europe (Spain, Italy, Portugal, United Kingdom), Latin America (Peru) and USA\textsuperscript{99}. Forbes currently rank Sonatrach to be the 12\textsuperscript{th} biggest oil company in the world, estimating a production of 2,7 million barrels per day\textsuperscript{100}.

The company was founded in December 1963, after Algeria gained its independence from France the 5\textsuperscript{th} of July 1962. After becoming an independent nation its economy was devastated. Only one sector showed growth potential; hydrocarbons. The new national leadership envisioned exploiting this sector in order to overcome the current backward position the country was left in by the colonial powers. Hence, already from the start its oil and gas production was central to the Algerian efforts to socialize the economy and expand the infrastructure\textsuperscript{101}. In 1967, Sonatrach became the leading company in the distribution of petroleum products on the domestic market; they acquired a majority stake in the Algerian hydrocarbons pipeline transportation and obtained monopoly in the domestic gas market\textsuperscript{102}. The first three decades of its existence can be divided into three stages of development. The first stage was the foundation of the company in 1963, followed by the nationalizing of foreign interests and acquiring necessary infrastructures. The 1970s was a period of consolidation for Sonatrach as they began several joint ventures with foreign partners. In the 1980s the company became one of the worlds main suppliers of liquefied natural gas\textsuperscript{103}.

With the ambition of becoming one of the major oil and gas producers in the world, Sonatrach implemented an aggressive growth plan in the 1990s. The goal of the government was to reach 1,5 million crude oil barrels per day by 2001. One of the methods to reach this goal was

\textsuperscript{98} http://www.sonatrach.com/en/sonatrach-en-bref.html \\
\textsuperscript{99} http://www.eia.gov/countries/analysisbriefs/Algeria/algeria.pdf \\
\textsuperscript{100} http://www.forbes.com/pictures/mef45lhj/12-sonatrach-2-7-million-barrels-per-day-17/ \\
\textsuperscript{101} Entelis, 1999 \\
\textsuperscript{102} http://www.sonatrach.com/en/elements-histoire.html \\
\textsuperscript{103} http://www.fundinguniverse.com/company-histories/sonatrach-history/
for Sonatrach to start several joint ventures to develop numerous new oil and gas fields in Algeria. In the 2000s, Sonatrach continued their growth and new joint ventures secured further funds in developing new oil field and raising the daily output of crude oil and gas104.

Today Sonatrach dominates the country’s hydrocarbon sector, owning 80 percent of all hydrocarbon production. By Algerian law Sonatrach are given majority ownership of all oil and gas projects in Algeria and Sonatrach are now not only the largest oil and gas company in Algeria, but also the largest in Africa.

Sonatrach is fully owned by the Algerian government.

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104 http://www.fundinguniverse.com/company-histories/sonatrach-history/
4.4 Algeria

The People’s Democratic Republic of Algeria is a North African country bordering the Mediterranean Sea, in between Morocco and Tunisia, in what is called the Maghreb region. It is the largest country in Africa and the 10th largest in the world. It is officially an Arabic speaking country, but most people also speak French, where Sunni Muslim is the state religion. The current population is 38 million (July 2013), where 73 percent of the total population live in an urban area. The current unemployment rate is 10 percent, down from staggering 29 percent at the turn of the millennium. Algeria is a presidential republic where the President is the head of state. Algeria’s history is embedded with revolution and regime changes, frequently leaving the political climate in a state of transformation. Power is concentrated to the presidency, with the parliament having little actual power. Instead there is a group of unelected civilian and military deciders, known in Algeria as “the power”, who has much of the control. The Democracy Index 2012 describes Algeria as an authoritarian regime, ranking them at 118th place out of 167 countries.

Algeria gained its independence the 5th of July 1962 after a 7-year long independence war against France. The war left the newly founded country with a severely disrupted society and economy. The country was in physical bad shape as well as lacking skilled workers, as most of them had been French. During the 1960s and 1970s Algeria industrialized its economy while keeping it state-controlled. The economy became highly dependent on oil and gas and suffered greatly when the oil price collapsed in the 1980s. This crisis, along with other factors, founded social unrest culminating in a civil war in 1991 between the government and various Islamic rebel groups. However, an amnesty in 1999 convinced many rebels to lay down their weapons. After years of political unrest and violence, Algeria’s economy has been given a lift by frequent oil and gas finds. Algeria has the world’s 10th largest proven natural gas reserves as well as the 16th biggest proven oil reserves. These oil and gas reserves are located in the Saharan desert and the estimate of 12.2 billion barrels of oil reserves and 4.5

107 http://www.tradingeconomics.com/algeria/unemployment-rate
108 http://www.bbc.co.uk/news/world-africa-14118854
trillion cubic meters of gas reserves attracts strong foreign interest\textsuperscript{111}. This interest, and the governments wish to grow their hydrocarbon industry, has gradually increased the cooperation with foreign companies during the 1990s. By 1999, Algeria had 25 foreign companies doing business in the country\textsuperscript{112}. Today Algeria is the largest natural gas producer and second largest oil producer in Africa. The economy is still heavily dependent on the hydrocarbon sector, which accounts for almost 70 percent of government budget revenue and about 98 percent of export earnings in 2011. In recent years, the crude oil production has stagnated, while natural gas production has gradually declined. This is due to delays in new production and infrastructure projects\textsuperscript{113}. Most of Algeria’s vast ocean areas in the north are expected to have large amounts of oil and gas, but these are yet to be explored. Much of the Algerian Saharan desert is also unexplored and expected to contain big reserves, making Algeria a potential powerhouse of oil and gas production\textsuperscript{114}.

Algeria’s biggest economic strain the last decades has been all the violence in the country. The violence comes in the form of Islamist terrorism, and internal contradictions and social discontent that evolves to violence\textsuperscript{115}. The militant attack on the In Amenas gas facility in February 2013 has raised security concern about operating in Algeria’s remote areas\textsuperscript{116}. The attack in question took the lives of 40 hostages, including 4 BP employees and 5 Statoil employees, and held over 800 people hostage during the 3 days of the attack. The attack led BP and Statoil to withdraw their workers connected to In Amenas in wait of independent security reports and assurances from the government in relations to it happening again\textsuperscript{117}.

Algeria is, according to IMF, a developing country that is neither part of the least developed countries nor of the newly industrialized countries. It has experienced many of the emerging country symptoms in its history, like rapid growth and industrialization, but has lacked the stability to be considered a truly emerging market. It is currently one of many countries that go under the loose description of a developing emerging economy\textsuperscript{118}.

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\textsuperscript{111} http://www.opec.org/opec_web/en/about_us/146.htm
\textsuperscript{112} http://www.fundinguniverse.com/company-histories/sonatrach-history/
\textsuperscript{113} http://www.eia.gov/countries/analysisbriefs/Algeria/algeria.pdf
\textsuperscript{114} http://www.energytribune.com/79550/algeria-the-arab-worlds-often-forgotten-massive-oil-giant#sthash.iUSWSsW3.dpbs
\textsuperscript{115} Ivan, 2003
\textsuperscript{116} http://www.eia.gov/countries/analysisbriefs/Algeria/algeria.pdf
\textsuperscript{117} http://www.hydrocarbons-technology.com/projects/in-amenas-gas-project-algeria
\textsuperscript{118} http://www.imf.org/external/pubs/ft/weo/2008/01/weodata/groups.htm#oem
\end{flushleft}
4.5 In Amenas Gas Project

The In Amenas Gas Project, located near the Libyan border in the Saharan desert, is the largest wet gas development project in Algeria. It commenced production in 2006 and the project includes the development of four primary gas fields, namely Tiguentourine, Hassi Farida, Hassi Ouan Taredert and Hassi Ouan Abecheu in the Illizi Basin of the In Amenas region. The In Amenas fields cover an area of more than 2,750 km²¹¹⁹.

The gas project is a joint venture between BP, Statoil and Sonatrach. In 1998, Sonatrach signed a contract with Amoco Corporation to jointly develop the four In Amenas gas fields. However, BP took over Amoco Corporations that same year. The merger documents, dated back to 11.12.1998, fail to mention Amoco’s original ownership shares in the joint venture, but it is unlikely to be more than 49 percent¹²⁰. In June 2003, BP entered a farm-out agreement with Statoil, who bought 50 percent of BP’s interest in the In Amenas fields. BP and Statoil’s working interests in the project are respectively 46 and 45.9 percent. In Amenas produces 9 billion cubic metres of natural gas and 50,000 barrels of condensate per year and accounts for one tenth of the Algerian gas output. However, the terrorist attack on the facility in 2013 significantly brought down the In Amenas production and the production is not expected to rise again until later in 2014 after new strict security measures are in place¹²¹.

4.6 In Salah Gas Project

The In Salah Gas Project began in November 2001 and is a joint venture between BP, Statoil and Sonatrach. It is the third largest gas development in Algeria and is located in the remote Saharan desert. Three gas fields, namely Krechba, Teg and Reg, were developed during the first phase of the project and they realized first production in July 2004. The second phase of the In Salah Gas Project is to develop the remaining four gas fields: Garet el Befinat, Hassi Moumene, In Salah and Gour Mohmoud. The project will help maintain production at plateau levels when production from the three existing fields declines. The In Salah fields cover an area of more than 2,000 km² and account for about 12 percent of Algeria’s total gas output¹²².

¹²⁰ http://ec.europa.eu/competition/mergers/cases/decisions/m1293_en.pdf
BP and Statoil’s working interests in the project are respectively 33,15 and 31,85 percent. In the merger procedure, dated 19.12.2003, the transaction consists of the sale of a half of BP’s 49 percent ownership shares in the In Salah joint venture. BP and Statoil, on the one side, will acquire joint control of the joint venture, together with Sonatrach on the other side, leaving BP and Statoil with a 24,5 percent stake each.\(^{123}\)

Initially, BP and Sonatrach invested 100 million dollars in the project. This in order to compress, dehydrate, transport and inject that CO2 into a deep saline formation down-dip of the producing gas horizon at the Krechba field. The third partner, Statoil, joined the joint venture at production start-up in August 2004\(^{124}\). Because of this large investment at In Amenas and In Salah, BP and Statoil have become Algeria’s largest foreign investors\(^{125}\). A map of both oil and gas field, as well as the hydrocarbon infrastructure of Algeria is located below.

![Image of the Algerian hydrocarbon infrastructure\(^{126}\)](http://www.zeroco2.no/projects/in-salah)

\(^{123}\) [http://ec.europa.eu/competition/mergers/cases/decisions/m3230_en.pdf](http://ec.europa.eu/competition/mergers/cases/decisions/m3230_en.pdf)
\(^{124}\) [http://www.bp.com/sectiongenericarticle.do?categoryId=9033334&contentId=7061356](http://www.bp.com/sectiongenericarticle.do?categoryId=9033334&contentId=7061356)
5.0 Analysis – Part One: Who is Doing What?

In this chapter we will take a look at each company and how they conduct their corporate governance. To help us, we have used the King Report on Corporate Governance for South Africa. In accordance with this report, we have named several key points in which we find essential to good corporate governance. From first to last it’s responsibility, risk-awareness, transparency, independence and fairness. While we also find other factors, like CSR, to be important aspects of good corporate governance, we will not be giving them further attention in this study. Using these key points, we will be able to analyse how each company conducts themselves both internally and externally. We will also be able to find out how the different companies stress the different issues and what actions they have put in place relating to them.

5.1 Good Corporate Governance

Responsibility pertains to behaviour that approves corrective action and punishes poor management. The BOD is responsible for keeping the company on the right track and also act responsibly to all of its stakeholders. With risk-awareness we find that it is essential for the management to identify and evaluate actual and potential areas of risk as they pertain to a company. Risk assessment should address the company’s exposure to the following: physical and operational risks; human resource risks; technical risks; business continuity and disaster recovery; credit and market risks, reputation risks and compliance risks. Transparency is the degree of how much company information is kept available to the public, including the economic fundamentals and the non-financial aspects relevant to that company. This information should also be given in an accurate and timely manner and will help the investors acquire a precise image of what the company is up to. With independence we mean the extent to which mechanisms have been established to minimize, or avoid all together, potential conflicts of interest that may exist. These mechanisms range from the external parties such as auditors to the composition of the board and their appointment to committees. With fairness we imply that all the systems within the company must be balanced in such a way that they
take into account all those that have an interest in the company and its future. All groups should be recognized and heard, such as all minority shareowners\(^ {127}\).

### 5.2 British Petroleum – Corporate Governance

BP’s objectives are to create value across the entire hydrocarbon value chain. They start with the exploration of oil and gas, then move on to develop and extract it, transport and trade it and lastly manufacture and market the fuels and products. It all ends with providing a product that is fundamental to everyday life. BP identifies opportunities to create value in each stage of the hydrocarbon value chain and aims to utilize them fully\(^ {128}\).

As mentioned earlier, BP was fully privatized and thus do not have one great majority shareholder, as both Statoil and Sonatrach have, namely the Norwegian and Algerian government. They accordingly state that they make up their own code of conduct, in which they routinely update when needed. Their code of conduct is based on their values and thus clarifies the ethics and compliance expectations for everyone who works at BP. Where and when the rules are not stated explicitly, their everyday business decisions are guided by their strong values. The code includes sections on operating safely, responsibly and reliably and financial integrity. The code also takes into account key points from BP’s internal standards related to anti-bribery and corruption, anti-money laundering, competition and anti-trust law and trade sanctions\(^ {129}\).

In joint ventures and entities over which BP does not have overall control, the code outlines their expectations to influence the partners to follow similar principles. BP also highlights that they seek to work with contractors who operate under principles that are similar to their own code. They state that they seek a contractual commitment from such contractors to comply and work in line with their code of conduct when it is possible and when they have the right to do so. BP will consider terminating contracts when a contractor has not complied with their obligations, or not renewing contracts when a contractor has acted in a manner that is not


consistent with BP values or codes. According to their website, in 2012, they terminated or refused to renew six supplier contracts. In 2011 the number was even higher, with 14 supplier contracts not being able to meet BP’s requirements\(^{130}\).

### 5.2.1 Responsibility

As mentioned earlier, BP states that all contractors have to sign a contract stating their commitment to follow BP’s code of conduct. If the contractors in any way breach this pledge, BP clearly express that they are in their full rights to terminate the contract. Behaviour that pertains to responsibility is clearly shown when BP, over the period of two years, terminated or refused to renew 20 supplier contracts\(^{131}\).

The requirements for responsibility applies to all employees, supported by various group requirements covering issues such as anti-money laundering, anti-bribery and corruption, competition/anti-trust law compliance and trade sanctions. BP also seeks to monitor new regulations and legislation and plan their response to them. They operate a range of compliance training and monitoring programs for their employees, including OpenTalk, their confidential helpline for employees\(^{132}\).

### 5.2.2 Risk-awareness

BP’s risk management system is designed to help ensure that risks are identified, understood and managed so that they can deliver safe and strong operations. BP’s risk management system focuses on three levels of activity. The group’s operations level, the business and functional level and the board level. At the first level the day-to-day risk identification and management occurs, with the approach varying according to the types of risks faced. At the second level, the business and functional level, periodic review of risks and risk management plans happen. Risk management activities are assessed and any further improvements are planned. Lastly, at board, executive and function levels, oversight and governance occurs to help foster an effective group-wide oversight, business planning and resource allocation, intervention and knowledge sharing. Also, in 2012, they formed a new risk team to hold a


view of the group’s risks, coordinate reporting activities of these risks, and maintain BP’s overarching risk management system\textsuperscript{133}.

BP aims to manage risks associated with the general macroeconomic outlook, and changes in prices and markets, by responding to early warnings from their economics and treasury teams and customer-facing businesses. In order to manage their liquidity, financial capacity and financial exposure risks, they apply financial frameworks and conduct liquidity stress testing and interventions based on scenario planning\textsuperscript{134}.

With diverse locations all around the world, BP is exposed to a wide range of political developments and changes to the economic and operating environment. BP seeks to manage these risks actively and this includes monitoring compliance with applicable standards. In 2011, BP set out a 10-point plan to address near-term strategic priorities. Among other things, the plan aims to target investment and disposal efficiency, renew and reposition their portfolio and deliver their major projects to plan. As part of managing the 10-point plan, BP regularly conducts planning and performance-monitoring activities\textsuperscript{135}.

Crisis and continuity management plans, including oil spill preparedness and response, have been developed to help BP to respond effectively to emergencies to minimize impact and to avoid potentially severe disruptions in their businesses and operations. Security threats require continuous monitoring and control as hostile actions against staff, facilities (as in the In Amenas joint venture in Algeria) and digital infrastructure (cyber security) could cause harm to people and could disrupt BP’s operations. They thus have procedures that are intended to monitor for threats and vulnerabilities and policies to manage physical and digital security\textsuperscript{136}.

5.2.3 Transparency
In addition to being a board member, British Petroleum is a founding member of Extractive Industries Transparency Initiative. EITI’s main focus is to work with governments, non-
governmental organizations and international agencies in order to increase transparency of revenue flows. The EITI is a coalition of governments, companies, civil society groups, investors and international organizations working together to promote globally developed standards for revenue transparency at the local level. Also, the Securities and Exchange Commission adopted the final rules in respect of the Dodd-Frank legislation regarding resource payment disclosure in August 2012. BP is preparing to comply with these disclosure requirements, with the first disclosures being due in May 2014. BP has also been essential in the founding of the Oxford Centre for the Analysis of Resource Rich Economies. The centre carries out research into the impact of natural resources development on the economies and societies of countries. With time, they aim to disseminate global best practice in revenue management. BP also has a concurrence with Transparency International and Great Britain is currently ranked as the 21st most transparent country in the world, measured in a financial secrecy index, out of 82 countries (2013). They are number 17 on the Corruption Perceptions Index (2012), they have a 90 percentile rank when it comes to Control of Corruption (2010) and has a score of 88/100 on the Open Budget Index (2012).

5.2.3.1 Bribery and corruption
BP’s code of conduct clearly states that they will not engage in bribery or corruption in any form. This applies for every BP employee and contractor. Potential risk associated with third parties is undertaken with high due diligence. Also, if they are suspicious of any activities that might be at high risk of corruption, audits are conducted in respect of some suppliers. BP’s contracts situate the due diligence requirements for sub-contractors and contractors who may hire services on BP’s behalf and may be terminated if found not compatible. BP also supports the UN Global Compact and the Business Principles for Countering Bribery.

5.2.4 Independence
BP ascertains that all processes, decisions and mechanisms used to do the former will be established so as to minimize or avoid potential conflicts of interest. Thus, the composition of

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139 http://www.transparency.org/country#GBR_DataResearch
the BOD will be of such that all matters will be treated with equal importance and with minimal conflicts of interest. Also, in many of the countries BP operates in, the company has set up several independent panels, who’s main task is to provide assurance and feedback on their activities and develop recommendations on how to navigate the issues. The panels report their findings publicly, and accordingly, BP publishes its responses to their reports. An example of such a panel is the Tangguh independent advisory panel. It has been monitoring progress at the Tangguh liquefied natural gas facility in Indonesia since 2002. The panel publishes an annual report, which BP includes, along with their response, on their Indonesia website. The Azerbaijan social review commission is another example of independent panels. It was set up in 2007 to help BP recognize and address challenges and long-term social performance activities that BP undertakes on behalf of its joint venture partners\(^{141}\).

\subsection{5.2.5 Fairness}

BP has designed board governance principles in order to operate within a clear framework. This means that the BODs relationships with shareholders and executive management are clearly stated within a consensual framework. This framework also includes the conduct of board affairs and the different requirements for board committees. In accordance with the notion of fairness, the principles outline the boards focus when it comes to the activities that enables the BOD to promote shareholder interests, including the active consideration of strategy, the monitoring of executive action and on-going board and executive management succession. The board has developed these principles to help it fulfil its responsibilities and regularly keeps its work and performance under review. They also revisit the board governance principles annually\(^ {142}\). The board governance principles allocate the tasks of monitoring executive actions and assessing performance to certain board committees. There are committees for everything, such as audits, remuneration, safety, ethics and environment assurance and nomination and chairman committees. This so that everything is conducted in a fair and impartial manner\(^ {143}\). Also, if shareholders, no matter how small, want to speak up, BP has a range of interactive tools and online account management, helping to provide in-depth information for them.

\begin{footnotes}
\footnoteref{http://www.bp.com/en/global/corporate/investors/governance.html}
\end{footnotes}
5.3 Statoil ASA – Corporate Governance

Statoil’s objectives are to secure long-term value creation for its shareholders. They aim to do this through exploring, producing, transporting, processing and marketing petroleum and petroleum-derived products. In order to maintain the highest degree of success they have strict ethical requirements and a code of conduct that promotes their own integrity and respect for the environment. Statoil’s corporate governance is thus a result of vigorous ethical guidelines and sturdy corporate values. In addition, the work of the BODs is based on the existence of clearly defined divisions of roles and responsibilities between the shareholders, the board of directors and the management in Statoil.

As mentioned earlier, Statoil was partially privatised with listings on the Oslo and New York stock exchanges on 18th of June 2001. However, the Norwegian government, with its 67 percent, is still Statoil’s main shareholder and its owner interests are managed by the Ministry of Petroleum and Energy. The Norwegian state is eager to communicate its expectations to its companies and to the society on how the state is to act as owner. The Norwegian state also accentuates that state-owned companies must comply with principles for good corporate governance and the Ministry of Trade and Industry’s Ownership Department has cooperated with key players to develop “The Norwegian Code of Practice for Corporate Governance”. Thus, in addition to abiding by the Oslo stock exchange listing rules and the New York stock exchange listing rules, Statoil’s BODs also endorses the “Norwegian Code of Practice for Corporate Governance” as of the 7th of December 2004 (last updated in October 2012).

5.3.1 Responsibility

Like BP, Statoil also has stringent requirements for doing business with others. They state that a business relationship with a potential counterpart shall only be established if the resulting relationship satisfies Statoil’s requirements for integrity due diligence. However, if the employees come across cases of ethical doubts or breaches of Statoil’s ethical requirements, these concerns must be reported immediately. Individuals can report their

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concerns through the regular channels; to their superior, or to their superior’s superior, or to the internal entity whose duty it is to follow up such matters. Managers who receive such an enquiry must consult their own superior in cases of doubt. Thus, regulations are clearly in place to secure Statoil’s responsible manners. If the individual is uncomfortable with using regular channels, their concern can be reported to Statoil’s ethics helpline, which ensures the individuals anonymity. Breaches of the group’s ethical requirements may result in disciplinary action, or dismissal with or without notice, and may be reported to the relevant authorities. The BOD’s responsibility to keep the company on the right track and act responsibly to all of its stakeholders has resulted in several ethics committees. These committees have been established in the individual business areas, comprising the respective management teams. The committees will ensure strong focus on, common understanding of and compliance with Statoil’s ethical requirements147.

5.3.2 Risk-awareness

Statoil defines risk as a deviation from a specified reference value and the uncertainty associated with it. A positive deviation is defined as an upside risk, while a negative deviation is a downside risk. The reference value is expectation, most likely a forecast, percentile or target. Statoil’s overall risk management approach includes identifying, evaluating and managing risk in all of their activities. In order to achieve optimal corporate solutions, they base the risk management on an enterprise-wide risk management approach148.

Statoil takes a holistic and multi-disciplinary approach to risk management, which means that they have a risk and reward focus at all levels of the organization, they evaluate significant risk exposure relating to major commitments, and manage and coordinate risk at the corporate level. All risks are related to Statoil’s value chain149.

In addition to the economic impact these risks could have on Statoil’s cash flows, they also try to avoid health, safety and environment (HSE) and integrity-related incidents (such as accidents, fraud and corruption). Their policies and guidelines require them to identify and

document HSE risks for all activities, to establish and document risk tolerance criteria at the relevant level of activity and to assess the identified HSE risk factors against the established tolerance criteria. Necessary risk-reducing measures must be implemented in order to meet the established criteria and further to reduce the risk of harm so that it is as low as reasonably feasible. They use quantitative and qualitative risk analyses actively to obtain a balanced picture of probability and consequences of incidents, to identify and assess critical HSE functions and defects and as a basis for design and improvements. Also, projects in medium-to-high-risk countries are assessed for country risk effects on their net present value. Endeavours are thus made to estimate which risks have the potentially largest effect on the cash flow of a project and thereby to enable management of these risks\textsuperscript{150}.

Their chief financial officer heads their corporate risk committee and its members include representatives of principal business areas. This is an enterprise risk management advisory body that primarily advises the chief financial officer, but also the business areas’ management on specific issues and meets up at least six times a year to decide current risk and management strategies. Statoil has also implemented a web-based early-phase risk assessment tool for evaluating new business opportunities, to ensure that HSE, social, human rights and integrity risks are considered at an early stage. The early-phase risk assessment tool (EPRA) is used to support risk assessment workshops in which representatives of HSE, CSR and ethics and anti-corruption disciplines\textsuperscript{151}.

5.3.3 Transparency

Statoil argues that how they deliver is as important as what they deliver. Their commitment to ethics and transparency is ensured, like BP, through their code of conduct and value statement: “open” is one of Statoil’s four company values.

Statoil were one of the first major oil and gas companies to start disclosing all revenues and payments in the countries in which they operate. While BP is one of the founding members of EITI, Norway became EITI-compliant in 2008. Thus, Statoil is participating in this


transparency process, making their data available by the means of reporting to government bodies. In 2009, Statoil became a board member in EITI, representing the national oil company constituency together with Pemex of Mexico. The EITI standard implies that Statoil reports what they pay to governments and governments disclose receipts of payments. Tax, royalty payments and other relevant payments are reconciled in an EITI country report by an independent third party. Statoil also has an agreement with Transparency International Norway\textsuperscript{152}. Norway is currently ranked as the 50\textsuperscript{th} most transparent country in the world, out of a total of 82 countries, measured in a financial secrecy index (2013)\textsuperscript{153}. They are number 7 on the Corruption Perceptions Index (2012), they have a 97 percentile rank when it comes to Control of Corruption (2010) and has a score of 83/100 on the Open Budget Index (2012)\textsuperscript{154}.

\subsection*{5.3.3.1 Bribery and corruption}

Like BP, Statoil also is against all forms of corruption, including facilitation payments. There is an anti-corruption program in place in order to fight this and an important part of this program is the compliance network consisting of dedicated compliance officers in the business and staff units. Same as BP, Statoil also practice strict requirements for integrity due diligence and accordingly screen new investments, partners, suppliers and contractors for risks associated with integrity- and human rights violation.

Statoil is actively engaged in anti-corruption and transparency issues on a local and global basis by membership and participation in various business networks and non-governmental organizations. They support the World Economic Forum’s Partnering Against Corruption Initiative, the UN Global Compact, the Business Principles for Countering Bribery and the OECD Guidelines for Multinational Enterprises\textsuperscript{155}.

\subsection*{5.3.4 Independence}

Statoil quite firmly states that they will have a BOD that is independent of the group’s management. Thus, the board focuses on there not being any conflicts of interest amongst the owners, the BOD and the company’s management. The BOD will additionally base its

\textsuperscript{152} http://www.statoil.com/en/EnvironmentSociety/SustainabilityMain/EthicsAndTransparency/Pages/default.aspx
\textsuperscript{153} http://www.financialsecrecyindex.com/introduction/fsi-2013-results
\textsuperscript{154} http://www.transparency.org/country#NOR
\textsuperscript{155} http://www.statoil.com/en/EnvironmentSociety/SustainabilityMain/EthicsAndTransparency/Pages/default.aspx
practical work on the principle of good corporate governance applicable at all times. Statoil states that the BOD, including the chair and the deputy chair, shall be elected by the corporate assembly. The board of directors may be elected for up to two years, securing that the BOD is fully independent of its peers. The corporate assembly shall hold at least 2 meetings annually and the board shall appoint the company’s chief executive officer and stipulate his/her salary\textsuperscript{156}. There are clear codes of conduct when facing a situation with a potential conflict of interest. Statoil, like BP, also has many independent panels and committees ensuring the minimization of potential conflicts of interest that may exist. For example, the board’s audit committee is responsible for ensuring that the group is subject to an independent and effective audit. Every year, the independent auditor presents a plan for the audit committee for the execution of the independent auditor’s work. The independent auditor is present at the board meeting that deals with the preparation of the annual accounts and participates in meetings of the audit committee. When evaluating the independent auditor, emphasis is placed on the company’s competence, capacity, local and international availability and the size of its fee. The audit committee considers all reports from the independent auditor before the board of directors considers them. The audit committee holds regular meetings with the independent auditor without the company’s management being present\textsuperscript{157}.

Also, the BOD has delegated authority to the audit committee to pre-approve assignments to be performed by the independent auditor. The audit committee has issued guidelines for pre-approval by the management of assignments to be performed by the independent auditor.

5.3.5 Fairness

As with BP, Statoil has developed principles stating what the BOD should or should not do in given situations. Among other things, their governance principles clearly state that all shareholders will be treated equally and that Statoil will ensure that all shareholders have access to up-to-date, reliable and relevant information about the company’s activities. The board must approve any agreement between the company and a member of the BOD or the CEO. The board must also approve any agreement between the company and a third party, as a member of the board or the CEO may have a special interest in the matter. Also, like BP,

\textsuperscript{156} http://www.statoil.com/en/about/corporategovernance/articlesofassociation/pages/default.aspx

\textsuperscript{157} http://www.statoil.com/en/about/corporategovernance/articlesofassociation/pages/default.aspx
Statoil has sub-committees for most operations and an example of such committee work would be the remuneration of the board and its sub-committees, which are decided by the corporate assembly, based on a recommendation from the nomination committee. Equal treatment of all shareholders is a core governance principle in Statoil and each share confers one vote at the general meeting. The articles of association contain no restrictions on voting rights and all shares have equal rights.\(^{158}\)

### 5.4 Sonatrach and Algeria – Corporate Governance

As a company completely under Algerian government ownership and control it is natural to believe that Sonatrach is very influenced by the national level of corporate. In this analysis we will take a closer look on the corporate governance in Sonatrach and Algeria and how closely linked they are.

#### 5.4.1 Responsibility

Sonatrach is abiding by the laws and regulations of Algeria, as well as the local law in countries they operate in. In addition to this they have a code of conduct that is binding for all of their employees. Algeria also has a national Algerian corporate governance code, but its adoption is made voluntarily. There is a lack of an institution that coordinates corporate governance policies within the government and all corporate governance initiatives are done individually, mainly due to international pressure. Hawkama El Djazair is the Algerian Institute for Enterprise Governance, and is the only authority in Algeria that makes policies, as well as regulates, supervises and promotes better corporate governance practices.\(^{159}\)

Algeria is not an OECD member state, meaning that Sonatrach are not required to follow the OECD Guidelines for Multinational Enterprises. Algeria is one of the 12 member states of the oil cartel OPEC, having a say in how to secure a steady income for its member state and secure a supply of oil to the consumers.

5.4.2 Risk-awareness

Algeria avoided the Arab Spring that sent a wave of rebellion through the region in 2011. Instead, the ruling elite has consolidated its hold on power while conceding minimally in terms of meaningful political reform. In contrast to other countries in the region, the support for Islamist parties in Algeria has decreased the last years and they suffered a net loss of seats at the parliamentary election in May 2012. There is, however, a presence of Islamist militants in northern Mali, which shares a 1.376 km long border with Algeria\textsuperscript{160}. This has resulted in an increased army present along the border as the fear of violence spillover across the border is increasing. There have been several clashes along the border with rebels and the Islamist terrorist attack on In Amenas on the 19\textsuperscript{th} of January 2013 is said to be retaliation for French intervention in the Mali conflict. To this day the conflict in Northern Mali is still ongoing. To protect foreign installations from attacks by Islamic militants there is a strong army presence as well as arrangements made with private security companies\textsuperscript{161}.

Despite a weak global economy, an unstable regional environment and a lack of significant structural reforms, the economy in Algeria has had a decent growth averaging 2.7 percent in 2011-2012. However, because the country has seen a rapid decline in hydrocarbon output and exports, it is putting a lot of strain on the government budget, thus creating some uncertainty surrounding the future\textsuperscript{162}.

When it comes to FDI, in 2012, the current Net Foreign Investments was 0.8 percent of GDP, the lowest since year 2000 and significantly down from the top year in 2009 (2.2 percent)\textsuperscript{163}. This is due to unclear policies and doubt surrounding the risks of investments, giving concerns about the Algerian government not being so committed to privatization and reforms. Algeria’s history of nationalizing all foreign businesses and capital in the 1960s is also slightly impacting the wish to invest for foreign investors\textsuperscript{164}. There is a lot of restrictions for investments in the Algerian market, although there is much less restrictions in the energy sector, indicating a lack of local skills and technology. This makes foreign investment essential to developing the oil and gas resources. The day Sonatrach and Algerian workers

\textsuperscript{160} Algeria Country Report 2012, The PRS Group, Inc.
\textsuperscript{161} Victor, Hults & Thurber, 2011
\textsuperscript{162} http://www.worldbank.org/en/country/algeria/overview
\textsuperscript{163} http://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS
\textsuperscript{164} http://www.aig.com/country-risk-report-algeria_2590_376764.html
acquire the needed skills and technology there will be an increased chance of a policy change, removing the benefits or excluding the foreign investors from the hydrocarbon sector\textsuperscript{165}.

Probably the biggest uncertainty and risk in Algeria is tied to the 2014 presidential election. With the current president Bouteflika being 76 years old and with his health being a source of speculation, there is a major ambiguity tied around the election. Many of the ingredients that proved to be a recipe for rebellion in Egypt and Tunisia, like high unemployment, large wealth gap, huge corruption and limited opportunities for the large and growing youth population, are present in today’s Algeria. If the government fails to deliver their promises of addressing the problems of the population, there is a risk of widespread discontent that can refuel the religious extremist and revive armed Islamic groups, which have been more or less neutralized since the end of the civil war in the 90s\textsuperscript{166}.

\textbf{5.4.3 Transparency}

One of the focus points of Sonatrach’s code of conduct is that they strive towards full transparency in the company, complying with national laws in the countries of operation. However in Open Budget Index Score, Algeria scores a very weak 13 out of 100, ranking them in the worst category of Scant or No Budget Information. Nevertheless, it is an increase from their last scoring of 1 (2010). Algeria only scored 52,59 on the Doing Business 2014 report, ranking them 153\textsuperscript{rd} of 189 countries\textsuperscript{167}. This is down 2 places from the 2013 report and this puts them in the least favourable category worldwide. The Doing Business report is a good indicator on how transparent a country is as it highlights all the areas surrounding the ease of doing business. The low scores here indicate an extensive bureaucracy system, where there are great difficulties in opening and running businesses.

The Algerian government claims their regulatory system is transparent, but the authority of the decision-making remains with the people on top of each organization. The access to these decision makers is often limited and combined with a slow and protocol oriented bureaucracy,
even small paperwork errors can lead to significant delays\textsuperscript{168}. Sonatrach has been expanding into new geographical areas the last decade to obtain access to new markets, but their main sphere of operations will continue to remain in Algeria where the company enjoys preferential treatment from the government and is not required to be transparent in its operations\textsuperscript{169}.

\subsection*{5.4.3.1 Bribery and corruption}

On the one hand, corruption in Algeria may not be as prominent as in many other developing countries. On the other hand, there have been several arrests in 2009 and 2010 of high-ranking Algerian government officials on charges of corruption. Sonatrach got involved in a big corruption scandal when the Algerian press in January 2010 revealed that Sonatrach’s president and CEO, Mohamed Meziane, along with the vice president and four other senior employees, had been suspended. Meziane got sentenced to two years in jail in May 2011, as well as ordered to pay a fine of around US $7,000. He and the other employees were convicted of corruption of public funds through awarding contracts directly rather than through bidding process\textsuperscript{170}. They took advantage of their powerful position to secure Sonatrach contracts with foreign companies to which they had personal links and to acquire property and benefits both in Algeria and abroad. The scandal topped itself with Energy Minister Chakib Khelil losing his job in May 2010\textsuperscript{171}. In the aftermath of this scandal, former Sonatrach vice president Hocine Malti stated that the corruption at the company goes far deeper. He appealed to the public to go after the oil sales, which would reveal that Sonatrach completed few spot sales and most of its exports went out to just four or five customers\textsuperscript{172}.

On the Corruption Perception Index (2012) Algeria scores a low 34/100 points, putting them in rank 106 out of 176 nations\textsuperscript{173}. By having a score lower than 50/100 indicates that the country has serious corruption problems. The Worldwide Governance indicators also gives them a low score, ranking them at the 36 percent rank where 1 percent is the worst and 100

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{168} http://www.state.gov/e/eb/rls/othr/ics/2013/204588.htm
\item \textsuperscript{169} Victor, Hults & Thurber, 2011
\item \textsuperscript{170} http://www.meed.com/sectors/oil-and-gas/oil-upstream/analysis-the-sonatrach-corruption-scandal/3079263.article
\item \textsuperscript{171} http://magharebia.com/en_GB/articles/awi/features/2013/02/27/feature-03
\item \textsuperscript{172} http://magharebia.com/en_GB/articles/awi/features/2010/02/10/feature-01
\item \textsuperscript{173} http://www.transparency.org/cpi2012/results
\end{itemize}
\end{footnotesize}
percent is the best. Both of these indexes ranks Algeria quite low, indicating that the country is suffering from severe corruption.

Many Algerians believe that corruption is common among the upper reaches of the government. There has been evidence to suggest that bribes are usually paid to bypass bureaucracy and to avoid interference by the Algerian government. The government of Algeria adopted an anti-corruption bill in 2006, in which brought Algeria into compliance with the UN Convention against Corruption. The law was designed to promote transparency in government. In August 2010 they created the National Commission for the Prevention and Fight Against Corruption, as specified by the 2006 anti-corruption law. Still, it is estimated that around 50 percent of the Algerian economic transactions are done within the informal sector, thus avoiding the state auditors.

Sonatrach’s most current code of conduct strictly prohibits its employees from receiving or using bribery as a method to obtain a material benefit. The rules of the company allow Sonatrach to dismiss any employees involved in proven cases of bribery. They have an ethics committee in place to handle all issues regarding ethics and breach of ethics.

5.4.4 Independence

Sonatrach’s board of directors has since its establishment in 1962 had really close ties with the Algerian government. The management in Sonatrach and government officials have historically switched positions over the years, increasing the already tight relationship. Several CEOs have held related ministry posts at the government at the same time as being Sonatrach’s CEO. For example, Mohamed Meziane was the chairman and CEO of Sonatrach from 2003 until 2010, joining Sonatrach from his position as director general of hydrocarbons for Algeria’s Ministry of Energy and Mines. Before this again, he was a part of Sonatrach’s management team. He and four vice presidents got removed in 2010 after the corruption scandal at Sonatrach, as mentioned in the above section on corruption. This is just

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177 http://www.fundinguniverse.com/company-histories/sonatrach-history/
an example of the fuzzy line between Sonatrach and the government when it comes to moving personnel in-between state and company.

Sonatrach had a restructuring in 1998 and today’s structure is essentially the same, as shown above in figure 8. In the new organizational structure, the National Energy Council (NEC) receives reports from Sonatrach’s General Assembly. The ministry of Energy and Mines chairs the General Assembly and nominates the CEO and chairman of Sonatrach, as well as approving the Executive Committee. The Board of Directors is populated with individuals from different ministries of the state, in addition to the CEO and four senior managers. The Executive Committee consists of twelve senior managers from Sonatrach. Above this structure resides the Algerian president, whom has the final say on personnel and on appointments of managers and vice presidents. The operational and legal control of Sonatrach is embedded within the NEC, where the leader is the president of Algeria. However, since
1998, the NEC has not been a formal institution, effectively making the president a one-man decision making organ\textsuperscript{178}.

The biggest reform was a bill passed in 2005, restructuring the hydrocarbon sector and opening it up for more foreign investment. The new law was put in motion to eliminate the conflict of interest pertaining to Sonatrach having both a regulatory function, as well as commercial function. The new law allowed Sonatrach to function purely as a commercial entity and improving the operating environment for foreign oil companies looking to invest in Algeria. The law also limited Sonatrach’s stake in new ventures to 20-30 percent at tops. Under a year later an adjustment was made to the law that limited its effect, for instance by removing the maximum stake of the 2005 law and reinstating Sonatrach’s 51 percent stake. This revision aligned itself with Algeria’s long-term strategic objective to control and exploit the country’s main source of revenue, in which empowers the government\textsuperscript{179}.

As we can see from figure 9, the bill passed in 2005 did little to threaten the Algerian government’s stakes in the oil and gas industry. As the government revised the law in 2006, Sonatrach is still, by far, the biggest party in the industry, with foreign companies having only minor percentages.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{pie_chart}
\caption{Company Ownership of Oil & Gas Producing Assets in Algeria, 2012}
\label{fig:company_ownership}
\end{figure}

\textit{Source: www.eia.gov}\textsuperscript{180}

\begin{flushright}
\textsuperscript{178} Victor, Hults & Thurber, 2011
\textsuperscript{179} Victor, Hults & Thurber, 2011
\textsuperscript{180} http://www.eia.gov/countries/cab.cfm?fips=ag
\end{flushright}
In order to remain in power, the Algerian government is heavily dependent on the revenue from the hydrocarbon industry. In other words, the Algerian government is heavily dependant on Sonatrach. Sonatrach has been the locomotive and the instrument for state development of the Algerian state since its independence. There are no indications, now or in the close future, that Algeria will transform away from being a hydrocarbon-dependent state controlled economy into a more diversified and private sector led economy.

5.4.5 Fairness

The Algerian government is the sole shareholder of Sonatrach and the regulator for the hydrocarbon sector, as well as having a broader function of allocating the benefits to social functions. This triple and conflicting role creates favouritism towards Sonatrach in any matters regarding the hydrocarbon industry.

Sonatrach has promised, as a citizen company, to respect its employees, acknowledge them, preserve their health, ensure their safety and ensuring safe facilities. They have a monitoring board in place to create equal chances for equal competences, thus promoting recruitment, access to training and higher positions for women. The percentage of full time female employees has increased from 11,2 percent in 2003 to 14,6 percent in 2010, giving a 78,6 percent increase in female full-time employees in that time period181.

The human resource department at Sonatrach has a key position in the company’s strategy. Sonatrach wishes that their employees work and evolve inside the company, wanting to give everyone a chance to get involved in bigger and more diverse projects. They have created the Company Improvement Centre and the Algerian Petroleum Institute Corporate University as they wish to prioritize the workers development, training and qualifications. According to Sonatrach, around 55 percent of their full time staff was involved in one of their training programmes during 2009. The budget for training was around 10 million dollars in 2009, having increased over 20 percent compared to the previous year182.

6.0 Analysis – Part two: Adding Theory

In this part of our analysis we will focus on the working relationship between British Petroleum, Statoil and Sonatrach. By using our theoretical framework and country and company analysis from the previous chapters, we will be able to examine the corporate governance in the joint ventures In Amenas and In Salah in Algeria.

We will conduct this second part of the analysis by using the same structure as our theory chapter. We will analyse one theory at a time, while adding facts and information about Algeria and the three companies as we go along. We will begin with joint venture theory, move on to institutional theory and so forth. By using this approach throughout the following chapter we feel confident about our ability to answer our research question.

6.1 A Joint Venture in Algeria

As stated previously, these joint ventures consist of three legally distinct organizations, thus making these joint ventures differ from popular assumptions. With three parents also come greater resources, albeit more potential costs. First we will take a look at the different resources the different companies bring to the mix. BP and Statoil both bring a lot of the same resources to the ventures. They both have rich expertise and experience in world markets and they can both supply capital. While BP has a special ability to use its economy of scale, Statoil is one of the more technologically gifted oil companies in the world.\textsuperscript{183} Sonatrach on the other hand, supplies the joint ventures with Algeria’s natural resources in terms of the actual oil and gas and full rights to everything concerning it. They also have a major national network, which is quite beneficial for the joint ventures. For example, their superior networks with the state regulators and business community leads them to obtain needed information more effortlessly. Lastly, they also supply most of the working staff and their managers. For a comparison, Statoil only has 27 employees divided over the two oil and gas fields\textsuperscript{184}. All these resources, put together, make a good match on paper. What Sonatrach seems to lack in resources is covered by BP and Statoil and vice versa. Also, both BP and Statoil contribute

\textsuperscript{183} http://www.statoil.com/no/technologyinnovation/researchinstatoil/Pages/default.aspx
greatly with CSR to the areas around the oil and gas fields, giving Sonatrach and Algeria a bigger incentive to work with them. However, while the “task-related” partner criteria must be important to both BP and Statoil, Algeria has an exceptional poor rule of law, scoring only 25 percent on the World Bank governance index and their control of corruption being only 36 percent, giving great importance to the “partner-related” criteria concerning Sonatrach. These “partner-related” criteria’s will be covered when we analyse the cultural drivers from the different countries further down in this section.

6.1.1 Contract Completeness

When dealing with three individual and highly competitive companies it is safe to assume that they will have a more or less complete contract. This especially because both BP and Statoil come from cultures where the norm is to put everything in writing. However, while a common pitfall is that great diversity can make you overlook certain contingencies during contract negotiations, this does not seem to be the case here. Both BP and Statoil are used to international business partners and they will be especially aware of certain unconventional aspects of doing business, like bribery and inside favouritism. They will thus put a wide-ranging contract in motion in order to play by certain rules, or get the opportunity to terminate the arrangement if the terms are broken. Also, with both money and technology being provided by BP and Statoil, they will be especially motivated to secure their resources from an abrupt work termination from Sonatrach. However, there is still a considerable risk connected with the contract completeness. With changes in the rule of governance in Algeria, there will be no real body of authority to make sure the terms of the contract are being upheld, if something were to happen.

One reason for creating a joint venture is to reduce transaction costs and country volatility. Algeria is a country with rich oil and gas reserves and runs it monopolistically. BP and Statoil had no other opportunity than to collaborate with government-owned Sonatrach if they wanted to enter Algeria. However, the upside here is that both western companies knows that the government will be working for profit, not against it. To be in cahoots with the people making the rules and regulations seems to be a safe way to secure your market position. Also,
the benefit of being two western companies joined with one African company gives BP and Statoil the opportunity to use each other as intermediaries to bridge the cultural distances. Being two, they can lean on each other and have confidence in their own standings with Sonatrach. While one should always try to keep the number of parents in a joint venture to a minimum, it does not seem to be an advantage in this case as both BP and Statoil benefit from having each other while pooling resources with Sonatrach.

6.1.2 Deep Drivers of Norwegian and English Culture

However, one question still remains. Are the benefits enough to outweigh the fundamental differences between the companies? The linkage between structure and performance varies by the nationalities of partners and the need for a systematic assessment of salient characteristics of potential international partners emerges. While BP and Statoil both originate from Europe, they come from two completely different countries. Thus, shoving them under the “western rug” may not be an accurate fit.

![Cultural comparison between Norway and the United Kingdom](http://geert-hofstede.com/norway.html)

*Fig. 10: Cultural comparison between Norway and the United Kingdom*

*Source: geert-hofstede.com*[^186]

[^186]: http://geert-hofstede.com/norway.html
The figure shows 6 deep drivers of both the Norwegian and British culture. The first driver is power distance, which means whether or not all individuals in the society are equal. With both countries scoring low it means that both countries sees its individuals as being independent and having equal rights. Hierarchy is for convenience only and power is decentralized with managers counting on the experience of their team members. Individualism has to do with whether people’s self-image is defined in terms of “I” or “We”. Norway with a score of 74 is considered an individualistic society. This means that the “Self” is important and there are clear lines between work and private life. The employer-employee relationship is based on a contract and leaders focus on management of individuals. However, with a score of 98, Britain ranks amongst the highest of the individualistic scores, only beaten by countries like Australia and the USA. The British are highly individualistic and private. Children are taught from an early age to think for themselves and how they uniquely can contribute to society.

The dimension “Uncertainty Avoidance” has to do with the way that a society deals with the fact that the future can never be known. Here Norway scores 40 and do not get very anxious when faced with ambiguity and do not go out of their way to avoid uncertainty. However, there is a small focus on planning and emotions are not shown much in Norway. At 26 the UK has a low score on uncertainty avoidance, which means that as a nation they are happy to wake up not knowing what the day brings and they are happy to “make it up as they go along”. The British is thus very comfortable in ambiguous situations. When it comes to being pragmatic and whether or not all things around you can be explained, Britain scores an intermediate score of 52 and a dominant preference in British culture can thus not be determined. However, with a relatively low score of 34, Norwegian culture is more normative than pragmatic. People in such societies have a strong concern with establishing the absolute truth and they exhibit great respect for traditions. When it comes to indulgence and the extent to which people try to control their desires and impulses, Britain differs somewhat from Norway in the sense that they, to a greater extent than Norway, possess a positive attitude and have a tendency towards optimism. With a high score of 69, it indicates that the British generally exhibits a willingness to realize their impulses and desires with regards to enjoying
life and having fun. Norway has an intermediate score of 55 and therefore a dominant preference cannot be determined\textsuperscript{187}.

While both Norway and the UK come out reasonably similar in the five first cultural drivers, the final driver puts them miles away apart. While the five aforementioned drivers may indicate that BP and Statoil makes a good joint venture match, the masculinity dimension can make it harder to collaborate. A high score on this dimension indicates that the society will be driven by competition, achievement and success, with success being defined by the winner. A low score on the dimension means that the dominant values in society are caring for others and quality of life. Such a society is described as feminine whereas quality of life is the sign of success and standing out from the crowd is not admirable. Norway scores 3 and is accordingly the second most feminine society in the world, only beaten by Sweden. Trying to be better than others is neither socially nor materially rewarded. Incentives such as free time and flexibility are favoured. An effective manager is a supportive one and decision-making is achieved through involvement. However, Britain scores a 68, thus highly success oriented and driven. In comparison to feminine cultures such as the Norwegian one, people in the UK live in order to work and have a clear performance ambition.

This gives a mismatch in both goal setting and the methods used to get there. Nevertheless, in this case we are not talking about the generalized populations of each country. BP and Statoil are two international oil and gas companies that both strive for success. Statoil is working hard to remain the best in its field and the Norwegian way of thinking about standing out in a crowd does not seem to be top of mind. Statoil wants to move forward and their business strategy should thus not differ greatly from BP’s. Thus, the differences between the two companies may thus not be large enough to constitute issues in problem solving, goal setting and other crucial areas of joint ventures.

\subsection*{6.1.3 Conflicting Cultural Drivers in Algeria}

Nevertheless, while BP and Statoil seem to make up a good team, what happens when Sonatrach is tossed into the mix? While Algeria is not explicitly listed in Hofstede’s country

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{187} http://geert-hofstede.com/united-kingdom.html
\item http://geert-hofstede.com/norway.html
\end{itemize}
\end{footnotesize}
comparisons, we can use a regional comparison with the two aforementioned countries. The Maghreb region has hierarchical societies and stands out in contrast to the UK and Norway. In the Maghreb region people accept a hierarchical order in which everybody has a place and which needs no further justification. Consequently, their score on individualism is low. With a score of 22 the society fosters strong relationships where everyone takes responsibility for fellow members of their group. Offence leads to shame and loss of face and the employer/employee relationship is perceived in moral terms, like a family member. This is also quite different from the UK and Norway, as both score reasonably high on this dimension. The Maghreb region scores 58 on uncertainty avoidance and thus has a very high preference for avoiding uncertainty, relating them to Norway. When it comes to pragmatism, the Maghreb region has a very low score of 11, making them way more normative than both the UK and Norway. However, as Norway also is a normative country and the UK’s preference not being able to be determined, this should presumably not be a problem. When it comes to indulgence, the low score of 25 indicates a culture of restraint. Societies with a low score in this dimension have a tendency to cynicism and pessimism, strongly contradicting the British society188.

Lastly, where Britain and Norway greatly differ, the Maghreb region seems to follow a British way of thinking. While somewhat indicating that the society will be driven by competition, the score of 53 is not enough to give a conclusive preference. So, in spite of these obvious differences, can these three companies form a viable joint venture? We need to look at other aspects of the working relationship in order to fully answer that. As stated earlier, Luo (2007) argues that the positive correlation between opportunism and information unverifiability will be even stronger when a joint venture depends more on the environment in the host country. This is without a doubt true in our case, as the joint ventures are solely dependent on Algeria’s oil and gas reserves. Because of this, both BP and Statoil are likely to perceive the environmental volatility in Algeria differently than they would if penetration of the local Algerian market was their main focus. Because BP and Statoil consider the host country as merely a production platform for exports, their reliance on the local environment also makes the exit costs and sunk costs considerably higher than with other joint ventures. Hence, costs concerning opportunism will not be welcomed. However, as Luo (2007) states,

188 http://geert-hofstede.com/countries.html
when operating in an international joint venture, the domestic partners seem to be less sensitive to perceived information unverifiability. This may, in this case, be because Sonatrach are better equipped to deal with information unverifiability given their home-grown experience and greater tolerance when facing governmental non-transparency. As a result, opportunism stemming from information unverifiability should not be a worry for BP and Statoil.

6.1.4 Sonatrach’s Connections with the Government
As mentioned before, the weaker the local partners’ connections with the local judiciary and governmental authorities, the higher the law unenforceability is perceived to be. Nevertheless, while the Algerian rule of law is quite low, Sonatrach still has strong ties with the governmental authorities. Thus, while the legislative institutions might not be up to scratch, it does not necessarily mean that the law unenforceability is high. As mentioned previously, in developing countries, “people”, rather than the law itself, take a considerable part in determining commercial activities. Therefore, as Sonatrach has strong ties with the government politicians and is owned by the Algerian state, the commercial activities determined by the “people” will at least be of some benefit for Sonatrach, leaving their law unenforceability slightly lower than with other Algerian companies.

However, a common fear is not only that the domestic country acts opportunistically, but that the international partner or partners also do. Luo (2002) tells us that this will be especially prominent if they choose a state-owned company as a local partner. Especially in emerging markets, international joint ventures are created in order to share risk and costs. As a result, if law unenforceability hinders BP and Statoil from witnessing this prospect of reduced risk, the two companies are more likely to behave opportunistically. Albeit, considering Sonatrach and their ties to the government and their seemingly lower law unenforceability, it leads us to believe that the legal environment in which BP, Statoil and Sonatrach conducts business in is to some extent perceived safe by the two foreign companies and consequently opportunism from their part should be at a minimum. The possible high return from their investments and the possibility to be included in future projects participates in creating this sense of safety for BP and Statoil. If not perceived as safe, they are at least comfortable with the risks involved in investing in Algeria as they have yet to withdraw after the terrorist attack.
6.1.5 Domestic Opportunistic Behaviour

At this point we have more or less ruled out that BP and Statoil have deep motives for behaving opportunistically and Sonatrach, with its lessened sensitivity to perceived information unverifiability and lower law unenforceability, will also have less drivers for opportunistic behaviour. Nonetheless, if we were to move this analysis to a more individualistic plan, this deduction may not be as applicable. As stated earlier, Chen, Peng and Saparito (2002) find that collectivists have a higher opportunistic propensity in inter-group transactions. In their research phase they found that students from Asia, commonly know as having collective societies, often showed a greater willingness to conceal or misrepresent information in order to help their employing company gain competitive advantages. Moreover, in thrashing out likely sanctions against such devious behaviour, Asian students tended to underestimate the negative consequences to themselves because they expected the company to bail them out, compensate, or even reward their self-sacrificial, even though they were guileful acts. Knowing this and knowing that the Maghreb region treasure their collectivistic culture, it is likely that the employees at Sonatrach will have a much higher propensity to act in an opportunistic way. We already know from earlier that hiring and promotion decisions in Sonatrach take account of the employee’s in-group, making the employees see their in-group as family, or close to. BP and Statoil thus risk that the local employees will help Sonatrach gain competitive advantages, whatever the means. Still, if the local employees see Sonatrach, BP and Statoil as a unified unit, their actions to distort information may not be directed at the two western companies, but to other companies outside this in-group. While BP and Statoil cannot support this kind of behaviour, they will still benefit from this in-group loyalty, especially concerning the protection of own technology and recourses.

6.2 National Institutions

Institutional theory is an important part of our analysis as the social context the theory examines is highly relevant for investing companies and the decisions they need to make. It is natural to assume that the formal rules and informal constraints that take place in Algeria will be reflected through the behaviour of the national companies. The background of the host
country is therefore important for us to understand the situation of the joint ventures of BP, Statoil and Sonatrach.

Ownership concentration is something that needs to be taken into account for corporate performance, as it will be deeply embedded in national institutions. There is a really close linkage between the government officials and Sonatrach executives, where there historically has been a blurry line between the national decision makers and the top management of Sonatrach. As mentioned several times before, many of the political decision makers have been a part of the management of Sonatrach and vice versa. This close tie could be used to exploit foreign shareholders in the sense that hiding information or changing the law to their benefit is a possibility if the Algerian top executives and government decides that is in their best interest. As Sonatrach owns a majority stake in all oil-and gas projects in Algeria, as stated by the hydrocarbon law\textsuperscript{189}, the foreign investors need to achieve thorough joint venture integration in order to attain some power over decisions. If BP and Statoil’s representatives in the In Amenas and In Salah joint ventures are not properly integrated in the joint ventures, it could lead to a misuse of power from Sonatrach. In order to prevent such misuse of power, one needs well-developed formal institutions. For most foreign investors, their strategic choices are heavily influenced by the formal constraints present in the host country.

6.2.1 Formal Institutions in Algeria

The formal institutions are needed to protect the interests of investors and others involved in business transactions. The rule of law is the indicator most suited to reflect on how well the democratic system works in a country. The indicator captures perceptions on the confidence in and abiding of the rules of society, particularly in the areas of contract protection, property rights, justice systems and the likelihood of crime and violence. Algeria scores a 25.6, ranking them in the bottom percentile of the list. Norway and the United Kingdom are in the opposite side of the scale with 100 and 92.9. This low score in Algeria indicates that there is a lack of basic institutional protection when investing in Algeria. This lack of basic institutional protection can be a problem in different ways. Firstly, problems relating to direct crime and violation of laws can transpire, such as the terrorist attack on the In Amenas facility in January 2013. These challenges are being countered with increased security, as well as

\textsuperscript{189} \url{http://www.state.gov/e/eb/rls/othr/ics/2013/204588.htm}
military presence, at facilities and borders. But there is no way for a foreign company to completely secure their personnel and assets from these kinds of attacks. For instance, the security ranking of Fraser Institute Global Petroleum Survey 2013 ranks Algeria at 149th place out of 157 countries, with only Pakistan, Libya, Syria, Iraq, Iran, South Sudan, Somaliland and Mali behind them. This security ranking mirrors the direct physical safety of personnel and assets in a country. This highlights the unstable current situation and shows that the security concern in Algeria is and should be one of the biggest concerns for foreign investors.

After the terrorist attack on In Amenas, BP and Statoil withdrew their people from the local facility. The companies are still waiting for the Algerian government to assure them that proper security precautions has been put into place in order to protect the workers from similar situations in the future. Secondly, problems can occur surrounding the contract and property rights. The lack of protection here is not that noticeable until the problem surfaces and there is a contract or a property dispute with your partner or government. Until now there has been no recorded problems regarding contracts or property for neither BP nor Statoil, but the protection, should something happen, is close to non-existent in Algeria. Having a positive relationship with the host country and company can neutralize these problems, where Algeria and Sonatrach would benefit more from keeping BP and Statoil as partners, than to, in worst case, seize their assets and revenue.

However, the rule of law is not the only indicator when determining whether or not the formal institutions are in place in Algeria. Voice and accountability is another World Bank governance indicator, which scores the free media, the citizens’ ability to participate in selecting their government and freedom of expression. Here, Algeria scores only within the 22,7 percentile rank. This is consistent with reports of journalists being detained by the government for the reason that they where investigating unwanted topics, for instance like conditions in a refugee camp in Western Sahara190. Albeit, Algeria got a new media law in 2012, which according to the government was a major step in advancement of press freedom. Then again, most journalists and civil society activists believe it is still restrictive. According to the Committee to Protect Journalists, of the 133 articles in the law, at least 32 can be used to restrict coverage by stifling free expression. The law uses broad definitions on areas that must be respected like “national identity and cultural values of society” and “economic

interest”. Breaking these definitions can lead to strict punishments of high fines or imprisonment. A total of 60 journalists have been killed in Algeria since 1992. This puts Algeria in 4\textsuperscript{th} place when indicating the world’s most deadliest countries for journalists. Yet, nobody has been killed since 2002\textsuperscript{191}.

According to the additional World Bank governance indicators, Algeria scores really weak in several other categories that describe the quality of the formal institutions. As we see from the table above, the Algerian control of corruption (36,4 percentile), government effectiveness (34 percentile) and regulatory quality (9,1 percentile) all lay in the lower percentiles. These low governance-indicator scores all point towards an institutional void in Algeria that will most likely hinder the protection and create uncertainty for foreign investors. These weak scores shows that BP, Statoil and other foreign investors will have to accept major institutional risks when they choose to invest in Algeria.

Combined with Algeria’s ambition to reduce the country’s reliance on FDI to finance development, consequently avoiding what president Bouteflika called “\textit{an uncontrolled...}

\begin{table}
\centering
\begin{tabular}{lcccc}
\hline
 & Algeria & Norway & United Kingdom \\
\hline
Rule of Law: Percentile rank & 25,6 & 100,0 & 92,9 \\
Control of Corruption: Percentile Rank & 36,4 & 98,6 & 92,3 \\
Government Effectiveness: Percentile Rank & 34,0 & 98,1 & 91,9 \\
Political Stability and Absence of Violence/Terrorism: Percentile Rank & 9,5 & 93,8 & 60,2 \\
Regulatory Quality: Percentile Rank & 9,1 & 91,9 & 94,7 \\
Voice and Accountability: Percentile Rank & 22,7 & 100,0 & 92,4 \\
\hline
\end{tabular}
\caption{Governance Indicators: Algeria, Norway and United Kingdom}
\end{table}

\textit{Source: Worldbank.org}\textsuperscript{192}

\textsuperscript{191} \url{http://cpj.org/killed/mideast/algeria/}
\textsuperscript{192} \url{http://info.worldbank.org/governance/wgi/index.aspx#reports}
liberalism that threatens the interest of the national group”193; the investment climate is somewhat unfriendly. Only in the event of a failure to award a contract to a domestic company will foreign company be allowed to submit bids. On the other hand, the exception to this is the hydrocarbon sector. This reflects the Algerian acknowledgement of their own lack of local skill, technology and experience, making foreign investment essential to the development of oil and gas resources. The 2013 Global Petroleum Survey tells us that Algeria has a great exploration potential but is, however, an over-bureaucratic nation with a non-unified government. When combining this information with corruption and security issues and tough contractual terms, it makes a number of companies pull out of the country194.

This summary, aligned with our country analysis of Algeria, explains one of the factors as to why Algeria scores so weak on the corporate governance indicators. Algeria is only ranked at 126th place of 157 countries in a ranking of investment barriers in petroleum industry. This displays a two-faced stance from the Algerian government. They want foreign investors in the petroleum sector, but are unwilling to reform laws to make investments attractive. The geopolitical risk has also increased in Algeria since 2012, moving them from the fourth quintile scores to the fifth and last quintile score in 2013195. This confirms our earlier belief that the political risk is increasing as Algeria faces an important upcoming election in 2014, combined with continuous troublesome conflicts in their neighbouring countries. Nevertheless, some measures have been taken along the terms of a newly revised hydrocarbon law that got approved by the parliament in 2013. The revised law maintained Sonatrach’s majority stake requirement, but has included some tax benefits and fiscal incentives to exploration companies that make investments slightly more attractive196.

6.2.2 Informal Constraints in Algeria

Peng (2002) names three informal constraints that will provide consistency for organizations when formal institutions fail. One of them concerns itself with bribery and buy-offs, gifts and other corrupt practises being common when working with bureaucracies, especially in

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196 http://www.eia.gov/countries/cab.cfm?fips=ag
Algeria. However, while this type of constraint may reduce uncertainty and provide consistency for the domestic company, this will not be the case with BP and Statoil.

Following this notion, Sonatrach could easily mess up the joint ventures’ performance. One likely scenario could be that Sonatrach and the government again would be involved in a new corruption scandal damaging BP and Statoil’s international reputation. As corruption is present in Algeria, and several Sonatrach ex-executives are in jail for corruption, the chances of this happening is far greater in Algeria than in most other countries of operation for BP and Statoil. In addition to the 2010 “Sonatrach 1” scandal, a new scandal emerged in 2013. Former Algerian Energy Minister Chekib Khelil, whom had to resign after the first scandal, his wife and his two sons were charged in the “Sonatrach 2” corruption case. The charges relate to corruption, money-laundering, irregularities in the award of contracts, abuse of office and the creation of organised criminal gangs. The court brought charges against 20 individuals, one of them being the nephew of former Foreign Minister Mohamed Bedjaoui.

While Sonatrach attends to one off the informal constraints, BP and Statoil are able to attend to the second one. As noted earlier, the weak institutions embedded in Algeria, and especially their rule of law, will force BP and Statoil to increase their transformation costs in order to secure their property rights and unenforceable contracts. BP and Statoil should then be especially well suited to address these institutional voids. For instance, their use of a common brand name with a good reputation sends strong signals as to reduce uncertainty for customers and investors. This leads them to provide the second informal constraint.

Before we move on to the third constraint, which is the makings of interpersonal relations that exist between executives, Douma, George and Kabir (2006) argue that there are other ways for business groups to tackle institutional voids. This is based on the fact that international investors have a superior ability to raise capital and train and rotate management. However, while the two western companies might be well suited for increasing capital, their power to train and rotate employees is debatable. It may not be in their best interest to fully train the Algerian staff in the ways of modern technology. While most parts of the workforce in the joint ventures are Algerians, and the actual profits will be in their working hands, the formal

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197 http://magharebia.com/en_GB/articles/awi/features/2013/08/16/feature-03
institutions limits the trustworthiness of the workforce. As mentioned before, a big long-term risk BP and Statoil is that their shareholder advantage are highly transferable. As securing property rights and enforceable contracts bring high costs with it, BP and Statoil may just want to take a more cautious approach to begin with. Also, as most of the workforce is Algerians, BP and Statoil will have much less power to rotate its employees. As noted, Sonatrach has a history of rotating their management in ways that are not ethically acceptable. This way of reshuffling the management may also lead to troubles when trying to engage the staff in mutually supportive networks, thus limiting the last informal constraint. Because of the reasons given above, it might be difficult to reduce uncertainty in the managers’ decision-making. The western managers may be biased towards the local staff and mutually supportive networking will be hard to achieve.

Thus, the only informal constraint, as listed by Peng (2002), that in this case will realistically reduce uncertainty and provide consistency for BP and Statoil will be the second one. Dealing with informal constraints we also choose to highlight codes of conduct. Both BP and Statoil have very extensive and detailed codes of conduct that comply and even surpass the national and international guidelines. For instance, the Norwegian government has strict laws when it comes to governance rules. Accordingly, for Statoil it is not enough to make up their own code of conduct, they also have to follow the “Norwegian Code of Practice for Corporate Governance”. With the UK being more individualistic than Norway, and the fact that BP is fully privatized, BP does not have to follow any national codes for conduct. Despite this, BP has developed a widespread code of conduct, ranging from anti-trust laws to trade sanctions.

6.2.2.1 Codes of Conduct and the Global Compact

On the other hand, in Algeria, there are no enforced national codes of conduct, only a minor voluntarily one. Sonatrach has chosen to create their own code of conduct and are following the UN Global Compacts ten principles that give guidelines on human rights, labour, environment and anti-corruption. Their code of conduct covers the same areas and all employees are required to follow it. However, the critical voices surrounding the Global Compact state that becoming a member is too easy, and that companies often sign up without any intentions of carrying out the directives. This leads us to believe that even though Sonatrach state that they follow the ten principles, this may well just be for show. Companies
like Sonatrach can do this because the Compact has no binding mechanism to hold the companies responsible. Civil regulations are characterized for being soft laws and while soft laws are said to offer many advantages, they do not give the enforcement that hard laws give. Knudsen (2011) finds that “good governance in the home country appears to ‘spill over’ into compliance with the Compact, whereas poor governance in the home country spills over into de-listings”. Therefore, as Sonatrach belongs to a country with weak domestic governance they are less likely to accomplish the requirements for the Compact.

6.2.3 Weakened Institutions

The concept of deinstitutionalization is also important when speaking of Algeria. The three key sources that weaken institutions and ultimately makes them disappear, are remarkably visible in Algeria. Functional pressures for deinstitutionalization in Algeria may arise from perceived problems in performance levels. The production and export of oil and gas has steadily sunk each year since 2005. This tells us that there definitely will be some unnerving concerns tied to Sonatrach’s performance levels. The share of GDP from the oil-industry did in fact sink with 11,4 percent over the course of five years. Another worrying sign for Algeria’s overall economic performance is the declining current account balance in percent of GDP. The World Bank has forecasted it to hit 0,1 in 2015, down from a mighty 24,7 percent in 2006. This implies that the value of the exported hydrocarbons is soon equal to imported goods. This notion will also lead to some disbeliefs pertaining to the effectiveness associated with Algeria’s institutionalized practices.

Their technology in the hydrocarbon field has been falling behind and this notion has led the Algerian government to rally the aid up externally, through the means of companies like BP and Statoil. These international investors have again put the Algerian government under pressure to, among many things, revise their hydrocarbon law. However, Algeria currently has more pressing political strains burdening them. The powerful current president Bouteflika is rumoured to be retiring due to natural health issues from being 76 years old. Nobody knows how the power situation will change after he is gone. There is the military lurking around the

198 Knudsen, 2011
199 Vogel, 2008
200 Knudsen, 2011; 342
201 http://data.worldbank.org/indicator/EG.EGY.PROD.KT.OE
202 http://data.worldbank.org/country/algeria
political scene again for the first time since the civil war, as well as Islamic fundamentalists that once more has increased their political and terrorist presence in the country. This current political pressure will climax in the 2014 election where the political direction gets decided after 15 years of relative stable government led by current president Bouteflika.

The social pressures associated with differentiation of groups may also influence the weakening of institutions in Algeria. While FDI in most of the Algerian industries are kept to a minimum, the oil sector stands out as the exception. This increased level of FDI in the oil and gas industry will likely bring with it a somewhat diversified workforce, in addition to capital. In this case, both BP and Statoil have brought some of their employees to work in the oil and gas facilities in Algeria. This brings with it increasing workforce diversity and the existence of miscellaneous or conflicting beliefs and practices. On this note, western staff members in Algeria will bring with them different interpretive frameworks and social definitions of behaviour. This, in turn, will act to diminish consensus and unquestioning obedience to taken-for-granted practices. Also, as these foreign investors “frown upon” certain ways of doing business, such as corruption, it will lead to changes in organizational laws or social expectations that again might hinder the continuation of a practice for the local staff.

6.3 Algeria as a Rentier State

Algeria is blessed with great oil reserves that have created substantial revenue since Algeria’s independence in 1962. The 98 percent share of export revenues in Algeria shows just how dependent the country and government is on the oil and gas industry. This blessing has moreover led Algeria to be a prime example of a rentier state, which suffers from an unfortunate political and economic development. Algeria furthermore acts in accordance with all the three most common features that confine the rentier state framework. Firstly, due to their oil revenue, rentier states do not rely on income taxation, thus freeing them from democratic obligations. Algeria has mostly been a rentier state since its independence, having had some democratic transitions, but never seen democracy fully consolidated. The government in Algeria has over the years had some of the same features as socialist states have, with free health care and education, retirement benefits and consumer subsidies. These
benefits have been financed through the revenue of the oil production, underpinning the
definition of a rentier state. Algeria is not a no-tax country, but has an inconsequential low
income tax and a low corporate tax for small business owners. This has given the Algerian
government the possibility to make decisions unaffected by the public. This way of
governing has been a way for the Algerian government to buy off the population with free
services, which in turn has led the population to retain themselves from making political
demands.

Secondly, the oil rents have gone straight to the government leaving the Algerian state in the
position to buy off or repress any political and civil opposition. This has been one of the
reasons to how Algeria evaded the Arab Spring in 2011, which in turn affected most of the
other countries in the region.

When it comes to the unfortunate economic development, the major benefits stemming from
the country’s oil and gas reserves has diminished over the last years. Accordingly, the country
has suffered a decline in their overall hydrocarbon revenues. Algeria has, like most rentier
states, suffered from isolation from social forces due to the fact that tax-collcetng efficiency
just is not that important and big compared to the oil revenues. This has left Algeria with a
weak institutional system that struggle with handling conflict resolutions and legal disputes.
This is in accordance with the third most common feature of rentier states. The oil wealth has
created social structures that are not favourable by democracy. These three features proves
how the government has consolidated its grip on power in Algeria, thus confining them as a
fully functional rentier state.

6.3.1 A North-African Military Outpost

Nevertheless, Algeria is also a bunker state in the sense that it has been a military outpost that
has defended itself from waves of civil unrest through manipulation. The primary concern in
bunker states is political control, and not economic growth. The lack of state autonomy from
social forces results in the state and the government becoming a tool for one side of the social
forces. This connection leads this specific social force to dominate the others and prevents

203 http://www.knowyourcountry.com/algeria3.html
development and growth in the country. Ever since their independence, the Algerian military has had political influence. However, this authority has steadily decreased since the civil war. Algeria is at an important crossroad with the 2014 election, where risk analysis bureaus like the PRS Group only gives the current power holders a 50 percent chance of continuing to be the ruling regime. A military regime is given a 40 percent chance of being the ruling regime when forecasting the next 5 years, with Islamist fundamentalist being given the last 10 percent. For foreign investors it is predicted that the two latter scenarios outside the current regime will impose higher investment and trade restrictions and an increase in domestic turmoil. There are concerns about the military regaining their political influence in national politics when Bouteflika retires. If today’s government, which is more or less free of military influence, shifts into a military influenced government, a fully military government or an Islamist fundamentalist government, it is likely that Algeria’s ruling elite would literally dig themselves further down in the bunker. This will be bad news as the biggest development in Algeria, in terms of moving away from the rentier state, has been the taming of political Islam and removing the military from the political scene. By reverting to a military regime or an Islamic regime will increase the difficulties for foreign oil investors like BP and Statoil and they might consider putting their resources somewhere safer.

6.3.2 The National Flagship and its Declining Revenues
Sonatrach is a textbook example of a NOC that is constrained by the government, thus increasing company cost and lowering efficiency. Sonatrach has been the major locomotive in the Algerian economy ever since the independence in 1962, supplying the government with funds to distribute. Many of the floor managers and the top management of Sonatrach are governmental employees and vacant positions have traditionally been handed to regime friends instead of managerial and technical experts. By being a NOC, Sonatrach has historically been more of a tool to the government than an independent company with profit-maximising behaviour. In theory these NOCs should be free from short-term pressure as they have a unique long-term perspective, compared to IOCs. However, Sonatrach has been constrained by the government and their incoherent and conflicting goals, which in turn has eaten away at this specific advantage. The rentier theory states that NOCs will suffer from lower efficiency and slow decision-making, not to mention being predisposed to corruption.

204 Algeria Country Report 2012, The PRS Group, Inc.
This is consistent with Sonatrach’s and Algeria’s current struggles with declining production and revenues, as well as having a history of company and national corruption. The total production of hydrocarbons has been declining every year since 2005 and was in 2011 at its lowest level since 2002\(^{205}\). The contributions made by hydrocarbons industry towards GDP had dropped from 48.4 percent in 2006 to 37 percent in 2011\(^{206}\). This is in combination with an exponential increase in domestic energy usage, leaving less and less for export. The export ratio versus domestic usage has sunk from 427 percent more export than usage in year 2000 to 248 percent more export then usage in 2011\(^{207}\). This is worrying for the sitting regime in Algeria as Sonatrach is the national flagship that provides funding for public services like education, social welfare and transportation as well as financing government projects that consolidates their power and it seems to be unable to increase production to stabilize the revenues.

### 6.4 BP and Statoil as Important Resources

As we have stated earlier, shareholders take up a huge spot in the resource pool. Albeit, there are great differences between these resources that determines whether or not they are valuable. Resource-based theory states that there are four categories of various shareholders; financial-foreign, financial-domestic, strategic-foreign and strategic-domestic. While the first two categories of shareholders often have a negative impact on the company, the two latter does not. In fact, their impact will be of great value to the company if used correctly. The category of strategic-foreign shareholders fits with both BP and Statoil. While they without a doubt bring foreign finances into the joint ventures, this is not their main concern as shareholders. Their goal is to use their ownership in order to further advance their strategic interests. While holding an ownership stake in these two joint ventures, they are able to access new markets, location-specific resources and low-cost production facilities. Because of this, the downfalls with financial-foreign shareholders will not prevail. As they will receive long-term benefits from these new opportunities they will be keen to commit to an enduring relationship with Sonatrach and they will not be as eager to plot exit strategies.

Besides these two obviously valuable shareholder benefits, both companies also bring other positive matters into account when looking at what affects a company’s performance. Foreign shareholders like BP and Statoil usually bring something into the company that the local shareholders or government cannot provide. For example, while Sonatrach and the Algerian government may be stuck in their ways, influences from these international giants may serve well for the overall production platforms. For example, BP has identified control of work in the joint ventures as a critical safety process. Control of work meaning having one common process of controlling work with the aim of ensuring a safe and consistent system is followed. They, among other things, hosted a workshop with their key partners, drilling contractors, rig equipment manufacturers and well service providers to develop a plan to deliver positive improvements in the control of work on their rigs. This gives a positive spillover effect on both Sonatrach and the government. Doing this will improve the safety in their oil and gas plants in In Amenas and In Salah substantially. By making the rigs more safe over time shows a degree on professionalism pertaining to Sonatrach, in which will improve their credibility towards new potential investors.

6.4.1 Working with the Algerian State

Domestic corporations are likely to have both the incentives and the skills to act as good monitors, which positively affects a company’s performance. However, while Sonatrach is the third shareholder on paper, the Algerian state owns the company. There thus lies a risk with a financial profit focus, which tends to lead to short-term behaviour. This especially since the Algerian welfare system solemnly depends on the oil and gas profits from Sonatrach. Moreover, with the way the hierarchy in Sonatrach is built up, with the management in Sonatrach and government officials practically switching positions throughout the years, there can also be a problem connected to their business relationships. For example, as mentioned earlier, quite a few CEOs have held related ministry posts at the government at the same time being the CEO of Sonatrach. This is without a doubt something that can lead to a complex maze of domestic networks that in turn can hinder the effectiveness of the joint venture. In addition to this, as government ownerships often are weighed down with multiple problems, it will also, in turn, significantly reduce their monitoring potential. With Sonatrach being completely government controlled, board members will not have the best incentives to

do a good monitoring job. Sonatrach’s performance will hardly ever affect the careers of these governmental bureaucrats and they have more short-term political ambitions than long-term company ones. This is conflicting with a profit-maximizing attitude that foreign investors and shareholders will have.

As we have discussed, the negative downfalls with financial-foreign shareholders are not prevailing in this case. However, there is a fuzzy line when it comes to Sonatrach being a financial-domestic shareholder or a strategic-domestic one. We will, nevertheless, bring forth the notion that Sonatrach is a strategic-domestic shareholder. While undoubtedly the financing, for the most part, comes from the Algerian state itself, we hope the government will not be so reckless as to let short-term profits get in the way of long-term national growth anymore. As, stated earlier in the analysis, a reoccurring problem throughout Algeria’s history is their problem to think ahead. The politicians have been more focused on goals that give “here and now” returns and things that will make them look good in the present. However, as the government is more or less aware of this problem, it is plausible that they at least will try to not let short-term profits get in the way of lasting national growth, if the 2014 election goes favourably.

Its reasons for these joint ventures must be strategic, as production in the natural gas sector in Algeria has steadily declined over the last decade. This demur can be critical for the hydrocarbon dependant government if it continues and the solution must be a long-term focus. It seems that the Algerian government has found the answer and solution for the production decline through foreign partners and will be highly strategically motivated in these joint ventures.

In this case, we feel that the two joint ventures actually employ both strategic-foreign and the strategic-domestic. This gives us the best of both worlds. The strategic-foreign and the strategic-domestic shareholders working together in order to take full advantage of their own company specific assets, thus impacting the company’s performance in the best possible way. While earlier listing the different things BP and Statoil brings to the mix, we pose that the two joint ventures also makes good use of their strategic-domestic shareholder, Sonatrach. With its governmental backing, the Algerian company is able to secure new markets with the help
of BP and Statoil, thus pursuing their own strategic interest. By being state-owned, Sonatrach operates in a monopoly, thereby terminating all competition with other national companies. This also gives them the sole precedence to national contracts.

However, a big long-term risk to bear in mind for both BP and Statoil is that their shareholder advantage, through technology, experience and expertise, is transferable as Sonatrach can copy their technology and train their employees. Accordingly, it is often said that the extent of foreign control is associated with the degree of resource and technology transfer. The risk of their bargaining power being diminished is very present. If it happens, both BP and Statoil may risk losing their revenues one way or another, as Algeria and Sonatrach has no value of keeping them as partners. The more globally embedded Sonatrach get, the less likely is this scenario, but the risk is still highly present. For BP and Statoil to keep their bargaining power in Algeria they need to either keep their technology a secret, or be so innovative that by the time their knowledge is copied they have discovered new and improved technologies.

6.4.1.1 Algerian incentives

Douma, George and Kabir (2006) pose that foreign corporate ownership positively affects a company’s performance in many ways. This is because their commitment to technology transfers, as they are in a much better position to use their relative advantages to achieve a positive performance, compared to domestic shareholders when facing imperfections in capital. Having a strong judicial system is usual an important criteria for foreign investors when looking to invest. In Algeria the judicial system is quite weak for foreign investors, as argued earlier in the analysis of national institutions. Because of this there is almost no foreign investment in Algeria, except from oil companies. Nevertheless, the possible revenue is so high for big oil companies, like British Petroleum and Statoil, that they are willing accept a lot higher institutional and investment risk then regular foreign investors. This especially shows itself as BP and Statoil still is present in the country, despite obvious safety concerns related to the facilities and workers. The Algerian government have failed to put their minds at ease regarding new security measures and BP and Statoil still considers the venture worth the gamble.
However, the domestic government does do something to attract foreign investments. The incentives for oil companies, despite the 51 percent stake of Sonatrach in all new joint ventures, are slightly more favourable than in other sectors. The Algerian government recognizes the need for foreign oil companies to improve their most profitable industry and this gives foreign investors an appealing encouragement to join forces with Sonatrach.

6.5 The Relationship between Principals and Agents

In this part will we explore the relations in the joint venture projects In Amenas and In Salah. With the help of agency theory we plan to gain a broader understanding of the different forces within the joint ventures. As optimizing agency solutions rely on an efficient governance context that exists in most developed economies, such an institutional framework does not exist in Algeria. Therefore, agency problems will most likely surface in their ventures. Traditional solutions in strong governance contexts are not necessarily effective in the weaker governance contexts of emerging economies.

Type 1 problems can occur when local managers do not act in the best interest of the owners. Type 1 problems can normally be blamed on goal incongruence between owners and managers and the risk in such cases is that the manager’s ambitions are not aligned with the owners. However, the managers in these joint ventures are mostly Algerians that have a working history with the owner Sonatrach. Hence, by using local workers, Sonatrach lowers the need for monitoring, as their managers’ goals should be aligned with their own. The problem in this particular case is that, as these managers act on behalf of Sonatrach, and may neglect the wishes of the minority shareholders BP and Statoil. In our case this can also lead to the managers distributing information to domestic and foreign owners differently. This is a common problem for foreign investors, as their domestic workforce usually feels a closer connection to the domestic owners, as they share a common background and culture. This can accordingly lead to a problem where important information is obtainable for Sonatrach, but withheld from BP and Statoil. A possible countermeasure for this problem could be that BP and Statoil get people employed and embedded in all areas of the joint ventures, thus leaving less room for information asymmetry. We will get back to this information asymmetry further down. Another solution to this is to give local managers incentives like stock options. While
the Algerian government undoubtedly will be hesitant to let go of any of their shares, risking their 51 percent majority stake, BP and Statoil may give the local managers some of their own.

A type 2 agency problem, as argued by Shleifer and Vishny, is the conflict of outside investors and controlling shareholders. Having the 51 percent majority share puts Sonatrach in the power position and becomes the agent in the joint ventures. BP and Statoil, with their minority share, operate as the principal. Sonatrach, as the controlling shareholder, has the advantage of having close to full control over the managers and employees in the two joint ventures. BP and Statoil, as a minority shareholder, have little influence in the joint ventures except from discontinuing their investments. Accordingly, a conflict of interest could derive from any kind of strategy, the management or from a financial disagreement, leaving BP and Statoil out in the cold. In such cases, Sonatrach, as the majority shareholder, could assume control over decisions and deprive BP and Statoil from receiving their entitled takings.

6.5.1 Foreign Principal versus Domestic Principal

Another agency problem can appear due to weak national governance. This is the principle-principle problem known from Dharwadkar, George and Brandes (2010). Here the risk lies with Sonatrach and their government backing. The close ties between the company management and the government creates a situation where BP and Statoil have no government institution to turn to in case of disputes or injustices. These agency problems are blooming in countries like Algeria, where the national legal protection is lacking. Similarly to before, in a worst-case scenario, Sonatrach, with the governments backing, might seize total control of the joint ventures through law changes and deny BP and Statoil their appropriate return on investments. As the host country principal they could also be at risk of threatening employee-shareholders with layoffs unless they vote with the local management. In either case, BP and Statoil will be in the same situation, accordingly being categorized as a weaker principal.

In other words, the close ties between Sonatrach and the Algerian government indicates that there is a lack of independent legal authority that can intervene if needed. Based on Algerian history, there is a major risk of nationalizing assets in order to increase the governmental
control of nationwide industries. This fundamental Algerian inclined way of thinking may lead to different goals in both joint ventures. Algeria may at some point want to, in light of their history, reinforce their national control of the hydrocarbon sector. They can do this in many ways, all disregarding the opinions and attitudes of BP and Statoil. As a minority shareholder, BP and Statoil will have little protection against this. Also, with being foreign investors they have less mechanisms of their own to protect their power. This also includes limited access to the Algerian court and in some cases to physical force, like the Algerian military. In all the latter cases, the Algerian government, along the lines of Sonatrach, has control.

However, foreign investors can get more effective control rights by being large. Thus, if BP and Statoil join forces, they make up 91.9 percent of the joint ventures working interest in In Amenas and 65 percent of the working interest in In Salah. If they compose a solid force towards Sonatrach and the Algerian government, they can play an active role in the corporate governance. However, these percentages are only in working interest, thus meaning how many percent of the total costs you as a company are in charge off paying. This is independent of share of ownership, which is confidential. As mentioned earlier, BP and Statoil own 49 percent combined of In Salah Gas Project. Conferring with the Algerian Hydrocarbon law, we feel it is safe to assume that Sonatrach has a 51 percent ownership-stake in In Amenas Gas Project as well. So, in practice, BP and Statoil will not have a majority say in neither of the joint ventures. Nonetheless, because of their international size, it is plausible to assume that Sonatrach will want to listen to them if they have injections to the matters at hand.

6.5.2 Adverse Selection and Moral Hazard

When dealing with information asymmetry, it is safe to assume that both adverse selection and moral hazard exist in these joint ventures. Hence, it is believable to assume that some agents, like the employees, will not come forward with information that can affect the money earned by Sonatrach. As mentioned before, the revenue from Sonatrach funds most of Algeria’s domestic investments, therefore making most of the population of Algeria stakeholders of Sonatrach. If the company’s profits go directly to the government and indirectly back to the workers in terms of some welfare schemes, they will be less likely to
address certain issues that may influence the principles. For example, if security issues made their way to the ears of BP and Statoil, they might not have set up shop where they did, thus reducing the profit pool the Algerian government uses on the population. In this way it is plausible to assume that some adverse information’s selection exists.

It is, however, even more likely that moral hazard takes place in the joint ventures. As both BP and Statoil has their main office in another part of the world, monitoring the local workers is both time consuming and costly. We mentioned earlier that there exist two categories of control mechanisms when striving for effective governance. The internal control mechanisms are in this case organization-based and include monitoring done by the board of directors and by mutual monitoring done by management. While both BP and Statoil have fair ways of determining whom will be on the board and accordingly shifting the directors regularly, Sonatrach does not. Consequently, the internal monitoring will have its flaws. In the aftermath from the first corruption scandal, the current CEO of Sonatrach, Abdelhamid Zerguine, stated that the company had issued a new procedure, the R18, and that the procedure had allegedly been reviewed and amended by all the managers. Zerguine also claims to have improved the audit department, giving it much greater independence from Sonatrach’s other normal company structures. The department will operate on a division-by-division basis and will conduct investigations and impose higher ethical standards throughout. Whether these amendments have any practical implications is yet to be seen. In Algeria, talk is cheap.

Both BP and Statoil have a zero tolerance for corruption and bribery. Sonatrach is located in a country where both cases are a way of doing business. Thus, in order for Sonatrach to maintain its relationship and still receive goodwill from the two western companies, things will necessarily be kept on the down-low. While Sonatrach’s most current code of conduct prohibits its employees from receiving or using bribes as a method to obtain a material benefit, the corruption perception index (2012) ranks Algeria at 106th place out of 176 nations, indicating that the country has serious corruption problems. It is thus safe to assume that whilst the company rules allow for dismissal of any employee involved in

\[209\] http://magharebia.com/en_GB/articles/awi/features/2013/02/27/feature-03
\[210\] http://www.transparency.org/cpi2012/results
bribery, the deeds are still being conducted in a deviant manner. Also, the threat of being terminated may not be prominent in the Algerian company. With corruption and bribery being so common, few Algerians are in a position to point fingers at moral hazards.

6.5.3 The Curse of Short-Term Focus

Whereas many scholars have argued that state-owned companies are better at fixing agency problem than private companies, in this case the state might turn out to be the problem. We previously put forth the notion that both BP and Statoil may dwindle the quality of their resources, as a result of many reasons. They might be afraid that their technology will be copied and themselves made abundant, that their capital might get lost if they have to back out of Algeria due to safety concerns or they may simply have such a single-minded focus on profit that they will not think long-term. While the two first assertions might be true, both BP and Statoil have shown their long minded focus by not just investing capital in the joint ventures, but also invested in local CSR-schemes. For instance, in In Salah, BP has set up 4 desalination units used by approximately 27,000 beneficiaries while also establishing several language resource centres. This sends strong signals as to their long-term focus.

However, while an Algerian politician, motivated by the public’s welfare, can control the decisions of these joint ventures and thus improve efficiency, it is far more likely that the reality of Sonatrach’s state ownership is largely inconsistent with the efficiency argument. The behaviour of state companies can be explained by the fact that the real control rights belong to bureaucrats and not by the public. With Sonatrach being fully state-owned and their managers previously being employed by the government, they nearly have complete power to direct the company in the political way they so desire. Also, as the management has unusually strong ties with the current government and its politicians, these bureaucrats will have very different goals than the rest of the joint ventures.

Albeit, Shleifer and Vishny (1996) argued that because the profits from state-owned company’s flow into the government budget, the bureaucrats controlling said company will only have an indirect concern about its revenues. This does not seem to be the case here. The

management in Sonatrach has a direct link to the government and thus seems to share its goals for the company. Hence, a focus on profits will be prominent and serve the revenue goals of BP and Statoil. This may well be one of the positive sides to working with a fully state-owned company in an emerging market.

As noted several times before, the Algerian government needs to improve Sonatrach’s profits and BP and Statoil will thus be eating the fruits from this focus. However, as also mentioned several times before, the Algerian government is know for its lack of long-term focus. They want money and they wanted it yesterday. This direction of short-term goals may hinder both BP and Statoil reach their own goals of long-term profit.
7.0 Concluding Remarks

After our analysis of BP, Statoil, Sonatrach and Algeria and the joint ventures In Amenas Gas Project and In Salah Gas Project, we predict that BP and Statoil risk losing more of their bargaining power through technological advantages as times goes on. When looking closer at the institutional, agency and rentier factors it is evident that the power balance of the joint ventures is heavily leaning towards Sonatrach and the Algerian government. The possibility of a governmental change in 2014 is consequently a big risk. The outcome and aftermath of that election can change the playing rules drastically. As BP and Statoil’s bargaining power lies in their experience and technology, they might risk losing their investments altogether if they fail to maintain this advantage. The potential short-term risks are quite high and pose a lot of uncertainty for BP and Statoil in Algeria. The two biggest concerns today are the unpredictable 2014 election and the security situation. Safety in Algeria scores incredibly low in all ratings and while increased private security and military presence certainly will help, the problem is a regional issue and its deep roots are something one cannot be completely protected from.

BP and Statoil are also in danger of being involved in fraud or bribery in one way or the other, as history clearly shows that corruption is present in most layers of the Algerian society. This can negatively impact the public image should Sonatrach be involved in a future corruption cases. Sonatrach’s earlier involvement in big corruption cases, as well as weak scores in different corruption indexes, shows that the talk about non-tolerance towards bribery and corruption exist essentially only on paper. Also, if Sonatrach once again is proven guilty of corruption, BP rather publically states that they will cut their ties with any company involved in such activities. If BP fail to drop Sonatrach, and accordingly shut themselves out of one of the biggest hydrocarbon markets in the world, they could be blamed for acting hypocritical and the home-grown PR-scandal is a fact. While Statoil are not quite as vocal about the consequences of working with corrupt partners, it is no reason to believe that the scandal in Norway would not be just as big as the one facing BP in the United Kingdom. Also, the close connection between the government officials and managers of Sonatrach puts BP and Statoil in an ethical dilemma. Do they turn a blind eye to the alleged corruption or do they lay down the law and risk losing the Algerian marked all together?
The corporate governance in the three countries is quite dissimilar. While both BP and Statoil accentuate their codes of conduct and put major emphasis on their good reputation, Sonatrach seemingly fails to see the importance of this. As a rentier state, it appears that their social contract with the population has led them on a carefree path. While they claim to be above fraud, corruption scandals keep popping up. Cultural drivers show that BP and Statoil can make up a good team. Adding Sonatrach to the group poses an additional strain to a potentially culturally loaded relationship as Algeria value the opposite cultural drivers than the United Kingdom and Norway. Also, the close family ties in Algeria leads us to believe that there exists an information asymmetry within the joint ventures not beneficiary towards BP and Statoil. The lack of permanent personnel working for BP and Statoil in the joint ventures creates a divide between the local owner and the foreign investors, aiding Sonatrach. Nevertheless, as the joint venture takes place in Algeria, and Sonatrach’s homegrown experience makes the ventures better suited for dealing with governmental non-transparency.

BP and Statoil’s safety net is that they are operating in Algeria’s most vital industry and the government in Algeria really wants and needs to improve the hydrocarbon industry. This has both positive and negative implications for BP and Statoil. The positive outlook is that the government, through its dual role of being the owner and law-enforcer, can facilitate the situation through law changes and incentives. But, the ownership structure and corporate traditions in Sonatrach and Algeria pose a big challenge for BP and Statoil in their attempts to get “hands on” and be close to the decision making in the joint ventures, thus managing the projects properly. With a weak judicial system and absent institutional enforcements, it impedes a major barrier for BP and Statoil when trying to manage their way through all of the informal practices in the Algerian business environment.

On the bright side for foreign investors, as the production and the profits have steadily decreased over the last years, it should force Algeria to further loosen their strict policy of inward FDI as they push to seek fresh capital and technology from foreign investors. Accordingly, the government might become more lenient towards their control rights. The law has changed once, albeit revised only a year later. If the new 2014 government feels the international pressure to broaden their hydrocarbon mindset, they may opt to improve their FDI incentives and allow more power being allocated to foreign companies.
7.1 Recommendations

Algeria has the 10th biggest proven reserves of natural gas in the world, as well as the 16th biggest proven oil reserves in the world. Accordingly, it is natural for big MNEs to want to enter this market. Still, we will recommend that BP and Statoil to linger a bit on the sideline and closely monitor how the national security situation will be handled in the wake of the upcoming election. If they then opt to continue their ventures in Algeria, it will be important to continue to push for a close connection with Sonatrach and the Algerian government and push for reforms that will align the law and independence of the institutes to a more acceptable international level. This will push Algeria towards globalization, which can increase the institutional protection of BP and Statoil’s assets in Algeria.

Aside from the obvious unbalance in the allocation of power, the most pressing problem is the one of unethical corporate behavior. The alleged corruption can be blamed on a centralization of administration and BP and Statoil should aim to change the managerial hierarchy and decentralize the decision-making. It is quite critical that BP and Statoil get more embedded into the direct management of these joint ventures, to gain a more complete overview of the situation and to minimize the risk of Sonatrach misusing their power. However, whether this actually is possible is another question for another day. With Sonatrach being the Algerian government extended arm, the government has the power to direct the company in whatever way they see fit. Accordingly, while Sonatrach might let both BP and Statoil believe that they have a say in things, the Algerian government in reality has all the voices.

7.2 Future Research

In order to fully support our statements, further research using a multi-theoretical approach needs to be made. In order to fully grasp the complexity of joint ventures in emerging economies, researchers need to go more in-depth and conduct studies including primary data sources and thus decreasing the levels of subjectivity in the data collection and raising the overall validity of the data. Only by doing this thoroughly, and with multiple cases in different contexts, will one be able to get a more full-hearted picture of the corporate governance relationship between culturally different companies cooperating in joint ventures.
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