



# POLICY BRIEF

## State-owned enterprises

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### *Reforming NNPC Towards Operational Efficiency and Commercial Effectiveness*

#### Precept 6: State-owned enterprises

##### *Introduction*

The Nigeria Natural Resource Charter (NNRC) Benchmarking Exercise Report (BER) 2017<sup>1</sup> assessed the operational activities in the nation's oil and gas sector between 2015 and 2017 against the [Natural Resource Charter](#)<sup>2</sup>. The exercise sought to unveil the true state of oil resource extraction, governance, and transparency among others based on a set of underlying economic principles in line with international best practices. One of the precepts assessed is on State Owned Enterprises (SOE) with Nigeria National Petroleum Corporation (NNPC) as a case study. Although the report recognized mild positive changes in the NNPC, it scored the corporation low on the aggregate in the focus period. In sum, it concludes that the country is not getting the most from the nation's oil and gas firm in many fronts and suggests a reform that gravitates the corporation towards a commercially-driven and globally-competitive entity. This brief provides actionable policy recommendations that can enhance the operational and financial competitiveness of NNPC, especially in response to the challenges identified in the 2017 BER.

##### *Defining a clear role and mandate for the NNPC and facilitating adequate financing for its operations*

While NNPC has shown tremendous efforts towards reshaping and restructuring the corporation for strategic positioning and performance, certain events and practices have robbed the organization of the benefits inherent in effective corporate governance. On a note, there is the obvious muddle of the corporation's business roles with regulatory functions – the latter is unambiguously within the purview of the Department of Petroleum Resources (DPR). Nonetheless, NNPC is observed to discharge regulatory roles when interacting with the International Oil Companies (IOCs). This limits the power and functions of the DPR, the designated regulatory body in the oil and gas sector – the resulting conflict and confusion arising therefrom hinder effective performance of the oil and gas industry. The Petroleum Industry Governance Bill (PIGB), which failed to get presidential assent after being passed by the National Assembly, is one of the measures that sought to address this concern.

The BER noted that despite the several funding mechanisms put in place for the NNPC to finance its activities, they remain acutely inadequate to meet the corporation's huge investment requirements, estimated at US\$7-9 billion annually. In the past, NNPC struggled to meet its joint venture (JV) cash call obligations with IOCs. In fact, the Nigeria Extractive Industries Transparency Initiative (NEITI) noted in all its independent audit reports on the oil and gas industry that the management of JV Cash Call regime had constituted drain pipe to the country's scarce oil and gas revenues. However, the transition to incorporated joint ventures (IJV's) will

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<sup>1</sup> <http://www.nigerianrc.org/2017-benchmark-report/>

<sup>2</sup> The Natural Resource Charter is a set of principles on how to best harness the opportunities created by extractive resources for development for governments and societies rich in non-renewable natural resources.

enable the corporation to attract external investments, relieve the country of the complex financial burden of JV cash call arrangement, and cut revenue leakages.

#### *Reshaping the corporate governance system of NNPC*

To deliver the best results to the country, NNPC's corporate governance structure has to limit political interference in technical decision-making, while allowing for effective oversight.

A critical issue highlighted in the 2017 BER relates to the high level of political interference in the affairs of the corporation. Particularly, incessant political meddling is observed in the recruitment into top hierarchy positions of the corporation. This is detrimental to policy consistency and stability in the corporation as well as limiting to the effective operation of the board of directors. Also, at the heart of corporation's effectiveness lies its struggle to key into commercially-effective principles in its operations. Specifically, NNPC has not been incentivized to deliver commercially-viable services.

The corporation's commercial and non-commercial functions are not well aligned and, in most cases, conflicting each other. For example, part of the non-commercial roles discharged by the NNPC is to ensure regular supply of refined petroleum products irrespective of the prevailing economic conditions. This quasi-fiscal activity distorts market incentives and hampers its profitability and commercial viability – part of the explanation for the serial operational losses in the corporation.

Furthermore, since the publication of the 2017 BER, which acknowledged the removal of fuel subsidies, subsidies have crept back into the system. Particularly, NNPC has struggled to finance the difference between the commercially viable price of retailing petroleum products and the government approved retail prices, leading to huge imbalances on its books. This practice has drawn wide criticisms not just because it reintroduces fuel subsidies, but also because it leaves little room for legislative oversight.

#### *Committing to transparency and accountability*

Focusing on transparency and accountability, the 2017 BER found that NNPC performs low in the areas of timely financial audits, accurate financial records, and public disclosure of audited accounts. The corporation's audited accounts are only carried out when the need arises and at the behest of political office holders especially the executive arm of government. This is in contravention of section (7) subsection (2-3) of the NNPC Act (1977) which directs regular auditing of the corporation's account in a financial year. Also, the series of previous independent audits indicted the corporation of sharp practices in accounting information, the effect of which strongly undermine sound financial judgement of audited reports<sup>3</sup>. Furthermore, NNPC has not shown willingness in making its audited financial information publicly available - despite the existence of the Free of Information (FOI) bill and Fiscal Responsibility Act (FRA) which promote public knowledge of the activities of the Ministries, Departments, and Agencies (MDAs). For example, the Fiscal Responsibility Commission (FRC) has decried non-submission

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<sup>3</sup> See KPMG (2010) and PwC (2014) audited financial reports on NNPC

by NNPC of its audited financial reports since 2011<sup>4</sup>. However, the 2017 BER did observe that mild progress has been recorded in recent time. Notably in 2016, the organization started publicizing its monthly financial and operational information. Nevertheless, doubts remain about the sustainability of this practice.

### *Conclusion and Recommendations*

The combined effect of low transparency and accountability, ineffective corporate governance, and commercial ineffectiveness among others may explain the inability of the corporation to attract sufficient funds and have a workable funding mechanism for its operation over the years. A successful financial drive for the corporation strongly hinges on restructuring and strategic positioning that imbibes unalloyed transparency and accountability on one hand, and commercial effectiveness on the other. Open and transparent operationalization in NNPC would foster investors' confidence in the oil and gas sector. This in addition to business drive that is market-oriented as well as sound financial accountability would attract substantial resources into the corporation – the consequence of which would facilitate expansion and global competitiveness of the nation's oil firm.

Furthermore, some of the key findings in the 2017 BER that indicated marginal improvements in the NNPC have since changed. Particularly, the PIGB passed by the National Assembly failed to receive presidential assent and the perceived removal of fuel subsidy remains in question with the NNPC continuing to fund subsidies in what the corporation terms 'under-recovery'. Consequently, it is recommended that the government/NNPC:

- Allocate resources more efficiently. Specifically, NNPC should invest resources in income generating activities -such as the rehabilitation and effective management of existing refineries, and should be encouraged by the government to do so, rather than financing the government's mandate on subsidies. For proper checks and balances, if fuel subsidy is perceived as a national priority by Nigerians, it should be reflected in the national budgets to allow for proper oversight by the legislature.
- Commence oil sector reform by signing the PIGB into law, thus allowing new national oil companies to become more commercially oriented. Specifically, a change in the business model and ownership structure will improve efficiency in value addition and corporate governance. As recommended in the NRC, a good corporate governance system will promote sound business judgment, reduce the influence of narrow political interests and allow for predictable planning.
- Make NNPC more commercially viable to reduce losses and unlock investments to cover financing shortfalls, by adopting an effective corporate governance system that reduces political interferences, prioritizes commercial objectives of the corporation, and enhances financial and operational efficiency. The reform in ownership structure proposed in the PIGB is a step towards achieving this by phasing in private participation.

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<sup>4</sup> [www.businessnews.com.ng/2016/02/12/frc-tackles-nnpc-over-non-submission-of-audited-accounts/](http://www.businessnews.com.ng/2016/02/12/frc-tackles-nnpc-over-non-submission-of-audited-accounts/)

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