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In March of this year, China’s Ministry of Land and Resources announced that China likely has the largest reserves of shale gas in the world, estimated at 886 trillion cubic feet (TCF). The authorities had by then already trumpeted their ambitions of commercializing shale by 2015. Ultimately, says Jiao Xu Ding, founder of the landmark Chinese oilfield service company Copower, these vast resources may be able to support China’s current population for the next three centuries.
The announcement comes on the heels of a turning point for the country’s oil and gas industry. In the exploration, production, and marketing of traditional oil and gas, business has long been channeled through China’s principal ‘Big Three’ National Oil Companies (NOCs): China National Offshore Oil Corporation (CNOOC), China National Petroleum Corporation (CNPC), and China Petrochemical Corporation (Sinopec). Generally, non-state upstream enterprises can participate in E&P plays only through a production-sharing contract with one of the three. Service providers, meanwhile, must contend with extensive state-owned competition: each NOC is an umbrella organization housing every imaginable subsidiary from equipment manufacturer to engineering company to research institute, and the state gives preference to its own.

The government, however, has introduced a surprising directive: by the second round of bidding, shale blocks will be tendered not only to national players, but private domestic firms as well. CNOOC’s chief energy economist, Chen Wei Dong, speaks about the power of open competition in North America in inciting industry. In China, too, the private oil and gas industry is starting to mushroom, and the opening of the shale sector is more broadly emblematic of the authorities’ increasingly capitalistic mood.

Opportunity is also drawing the international industry to China in droves. China first introduced the ‘Reform and Opening Up’ policies in 1984. Under this series of legislation, the state formally opened its doors to foreign players, and the market has never looked back. The National Energy Administration’s deputy director of Oil and Gas, Hu Weiping, readily acknowledges the value that international businesses bring to the China market, crediting the open-door policy for helping China to rapidly modernize.

“During the last three decades of Reform & Opening Up,” Hu says, “the Chinese oil & gas industry has been able to to learn much from advanced international companies. Our industry has improved in terms of technology, finance, management, and—most importantly—ideas.”

Internationalization in China is both internal and external. As it has let companies in, it has directed its own ‘Big Three’ to ‘Go Out.’ Over the last years, each company became partially stock-listed, achieved increased autonomy from the state, diversified its activities, updated its technologies, skilled up its managers, and joined the Forbes Global 2000 list (at #7, #24, and #146, respectively). According to Ernst & Young, in 2009, 2010, and 2011, China’s NOCs accounted for 12-15% of all global M&A spend in the oil and gas industry. Chinese companies are now major players in traditional IOC areas such as U.S. shale gas, the Canadian oil sands, and Brazilian deepwater.

Private Chinese industry followed the NOCs abroad, but quickly found a market of its own; many private companies, in fact, went global even faster than their state-owned counterparts.

China’s oil companies sought the international market because, until unconventionals came onto the scene as a dark horse, the domestic market had grown too small. China has been steadily watching its energy basins deplete. Its top four oil fields—including its largest, Daqing basin in the northeast—have gone into decline. A net exporter until 1993, Chen notes that China today consumes 9 million barrels of oil per day and produces 5—an import imbalance of 125%. Natural gas became a net import in 2007; coal in 2009. Meanwhile, the International Energy Agency projects that over the next 25 years, China will alone account for

Fig. 1: China: Total oil demand (mb/d)
more than 30% of growth in global energy demand.

Just as it seeks greater energy autonomy, China seeks to lessen its carbon footprint. A vast industrial economy, the country’s pollution clouds are visible from space. In natural gas, the authorities have found a green, and ostensibly abundant, fuel, and plan to double its share in the energy matrix to 8.3% by 2015.

The Rebalancing

The developments of the last years—the promotion of green growth, the internal and external globalization of the industry, the precipitous emergence of the private sector, unconventional gas the poster fuel of the future—are all wound in a greater vision. They are consistent with the 12th 5-Year Plan, China’s latest strategy for national socio-economic development, effective from 2011-2015. At the end of this year, China will quietly experience a leadership shift that occurs once every decade. Current prime minister Wen Jiabao, and current president Hu Jintao, leave to their successors a progressive agenda.

Raphael Schoentgen, chief representative of GDF Suez’s China operations, opens his interview with Focus Reports with the following admonition: “The first idea we come across is a very, very strong one: that China cannot proceed with its existing path of development. It cannot follow the same energy pattern, and must shift completely—toward cleaner energies, and more energy efficiency.” Schoentgen calls the nation’s 12th 5-Year Plan a “rebalancing.”

The National Energy Administration’s Hu Weiping speaks of a dual-pronged approach: “To solve the problem of increased energy consumption, we need to ensure supply while controlling demand as much as we reasonably can. We need to adjust the structure of our economy and change the pattern of economic growth. In a recent address to the National People’s Congress, prime minister Wen Jiabao gave an overview of current government initiatives. The expected GDP growth rate for 2012 is set at 7.5%, which demonstrates our resolution to slow down our growth and adjust our structure.”

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More Than Merely Interesting

To be sure, as China moves to double the share of gas in its energy mix by 2015, the country will at first rely heavily on imports: LNG shipped from neighbors such as Australia and Qatar (17 million tons of LNG will be imported to China in 2012, according to a study by WoodMcKenzie); or pipeline gas directed via the 1,118-mile natural gas pipeline coming from Turkmenistan, China’s greatest single source of gas today.

However, to realize targets of improved self-sufficiency, China is putting greater stock into its own unfarmed backyard. Offshore gas plays in Bohai Bay and the South China Sea—both in shallow water and, today, deepwater—are generating increased attention, and the government is investing US$40 billion in the sector over the course of the 12th 5-Year Plan to support exploration and the development of infrastructure.

But where the country is truly betting big is unconventional. In addition to the abundance of shale, the Ministry of Land and Resources currently estimates that China’s coalbed methane (CBM) deposits may be the third largest in the world by volume, at approximately 120.7 TCF.

When Ole C. Willumsen, country manager of Statoil in China, arrived in the country in August of 2010, he found a distinct dynamism in the market. Willumsen tells Focus Reports, “It is difficult to pinpoint the moment when the exploration and production of unconventional fuel transitioned from something that was merely ‘interesting,’ to something that everyone is absolutely eager to take part in. I have the feeling that the drive warmed up around two years ago. I think the next couple of years will be crucial in terms of deciding on the potential commerciality in the various basins. Hopefully, China’s resource base will not disappoint.”

An overnight success?

Baker Hughes’ Mike Dolman on the prospects of shale gas in China.

Many experts are skeptical about China’s shale gas potential, saying that, while it does appear that reserves are vast, it is too early to tell how economically viable, or geographically challenging, exploitation will be. What is your opinion? Can China shale be the next success story for this industry, and for Baker Hughes?

This is one of the big questions in our industry today—will China be the next place for shale gas, and for unconventional?

The potential resources are there. Personally, I believe that the growth opportunities could be huge for both operators and service companies. However, from what I have seen in my three years in China, the Chinese take a very long-term approach. By thinking in broader terms, a strategy is being implemented to move from coal to cleaner energies. I see the investments being made. And yet, it will take time.

We will have to contend with challenges. The business here is completely different from North America. For instance, even the fundamental logistics are challenging—many of the areas that appear to have resource potential are in difficult-to-access, mountainous terrain with high population density. There is a potential lack of water sources for hydraulic fracturing. China must invest, too, in its pipeline network, as the gas must ultimately be transported to consumers.

For these reasons, I believe that a ‘shale gas boom’ will not happen overnight. However, I see a very bright future, because political will is clearly behind the exploitation of this resource. Baker Hughes is investing in these opportunities because we believe the market will develop.
China CBM: A history lesson

Far East Energy (FEE) is a micro-cap upstream CBM company with American roots and an operation based in China. It has three blocks in the region, and one of these—situated in Shaoyang County, Shaanxi Province—has yielded a large area of high-permeability coal that FEE’s country manager Robert Hockert believes “represents a turning point in the development of China’s CBM industry.”

Mr. Hockert, historically, some major energy companies—including Chevron and BP—exited China’s CBM sector in the early 2000s, citing policy constraints and low demand in the domestic market. Why did a small Houston-based enterprise decide to tackle what many would view as a challenging market?

Most major CBM assets that are developed today are discovered by small independent companies—the fact that the majors pulled out does not necessarily speak negatively about the potential of the resource. Having said that, at the time, gas demand was a shadow of the enormous demand that exists today, and then there were no pipelines and poor pricing. Today, demand is off the charts; pricing is very high compared, for instance, to U.S. gas prices; and pipeline access is increasing although still challenging. Those same majors are now looking at China CBM again.

Since 2005, when we first started really drilling, we have made a major discovery, and we have applied for reserve qualifications. We are pretty excited—we believe we have a great asset!

Unconventionals were, of course, a transformational resource for North America, which continues to aggressively mine its reservoirs on its way to greater and greater energy autonomy. China has made it no secret that it would like to do the same. Cheng Xu, president of Schlumberger China, believes that it can: “I believe that China will be able to replicate this story. The reserves are there. The geology is different, and more difficult—but the Chinese will find a way. Indeed, they must find a way, because they need these resources.”

And yet, the fact that China’s geology is quite unlike North America’s is not lost on the industry. Expectations are positive, but in many cases reserved, as the gas sits trapped in difficult terrain in inland provinces like Shanxi and Sichuan.

The unconventionals story in China has so far been fraught with delays. CBM, for instance, has been under development for 10-15 years, and yet results have been thin: BP’s China president Chen Liming points out that “the country’s CBM production is still very small; it currently produces only 1.5 billion cubic meters of the gas a year. We must look at what has happened in the CBM industry, and ask ourselves what we can do differently in shale gas.”

China has in fact taken steps in the right direction for both commodities. According to Chen, poor handling at the state level obstructed the CBM sector; today, a wave of new legislation has cemented CBM exploitation as a national priority and an attractive commercial undertaking. For shale, the intentions of the government are perhaps doubly clear.

Pipeline infrastructure and other midstream foundations, too, are nascent but under hurried development. Halliburton country VP Desmond Kong notes an advantage of the top-down system in China: “Everything is feasible if the government decides that it will sponsor or support it. The historical response of the government is well known: that infrastructure will be built—and it will be built in good time to support their targets.”

When China opens a Window...

Shell’s in-country chairman Lim Haw Kuang always tells his staff: “Let us not focus first on what we want. Let us focus first on what China needs in terms of energy, and how we can address those needs.”

China’s needs are growing. As the world’s largest energy consumer, China represents a pivotal downstream market. Companies like Shell
and BP actively participate in niches like lubricants, petrochemicals, and petrol marketing. Gas giants like GDF Suez are signing long-term deals for the provision of LNG to Chinese partners. An erstwhile compact, and notoriously closed, upstream market is looking increasingly attractive as well: private multinationals and national companies like Statoil alike are looking to partner with local organizations on natural gas plays—a situation prognostic of much-increased foreign presence in the sector.

Lim remains largely mum about the issue, but Shell’s extensive exploration partnership with CNPC has yielded what appears to be a large volume of recoverable shale gas in Sichuan, and others are eager to follow suit. As a measure of what is possible for foreign companies with the right value proposition, Shell China has grown from 4,000 people to 18,000 people in only the last 4 years.

Service needs in this environment are meanwhile changing. To Yann Reynaud, head of Schneider Electric’s Infrastructure Business in China, this has meant evolving his approach. Reynaud notes that, whereas some years ago, the Chinese sought “discreet services,” today they want multinationals to act as full partners, taking responsibility for their portions of a project and providing solutions rather than products.

Reynaud speaks, too, of being in China, for China: “Whatever you do, your competitors will come to this market and develop products here—whether these competitors are international or local. It is very naïve to think that just because you are not present in this manner, the Chinese customer will not gain access to the technology they want. If they do not get it from you, they will get it from someone else.

“We look at the concept of windows of opportunity. China often opens windows; what, sometimes, a European company does not catch, is the fact that these windows are not open for very long. You catch the window, and you capitalize, or you run after the train. And the train runs very fast, so usually if you are running behind it, you are already too late!”
Shifting Stomping Grounds

Andy Benson, managing director China for Core Laboratories—a specialized U.S. oilfield services company that works to optimize reservoir return—founded his subsidiary in 2005. Core Lab works with both domestic players and IOCs, but has found that it is easier to offer their premium-priced services to their traditional, multinational clients.

Benson says, “We are beginning to really focus on the IOCs working in China. They are already familiar with Core Lab’s reputation for quality, and they are beginning to partner with the domestic Chinese oil companies to explore onshore. Many of these partnerships are for unconventional gas reservoirs, and Core Labs has more unconventional reservoir data than just about anyone.

“The IOCs first entered the Chinese petroleum market via the South China Sea. Next they moved into the Bohai Bay area. Now everyone is interested in the unconventional gas reservoirs in Sichuan. These new reservoirs are challenging—deep, with low permeability and porosity. We have seen huge strides made in the development of such reservoirs in the US, and now the IOCs want to bring this technology to China.”

If an oil company or service provider can form strong relationships in the China market, moreover, the spillover effects may prove lucrative abroad as they capitalize on China’s wave of internationalization. GDF Suez, for instance, has a substantive business within China, with 4 Suez Environment companies present in the region and the introduction of the Energy business in 2009—but the group is thinking globally.

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Think Locally

Atlas Copco’s John Brookshire—former general manager of Compressor Technique in China, and current GM of the Compressor Technique Customer Center in the U.S.—and Kevin Illingworth, country manager of Expro China, on localizing a global company.

How does your organization adapt to the unique needs of the Chinese market?

John Brookshire: China is immensely important for our company. We have 15 manufacturing facilities in China, and over five and a half thousand employees. We bring a lot of technology to China—but we also create technology in China. We have two R&D centers in this territory: one focused on mining and construction, and another focused on compressors. We bring our latest technologies to this market right away; otherwise, we develop them locally.

This region is extremely large, and diverse. We serve many of our traditional customers here—foreign international companies. These customers tend to buy the same products globally. However, if we only focused on our international clients, we would miss a huge portion of the market. Our business is changing, and we are focusing increasingly on local clients, and local content. Indeed we have recognized that, for domestic clients, needs can be different.

We address the challenge of local competition with what we call our ‘multi-brand’ strategy. Within the Group, we have different tiers of products that offer different value propositions for different levels of the market. These tiers range from the high to the low end. In China, for instance, we have already purchased three local compressor manufacturers. This allows us to offer a different cost structure, and a different value proposition, to align with the needs of customers who are not interested in our more expensive products.

Kevin Illingworth: The China market is quite unique in terms of the way its national oil companies are structured. Sinopec, CNPC, and CNOOC each have individual subsidiary companies that are the equivalent of entities like Expro and Weatherford. There is hence a major domestic service provider presence, and the market is very difficult to penetrate—the NOCs prefer to give business to their own branch organizations.

Where we, as foreigners, can make a difference is in terms of new technologies and the experience we bring to the table. 10 or 15 years ago, Expro was trying to compete in China in very traditional niches. Today, Chinese companies are themselves very capable in those areas, and this avenue of business has largely gone away; now, we focus on areas where we can truly bring added value, such as cutting-edge technological segments.

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has continuously evolved—history has shown that it has evolved quite dramatically.

“In the same way, while one reason for partnership may phase out, another reason will emerge. We cannot say what will emerge in the future, but we are confident that good reasons will continue to incentivize multinationals and China’s companies to work together.”

China Inc.

It was not long ago that the international community watched CNOOC fail to enter the North American market with a takeover bid for Unocal. Five years later, the company bought one-third of Chesapeake Energy’s investment in South Texas in what was the largest Chinese purchase of United States energy assets the world had ever seen. As deals like this and CIC’s investment in GDF Suez take shape, ‘China Inc.’ continues to climb the international value chain.

Globalize

Sinopec chairman Fu Chengyu illustrates a developmental history that he shares with his colleagues at CNPC and CNOOC. “Sinopec,” he says, “has implemented a ‘Go Out’ strategy for more than 10 years. The difficulties we faced at the beginning of this journey were innumerable! However, we have accumulated experience, and learned the value of persistence. It is thanks to this troubled past that we can be confident about our future.”

Through waves of acquisitions, Fu says that he began to pay attention to a maxim put forth by the consultancy McKinsey: “30% of the work is acquisition; 70% is integration.” Chinese companies have had to modify their culture to succeed as global companies. Fu speaks of the “enterprise” culture that his organization has developed—a notion echoed by Chinese leaders throughout the industry. Like other international oil companies, today’s Chinese NOCs are creative, bold, and unafraid to take risks.

CNOOC’s Chen Wei Dong also notes a purely market-focused reasoning for China’s international expansion: “Company growth, and energy supply security, are not the same. These are two trends on different tracks. And yet, ten years ago—and even now—many people thought that the Chinese are venturing to international markets to secure supply for the domestic market. This is not true!”

Many people believe, too, that the Chinese are going to foreign markets
to bring expertise back home. Chen rejects this notion as well. In speaking about Chesapeake, Chen becomes animated: “We went to Texas—and, to speak of larger trends, Chinese NOCs are going outside China—in order to grow our business. We found that Chesapeake could benefit from our investment, and, because of the mature approach in the North American market, our profit margins could be higher. It is a matter of pure business! It is not a matter of bringing knowledge back to the country.”

Innovate

Chinese companies are, too, expanding R&D programs with a new mind frame. Chen Wei Dong explains, “We are struggling with a bit of a philosophical question: should we, as CNOOC, focus solely on our own business, or conduct R&D for the greater sake of the country? If we look at the evolution of the multinationals, their growth has been driven by very much focusing on their own interests: when they develop some technology or equipment that is valuable on the market, they guard it very closely.” In a break with the old mode, Chen is a firm believer that CNOOC should create intellectual property to serve its interests as a business, rather than its interests as a national company.

Zhang Mi, chairman of Honghua Group—a business whose revenues already exceed half of a billion dollars after offering an IPO little more than four years ago—remarks on a very interesting turn of events—and one that, increasingly, is not unusual. It is a very recent memory that Chinese oilfield service companies purchased complex oilfield equipment from North America. Today, companies like Honghua are selling this same equipment right back to a North American audience, with technological development programs that increasingly rival Western competitors.

Zhang tells Focus Reports that the evolution of his company “symbolizes the nation’s own transition from ‘Made in China’ to ‘Created in China.’”
A New Kind of Company from the Inside Out

China Oilfield Services Ltd. (COSL), a CNOOC subsidiary and the most prominent and successful of China’s oilfield service enterprises, began life in the fragmented form of seven CNOOC divisions. Its technologies and equipment were modest and underdeveloped, and the organization focused solely on the local market.

In 2002, COSL restructured as a single entity and went public in Hong Kong (following in the footsteps of major NOC upstream subsidiaries such as CNOOC’s own CNOOC Ltd.)—and its very character as a business began to undergo drastic change. As Li Yong, CEO and president, explains, part of the shift has been readily apparent to outside observers: company size more than doubled, reaching approximately 16,000 employees. Of these, the company took on over 2,000 international staff members from more than 30 countries. COSL came to own 34 drilling rigs, and developed 5 integrated R&D institutions.

The company also went global, a decision Li explains was driven by two factors: “One stimulus was that, after going public, our investors needed to see the company successfully expand overseas in order to feel sure about their investment. However, this was not the most important reason we saw to expand. The more significant reason was that COSL owned a substantial amount of heavy equipment, and had made a large number of investments. In order to ensure return on these investments, we saw that we could not rely on a single market—such an approach was too risky. Hence, we began to internationalize.” COSL is now present in major oil markets the world over, including in North and South America, the Middle East, Africa, Europe, South East Asia and Australia.

These are great measures of success; however, Li believes the greater transformation is internal: “During the years of our globalization, changes in revenue and market share have been very obvious. But I think the most notable difference is within our administrative team: the way we think and work has changed fundamentally. The ability of adapting and operating based on international standards is perhaps hard to observe from an outsiders’ perspective, but I can confidently say that the inner power and quality of our company has grown tremendously.

“if we look at our company’s history, we have been around for approximately 40 years. Even our restructuring story now has a 10-year history. And yet, we still think of ourselves as a very young company that is full of energy. Our entire team has a strong desire to develop the organization to greater heights.”

Privatize

Honghua is far from the only private Chinese company to achieve distinction. The last five years have seen a major wave of IPOs from private Chinese petroleum players as they find increasing success. Some say private companies are the future of the industry in China.

James Ma, chairman of Antonoil International, the global arm of oilfield service enterprise Antonoil, says that his company closely models their practices on their study of successful multinationals. Initially, Antonoil followed China’s NOCs overseas—something it called the ‘follow up’ strategy—a typical channel of expansion for China’s private companies.

However, having established a presence in foreign markets, Antonoil found that it could expand its customer base, and do more than provide services for China’s national organizations. Ma illustrates: “We went to Kazakhstan in 2008—we followed PetroChina to the market. However, after one or two years of business there, we had established an office, and had a number of full-time, local employees on site. We established a service base. It became more than a matter of ‘follow up.’ We began to communicate, arrange seminars, etc., with the national Kazakh oil company.”

“We do not want to be a ‘Chinese-international’ company. We want to just be an ‘international’ company. As a company that wants to do business internationally, you should tune every aspect of your business towards international practices: culture, engineers, investors, company strategy, structure, business model, and etc. If Chinese companies want to become global, they must change their ideas. They must change their culture. I have seen many Chinese companies try to operate abroad the same way that they do in China—but this is not enough. This does not work for the long-term.”
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Sustainable Productivity
To set up a specialized Energy Ministry, China established the National Energy Administration and the National Energy Commission. How do these bodies work in tandem with the National Development & Reform Commission (NDRC) in formulating China’s energy policies and regulating the energy sector?

In August 2008, according to the pronouncement Regulations on the Management of National Agencies from the State Council, the National Energy Administration was founded at a Deputy Ministry level, under the management of the NDRC. The NEA was founded on the basis of the former NDRC Energy Bureau, where I used to work. With our entire staff transferred from that bureau, the newly founded NEA upgraded and expanded upon its former duties.

The former and current administrators of the NEA, Mr. Zhang Guobao and Mr. Liu Tienan, are also vice chairmen of the NDRC. The office of the NEA is located within the NDRC complex.

In January 2010, to strengthen strategic planning and the overall coordination of the energy sector, the State Council decided to found the National Energy Commission (NEC). Prime Minister Wen Jiaobao is the director of the NEC.

The NEC is responsible for formulating national energy development strategies, studying key issues related to energy security and energy development, and providing overall coordination for major events in domestic energy advancement and international energy cooperation.

The NEC is a high-level coordination organization. The posts of the NEC General Office director and vice director are respectively held by the chairman of the NDRC and the administrator of the NEA. The General Office’s daily work is undertaken by NEA.

There is a growing concern, as China continues to expand, that it will not have enough energy to fuel its growth. What steps are the authorities taking, by implementing strategies like the 12th 5-Year Plan, to increase supply while efficiently managing market demand?

To solve the problem of increased energy consumption, we need to ensure supply while controlling demand as much as we reasonably can.

In order to ensure the supply of oil & gas, firstly we need to keep domestic oil production stable. Second, we need to enhance natural gas exploration and increase its production. Third, we plan to conduct exploration experiments in unconventional gas (such as shale and coal bed methane), attempt to make a breakthrough and to achieve commercial exploration. Last but not least, we would like to further international collaboration and continue to import oil & gas resources.
In order to control the demand for oil & gas, on the one hand, we need to adjust the structure of our economy and change the pattern of economic growth; on the other hand, we need to utilize alternative energies in communications and transportation—for example, we must encourage the development of electric vehicles and electric drive rails in order to decrease the amount of oil used in transportation.

In a recent address to the National People’s Congress, prime minister Wen Jiaobao gave an overview of current government initiatives. The expected GDP growth rate for 2012 is set at 7.5%, which demonstrates our resolution to slow down our growth and adjust our structure.

During the 12th 5-Year Plan period, we believe that we can ensure the stability of our oil supply. Furthermore, at the time we drafted the details of the Plan, we carefully studied the issue of balancing supply and demand.

The Reform & Opening Up policy brings opportunities for the Chinese oil & gas industry to learn from advanced international companies. Through learning, our industry has improved in terms of technology, finance, management, and ideas.

What have been the benefits of China’s “Reform & Opening Up” policy on the oil & gas sector thus far, and what should be the role of foreign cooperation in this industry today, in helping China to implement new technologies and international approaches?

During the last 34 years of Reform & Opening Up, the Chinese economy has developed at a very rapid clip—a great variety of sectors in our society have significantly evolved. The Reform & Opening Up policy brings opportunities for the Chinese oil & gas industry to learn from advanced international companies. Through learning, our industry has improved in terms of technology, finance, management, and ideas.

In 1982, CNOOC was founded. In the same year, it started to invite international bidding and tendering. From then on, CNOOC has been learning technologies and management techniques through cooperation with foreign companies.

In 1988, China dissolved the Ministry of Petroleum Industry and founded CNPC. From that point on, government and business have been separated in the petroleum industry.

In October of 2000, Sinopec went public in Hong Kong, New York, and London. Going public not only brought capital for Sinopec, but also helped it to improve its company structure and management practices. Presently, the three main national oil companies have all gone public internationally.

The above three major events were precipitated under the auspices of Reform & Opening Up. I should say that without the policy, there would be no development of within the Chinese oil & gas industry.

Today, China’s oil industry is quite mature and our technologies are competitive. Based on our national companies’ capabilities and strength, we can conduct exploration in most of the oil & gas fields in China. However, I think there are three main points that we should continue to learn from foreign entities.

The first point is to learn the technology of shale gas exploration. The US has garnered great success in the shale gas field, and China has abundant quantities of this resource. We hope that by importing advanced foreign technologies, we can accomplish the commercial exploration of shale gas.

The second point is to learn to economically exploit difficult-to-produce reserves. Today, when exploiting certain reservoirs, such as low-permeability oil fields and high-sour-gas fields, we cannot achieve much profit by utilizing current domestic technologies. We need to learn from other countries through international cooperation.

The third point is to learn deepwater oil and gas exploration and development technology. The exploration of deep-water oil is highly risky, and requires big investment and a high level of technology. In this aspect, we have much to learn from western countries.
Do you believe that China will be able to replicate the shale gas revolution of North America?

I participate very deeply in this discussion. I was recently a participant in a report on how to develop China’s shale resources, which has been sent to the desk of top leaders. And the outlook is positive: I think China is on the verge of releasing a breakthrough policy on shale gas quite soon. Officials will significantly open up the industry—which is what we need to succeed.

We must develop the domestic market, or face significant difficulties. Look to the figures: China produces 4Mn BPD of oil, but consumes 9Mn BPD. That is a gap of 5Mn. Chinese companies have acquired a wealth of resources from outside of the country, but the fact is that the largest share of our imports comes from trading. Only a small percentage of the oil that reaches China from abroad is secured by our NOCs. Company growth, and energy supply security, are not the same. These are two trends on different tracks. And yet, ten years ago—and even now—many people think that the Chinese are venturing to international markets to secure supply for the domestic market. This is not true!

Many believe that a stronger reason for Chinese NOCs to go abroad is to learn more about international E&P approaches. For example, CNOOC’s Eagle Ford shale play should be able to teach the company much about the international community’s approach to shale development. Would you agree?

Actually, I disagree with this viewpoint. This is a proliferation of this ‘United China’ thinking, that we as business people are moving away from. Shale gas extraction technology is invented, operated, and managed by service companies—as we have mentioned—not by the oil company. Chesapeake, for example, is an oil company, not a service company. On the contrary, it employs service companies to do the cutting-edge work.

Why buy a part of Chesapeake’s shale asset to learn about the technologies in use there? We can spend much less money, and take on much less risk, to hire the services company to come and provide the same work here. We went to Eagle Ford—and, to speak of larger trends, Chinese NOCs are going outside China—in order to grow our business. We found that Chesapeake could benefit from our investment, and, because of the mature approach in the North American market, our profit margins could be higher. It is a matter of pure business!

Ten years ago—and even now—many people think that the Chinese are venturing to international markets to secure supply for the domestic market. This is not true!
Do not be afraid of Chinese oil companies’ overseas investment. This trend is something that can elevate the entire industry.

It is not a matter of bringing knowledge back to the country.

The evolution of Chinese businesses interestingly mirrors the recent history of the world. After World War I, a ‘winner is king’ approach was adopted, wherein the winners of the war felt they had the innate right to persecute the losers, to take their land, to impose large penalties, etc. World War II, subsequently, began in large part because Germany—a loser in World War I—was not pleased with such an approach. And, after World War II, the order of the world was reorganized by national sovereignty: that is, country interests are the highest objects, and they should not be imposed upon by the loss of a war. This began the conception of ‘country is king’ rather than ‘winner is king.’ War penalties should be imposed only by one-on-one negotiations; winners have the duty to help losers, and losers retain their land.

Today, the trend has shifted again. Today, human rights—the rights of individuals—are higher than country rights. The Chinese have not yet developed this notion as completely as the West: but it will guide our future direction.

Oil & Gas ties into these concepts because before, we believed that if we hold on to our reserves, then we would be secure. This is no longer the case. For example, if we own reserves in Libya, can we move them to China in the midst of humanitarian crimes? Absolutely not; the world would not allow it.

China is now the leading energy consumer in the world, and its status as such will remain for the long-term, foreseeable future. There is no doubt about that.

After the industrial period, energy consumption became directly related to quality of life. The more energy consumed, the better life a country could provide for its people. There is also no doubt about this. China is growing, and the Chinese want to improve their life standards. Energy use, therefore, will continue to grow.

However, the Chinese energy structure is the highest CO2-containing energy structure in the world, due to our 70% reliance on coal within our energy matrix. Worldwide average gas consumption is about 24%; in China, it is between 3-4%. We understand that gas is the cleanest major, reliable energy source available. For sure, our country will improve our gas ratio—but it is a difficult challenge.

Firstly, in terms of conventional gas reserves, China is not a rich country. Conversely, it is estimated that China has a huge unconventional base—but we are just starting exploration in this niche. For instance, we began our CBM activities more than 15 years ago, but many would say that this initial trial was a failure, despite favorable government policies. We need to do better this time.

CNOOC believes that gas will be increasingly important here, and that the gas industry has a bright future in China. We are the first in our country to say that, while oil & gas are of similar importance, we will emphasize gas. We said this over 20 years ago. In implementing our strategies in this respect, we began LNG importation; today, we are the major LNG importer in the country. 80% of LNG that comes into China arrives through our channels. We are also an active participant in shale gas exploration. We have discussed Chesaapeake—this is just one indication that we believe shale gas is the future.

What is your final message to our readers?

Do not be afraid of Chinese oil companies’ overseas investment. This trend is something that can elevate the entire industry. Our participation in the international oil business will increase the whole world’s supply. Chinese NOCs do not, and cannot, bring what they produce overseas back to China directly. This means that our participation in international projects will directly benefit local markets. Global supply grows more secure with our involvement; indeed, because of energy geopolitics, no single country can be secure unless the whole world is secure.
Mr. Qiu, you were a co-founder of Maison E&C, the firm that WorleyParsons acquired to expand its business in China in 2004. What do you believe made your company an attractive acquisition target, and what has driven the development of your operations in the ensuing 8 years?

Actually, it was not only Worley (at that time, just Worley) that approached Maison. Another company of similar size also approached us. At the time, Maison consisted of approximately 200 - 300 employees. We decided internally that if we wanted to develop our business to the next stage, we needed to move past the bottlenecks associated with our status as a private company.

There were two options: one was Initial Public Offering (IPO), and the other was to be acquired. We decided upon the ‘acquisition’ route. So, we compared the bidders, and found that their offers were very similar, but Worley was much closer to us in particular regarding the strong customer orientation and flexibility in finding the best solutions.

From the beginning, our culture; practice and systems had an international focus, e.g. we had Western style accounting practices and all of our operational systems were bilingual.

The story of our growth from that point is founded on our people and our customer focused culture. These things are easy to say, but difficult to truly implement in a daily working environment. I remember the day that all five shareholders of Maison sat down together to plan the direction of the company. We thought about the factors that might make our business a success. So from that first day, this company has had a very customer-focused culture. We pride ourselves on our quick reaction and responsiveness to client requests, and find this essential and very crucial.

From the beginning, too, we cultivated a localized approach to staffing the company. We had only one expat — our American co-founder — in the management of the business until 2004. To this day, we try to staff our management roles with quality Chinese employees, rather than bringing in expats who may not have a strong understanding of Chinese business practices and culture. So 95% of our staff is local now — although we do maintain about 100 expats in the mix to broaden and diversify our capabilities. We hire strong people, and we retain them: particularly in senior and middle management positions, where our turnover rate is very, very low. Several of our top people have been a core team with us for the last 13 years.

Culture and localization is the key, however another important factor is selecting the right niche – between a Design Institute, and a large Multi-National Company (MNC). Furthermore, we believed, and continue to believe, in being international and local simultaneously.

An important move for us was to develop in-house engineering. At the time, this was quite groundbreaking as most of our international competitors sub-contracted the engineering to the Design Institutes while they retained management control over the projects. We acquired a Design Institute, obtained a license, and built up the in-house engineering capability. We currently have over 1600 people on our design and engineering team.

After merging into the WorleyParsons group we added workshare, however, at the time of the global financial crisis, we began to consider that as we are in China, why didn’t we cater for Chinese clients investing overseas? We found huge opportunities in working with Chinese companies and they need assistance in executing projects in Australia, Southeast Asia, Latin America, North America, Eastern Europe, Middle East, etc. Projects overseas are often done quite differently to those in China and WorleyParsons China is able to help bridge these cultures, practices and standards and codes.

Within China, foreign engineering firms need to offer Chinese clients something they don’t have already, or they will
prefer to use their own service entities. For international companies, that usually mean offering complex technical expertise or an integrated service with a robust system as, by and large, the Chinese service companies don’t have this capability.

Another interesting aspect of our development has been that, from 2003, we have offered what we call high-value engineering (HVE). This practice focuses on a partnership with other WorleyParsons project home offices, to offer drafting and engineering facilities in China to sustain and support overseas projects with competitive prices and still maintain the quality. Our first such undertaking was for a European oil giant’s project in UK. Most of the design work was actually done in China — a fact that probably few people know! Over the following nine years, we became quite familiar with U.S., British, and Australian code and practice standards. Now, when a Chinese client wants to do an overseas project in say for example Australia, we already have proven experience in design work for HVE that we can demonstrate.

Many of our competitors select India, the Philippines or Mexico for their HVE location; WorleyParsons, on the other hand, selected China. This puts us in a particularly strong and advantageous position when we work with Chinese clients who need to meet an international standard on given projects overseas.

You have mentioned that this company seeks to find an optimal point between globalization and localization. Denis Lucey, Asia and China Regional Managing Director of WorleyParsons, has further said that the China operation finds an optimal point between profitability and sustainability. As country president, how does your management approach reflect these happy medians?

As regards the optimal point between globalization and localization, I would make the following comment: after WorleyParsons acquired Maison, we integrated more systems and tools, more IT infrastructure, more expertise, etc. As an international EPC, you need to consider the benefits of your global organization. You have to remember that global access is an advantage, and that you are not isolated in China. For instance, we can easily ask our colleagues in the U.S. for support if we need it. In the days of Maison, we did not have this kind of support system — and, while we may have lost some efficiency as we grew, we had become members of the large family of WorleyParsons. As members, we implemented the global structure of risk management, integrity management, knowledge management, etc., and this was conducive to creating a large but healthy organization. Indeed, we needed to implement these structures to facilitate our growth.

In some cases, it is beneficial to think locally; in other cases, thinking globally can offer a huge advantage. The balance point is key: if you move to one end, you will see that you are very safe, and very secure, but your efficiency and agility are dropping off to unacceptable levels; on the other end with pure localization, like certain local companies, there is often a lack of system and financial controls, contract reviews and risk management, etc. Whilst his frees your people from the rigors of administration, it is a risky and inferior way to grow.

In terms of profitability and sustainability, I always cite a formula: profit is the functional relationship between total revenue minus total cost, divided by risk. Sometimes, you might think only of your revenue and costs, but there are instances when, even though you maximize revenue and lower cost as much as possible, poor risk management renders your profitability unsustainable. Perhaps your profits are strong one month, but weak for the next few.

As you grew, you began to implement various global WorleyParsons structures and practices — something you never had at Maison. How do you ensure that you don’t lose anything in the process, such as agility and maneuverability?

Clearly, as I have said, we did sacrifice some “efficiencies” and “agility” in some areas and tasks as we grew, this was perhaps unavoidable, in the name of stabilizing our organization. As a company size increases, there are some areas where agility is often impacted. However, WorleyParsons China runs a much larger business and is a profitable operation, relying on a mix of advanced tools and systems. With quality local and expat personnel, who can harness both. So, we structure our management systems for each project: mega and large projects need a much more robust level of management and systems than smaller projects/operations, where approaches can be simplified and efficiencies achieved. Clients, too, may or may not wish to pay for larger or smaller organizational systems depending on the size and complexity of their project.

We believed, and continue to believe, in being international and local simultaneously
Honghua went public in Hong Kong in 2008 as the second largest onshore drilling rig manufacturer in the world—can you describe the main strategies that drove the company’s growth in its first decade, and juxtapose this first stage of growth with your identity as a publically-listed company today?

Before going public, Honghua laid a foundation in the land-rig manufacturing sector through its technological innovations. Targeting the international high-end market, Honghua’s technology and products were well received in regions like North America. In 2006 and 2007, the U.S. started to explore shale gas intensively and thus had great demand for rigs. Capitalizing upon this opportunity, Honghua achieved strong growth abroad before going public. This sudden success was actually a matter of serendipity, rather than a purposeful effort!

After going public, Honghua primarily utilized the funds it raised to develop two business areas. First, we allocated approximately 2/3 of our new capital to develop our offshore capabilities. Honghua began to expand from onshore to offshore. Our second area of investment was in unconventional gas—shale gas especially. I believe that offshore and unconventional are the future of the oil and gas industry. Both are full of challenges and opportunities.

What competitive advantages does Honghua bring to the offshore and unconventional niches, which are quickly becoming saturated with numerous international competitors? Though offshore is a brand-new area to Honghua, I think we have some advantages in this niche. Firstly, we can learn from the successful experiences of other companies. Secondly, we can build upon and utilize Honghua’s edge in land rig manufacturing. Combining these factors, Honghua is a rising star in the sector. Honghua’s technology boasts low costs, high efficiency, and a short processing cycle. Our work in offshore applications symbolizes the nation’s own transition from ‘Made in China’ to ‘Created in China.’

Another of our advantages lies in our ability to deliver a holistic solution to offshore clients, from design to shipping to drilling, which can save a great deal of time and cost. Honghua also streamlines the exploration and production processes for unconventional gas, by offering comprehensive services from design to equipment production. As the major power for shale gas exploration, diesel is expensive and difficult to transport. Meanwhile, the current well sites and equipment take up too much space. Honghua offers advanced equipment with higher efficiency to solve these problems. We use the gas byproduct from the oil field as fuel for oil extraction. Power stations and a power grid are constructed, and a central power station is built to provide power for the wells. This practice can save 30%-40% of the cost, compared to traditional methods. It is also energy-saving and reduces emissions.

In five to ten years, the exploration of shale gas will rely on technologies such as those invented by Honghua, instead of using diesel as power. Honghua would like to lead this transition. Our new technology will ease the dependence on diesel, and will hence spur a structural transformation in resource extraction.

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In five to ten years, the exploration of shale gas will rely on technologies such as those invented by Honghua, instead of using diesel as power. Honghua would like to lead this transition. Our new technology will ease the dependence on diesel, and will hence spur a structural transformation in resource extraction.
The development of natural gas is a clear trend in the industry. China's current consumption of natural gas is only 1/5 of that of the U.S. In 10 to 20 years, however, there will be a complete turnaround in the sector, and China's natural gas consumption should meet U.S. levels. Approximately 2/3 of China's natural gas consumption will be met by unconventional gas from both domestic and international markets. Therefore, Honghua's equipment, technology and service for shale gas solutions are very promising.

Honghua initially focused on the Chinese market, but today has offices in the U.S., Egypt, and UAE. Do you believe your clients perceive you as a global company?

Honghua is a company that is based in China, but provides products and services to clients all over the world. Last year, 90% of our revenues were derived from the international market.

Traditionally, cutting-edge oil and gas technology has originated in the West and been exported to the East. However, today, Chinese companies are themselves developing innovative new technologies for this industry, and, in an interesting turn, selling them to Western markets.

You are correct. However, I would like to note that in the oil and gas industry today, ‘new technologies’ are generally the result of tailored engineering applications, rather than breakthroughs in fundamental, theoretical research. In this context, most Chinese players in our field have already mastered such capabilities.

Honghua, as a company targeting the international market, has developed rich experience in how to integrate the advantages of both East and West. The integrated solution I earlier mentioned combines sophisticated Western technologies with our own inventions. Honghua aims to integrate the best technologies from all over the world. Only in this way can we gain recognition from the global market and become a first-class service and equipment provider.

How would you appraise the company’s financial performance over the last fiscal year?

We achieved 3.5Bn RMB in revenues in 2011. While this was a steep increase over our result of 1.9Bn RMB in 2010, our income has exceeded 4Bn RMB in the past—a figure we reached in 2008. Our low performance in 2010 is attributable to the global economic recession, and was a cost of our internationalization. In 2011, we began a swift recovery.

Our goal for 2012 is to exceed our historic peak and achieve sustainable growth. Last year, Honghua’s new orders were valued at more than 1 billion USD, and hence we have favorable conditions to achieve this year’s targets. Based on our stable development in our traditional businesses and our approach to new areas like offshore and unconventional gas, Honghua has a bright future.

What do you believe it implies about the future of the Chinese economy that, in an oil & gas sector traditionally controlled by state-owned enterprises, a company from the private sector has been able to find such success?

If we take a broader perspective, China is only one part of the global market. Irrespective of the NOCs’ domestic dominance, Honghua faces a more open market abroad. For our company, it is vital to fully take advantage of the international arena. As the NOCs are less willing to meet challenges overseas, Honghua can take the opportunity to develop globally.

Furthermore, with increasing demand for oil and gas within China, a greater burden rests on the shoulders of the NOCs and the government. The authorities now encourage both state-owned and private organizations to work together to improve energy structure. This opens a door for Honghua to develop its domestic business. In 2-3 years, when China starts to intensively develop its shale gas resources, Honghua’s experience and influence on the international market will in turn help its domestic development.

Honghua’s strategy is to first develop the international market and then the domestic market. When Honghua becomes a first-class international company, the threat of China’s NOCs will no longer be a problem.
In a 2008 interview with China Business Weekly, you stated, “The $4 billion we have invested in China is a drop in the ocean. We are one of the world’s top energy companies, and we are not doing enough.” Has your opinion changed?

Indeed, looking at the global Shell portfolio, $4Bn is a drop in the ocean. However, I would say that I have ‘graduated’ from this view; as I have indicated, I now have a more global perspective.

Besides, our business here has been expanding very rapidly. Four years ago, we had about 4,000 people; today, we have 18,000 people. In the upstream space, we have a very successful tight gas project; we also have exploration work underway in Shanxi and the Sichuan basin. There are other very interesting projects in the pipeline, but we have not yet publicly announced them.

In downstream, China’s business environment can be divided into two segments: regulated and deregulated (there are also areas roughly in between, which usually lean more toward ‘regulated’). In the deregulated segment—lubricants, for example—we are growing very quickly. We have two strong brands in this sphere, which are 100% Shell-operated. I believe that we are by far the largest IOC in lubricant marketing in China.

Retail is a regulated environment, and there we work with joint venture partners. We know that we can never be as big as Sinopec and PetroChina in retail, and we do not intend to be. However, we have a firm determination to be number one in service and quality; thereby, we can offer a differentiated proposition to customers. In retail, we are also growing very fast, and covering more and more national territory.

In petrochemicals, we have a large joint venture with CNOOC for a processing plant in Huizhou, Guangdong province. We are also working with CNPC and Qatar Petroleum International to pursue a large, integrated petrochemical, refinery and marketing opportunity in Zhejiang province. We hope we receive the government’s principal support soon.

Back to your question, although I have changed my perspective, there is always much more to be done. China has great potential, as does international cooperation with our strategic Chinese partners. There is much more to be done under my four strategic priorities, which have been fully endorsed by the Shell Group, and which we have openly shared with our partners and the Chinese government, including Premier Wen Jiabao and Vice Premier Li Keqiang.

One of the most fascinating energy stories in the world is the relationship between Shell and PetroChina—likely the most advanced IOC-China alliance. CNPC Chairman Jiang Jiemin and Shell CEO Peter Voser regularly meet. How is the PetroChina-Shell relationship unique, and different from partnerships that Shell usually ties around the world?

An interesting point is that our relationship truly exists on variae.

I always tell my people: “Let us not focus first on what we want. Let us focus first on what China needs in terms of energy, and how we can address those needs.”
ous planes. It is not just a corporate partnership. At a range of key levels—particularly in-country—we have a strong relationship. This relationship has really developed over an extended period of time, and is not accidental.

Over the last 5 or 6 years, we have developed a high level of mutual respect based on our performance and delivery, and our understanding of each other. The top executives often meet; nothing can be executed unless there is a cohesive set of prerogatives at each level, from the bottom up. Providing instructions from the top is very important, but we must achieve alignment between the lower level staff. This makes all the difference: a relationship of friendship, trust, and respect at the top; and in-country relationships in a similar vein.

Importantly, as I have said, our collaboration is also based on delivery and performance. For example, PetroChina has long been telling people: learn E&P from Shell’s work in Changbei. To me, that is the highest compliment that can ever be given to a joint venture partner.

Win-win is always easier said than done. Globally, Shell has introduced something called the “5 Behavior Imperatives.” These are behaviors that emphasize external focus, commercial mindset, delivery, simplicity, and speed. It is quite fascinating to evaluate a partnership against these five guidelines in a country like China.

I always tell my people: “Let us not focus first on what we want. Let us focus first on what China needs in terms of energy, and how we can address those needs.” Everything we do, we do in line with national objectives. I think this in itself is the answer to your question.

Lastly, I will say that one of the mentioned behaviors is critically important in China today: speed. Shell in China, together with our head office, can work and move and make decisions extremely quickly. I will give you one illustration: just two days ago, a colleague of mine was attempting to close a deal, and we needed to make a decision in 48 hours. I sent a note directly to our group CEO, asking to receive approval within the timeframe. I sent the request on a Friday evening; I received support by Saturday morning. This is how quickly we can move today.

Many IOCs are voicing concern that for all of the wealth of reforms of the last 30 years, China has not become truly open to international competition. Do you share this view?

In any of today’s growing economies—be it India, Malaysia, Indonesia, China, etc.—you are not welcome, as a multinational, unless you add value.

Therefore, if anyone wants to come to China, and bid it to open up, they will find that they have no luck. They will find a similar situation in any other developing market. The IOC will always receive the same answer: “We do not need you. We can do it ourselves.”

Because of my various external positions, I have had the chance to engage with China’s top leadership quite regularly. I tell them that the problem with China is that it is too polite! 20 years ago, the authorities met with positively everybody regarding foreign direct investment. Today, I believe they should be much more selective. They should tell the visitor what they do not want, rather than have another courteous discussion.

Today, IOCs need to bring something that the Chinese want. They can continue to complain that regulation is not on their side, but this will get them nowhere—neither in China, as I said, nor in many other places. We have talked about win-win; indeed, let’s start with win-win. Let’s earn the right to grow. Let’s figure out as a corporation, how to earn this right—rather than demand it, and waste our time.
Can you begin by offering an overview of how you believe this company can complement China’s reformation goals?

Let’s begin by first discussing China’s growth pattern. China has enjoyed very rapid development over the last thirty years, averaging GDP growth of around 10%. This advancement has obviously uplifted the living standards of Chinese people—including myself. Hundreds of millions of people have elevated from poverty. China’s growth has also benefited not only its own people, but the rest of the world as well.

However, there is a price associated with this high rate of growth: in terms of the environment, climate change, and people’s health. A few years ago, the government began to recognize that speed is not everything. We need to look at the quality of growth; we need to ensure that there is a balance amongst economic development, energy consumption, and environmental concerns. The authorities have now decided to strategically shift priorities at the national level: quality first, speed second.

Can we, as a multinational company, play a role in this? Certainly we can. I believe that there are several areas where MNCs have and will contribute to China’s advancement. We can bring more than capital: we can bring management techniques and technology.

I recently had lunch with a friend of mine, and he asked me, “What is the value of multinational companies in this market?” I replied that if we measure the impact in numbers, then money is the only one indicator. However, if we measure things a bit differently, we obtain a value that is not calculable in terms of USD. We cannot underestimate the value of management, concept, and ideas, etc. MNCs have helped transform this country’s way of thinking. This is a very real benefit of our presence.

Another element that we must never forget is talent. MNCs initially bring their own people to the local market, but then begin to localize the majority of key positions. Through this process, foreign companies identify, nurture, and develop talents. These capabilities remain in the country. My philosophy is that, even if an individual has left my company, I feel that we have at least contributed to the society at large because we helped develop this local professional.

Looking ahead, I think companies like BP can continue to play an important role. We can continue to bring management, new concepts, talent development, and technology. In recent years, Chinese technology has begun to emerge; however, in many areas, MNCs are still ahead: for instance, in niches such as deepwater, shale gas, and CBM.

Furthermore, BP is jointly developing technologies with Chinese institutions. For instance, we have a strong collaboration with the China Academy of Science. As part of our work, we formed a 50/50 joint venture in Shanghai called the Clean Energy Commercialization Center (CECC). The Chinese Academy of Science is very good at research and development; however, commercialization is equally important. The latter is the space where BP can play a role—to convert ideas into products and productivity. It is well known that between technological development and technological deployment, there is a huge gap.

China has a rich history in science dating back to ancient times, but its research capabilities have stagnated in the modern age; it has taken a backseat to the West as a manufacturing hub for Western ideas. What fundamental issues MNCs have helped transform this country's way of thinking. This is a very real benefit of our presence.
must be addressed for China to regain its prowess in research?

My personal view is that the authorities must address a number of things: the first is education. The educational system in this country certainly focuses on science—there is no doubt about that. However, the more fundamental task is to call upon students’ creativity. Currently, there is too much emphasis placed on memorization and the calculation of equations. People can be very creative if the right environment is fostered—we must create this environment in the education system.

Intellectual property protection is also very important. In the past, this has been a highly criticized issue in China. The country has done quite a lot over the last several years to improve its systems of IP protection; however, this is a vast territory, and while we may have made a lot of progress, we are not quite there yet.

We also must see government policy encourage innovation. Officials should ensure that there is enough investment in this field. They should ensure that they support the peoples’ interest in producing innovation.

The still-precarious status of IP protection in this country has lead many Western companies to think twice about opening an R&D center here. Nonetheless, BP made the commitment. Is the company unconcerned about this issue?

Different companies will of course have different approaches, based on differing viewpoints. My personal view is that eventually, China will put a framework in place to meet high international standards of protection. This is certain; it is only a matter of time. I believe, therefore, that IP is a concern, but should not be a worry. As BP, we have not encountered any major issues in this regard here in China—there have indeed been some minor cases throughout our history in the region, but they have been resolved.

We feel that bringing our modern technology to China and working with the Chinese to jointly develop ideas can help our company. It has certainly helped us already. There are also certain technological areas where China is itself quite strong. If we think about joint development, and participation in the early stages, then we can also participate in the introduction of these technologies to the world.

BP has an extensive downstream and marketing business in China, but compared with the company’s other global markets, your upstream activities are relatively limited in this market. How would you appraise the attractiveness of this region for upstream activities?

I see two elements in considering this question. The first is that China is a huge market—the world well recognizes this fact. According to BP’s latest 2030 energy outlook, OECD crude oil consumption will decline by approximately 6 million barrels a day (Mn BPD) by 2030. China’s consumption, conversely, will grow by 8 Mn BPD. In other words, the decline in consumption in the OECD countries will be more than compensated for by the growth in China’s oil appetite. Yes, BP is an E&P company, but we are an integrated company, and we have a strong downstream presence as well. As such, this downstream market, as a region set to grow significantly, is very attractive for us.

On the other hand, China is also attractive from an upstream standpoint. Recently, China’s Ministry of Land and Resources made an announcement regarding China’s shale gas potential: the Ministry estimated that China has 31 trillion cubic metres (tcm) of ultimately recoverable shale gas resources, very close to 32 tcm of recoverable conventional gas resources. If we consider the major role that shale gas has played in recent years in the energy structure of the U.S., we hope that China can achieve the same by encouraging companies to explore this potential.

However, to develop this industry here will be challenging. We can think of coalbed methane (CBM) as an example. China essentially has tried to develop its CBM industry for the past 10-15 years—however, the country’s CBM production is still very small, it has developed this niche to produce only 1.5 billion cubic metres a year. We must look at what has happened in the CBM industry, and ask ourselves what we can do differently in shale gas.

Another E&P area where we see a lot of potential is in deepwater. BP is a global leading company in deepwater, and we are interested in developing this business in China.

Hence, to answer your question quite simply: we are interested in China as a consumer market, and we are also interested in its upstream resource potential.
The past two years have been marked by GDF SUEZ’s first medium-term agreement with a Chinese NOC—a 2.6 million ton, four-year LNG deal with CNOOC—and a landmark partnership with the China Investment Corporation (CIC) across multiple businesses that will see CIC as a first step become a 30% stakeholder in your gas E&P business. How do such collaborations reflect your strategy in the region?

As recently as three years ago, GDF SUEZ had no real large-scale interactions with Chinese partners on the energy side. This happened despite the fact that we started operating in China some 30 years ago, and had 7,000 employees and 30 JVs by 2008. We mainly concentrated in fact on water and waste management projects. We have 14 million customers in water today in China; that we can compare with our 12 million customers at home in France. And we have four companies under Suez Environment in the country: one is an engineering company, one is in water distribution, one is in waste management, and the last one is concerned with power.

Three years ago, we decided to extend to our energy activities China, on top of Suez Environment activities, and several new business lines started scrutinizing the market, notably the gas market. We began discussions with various potential partners and, as you can see, what have come fastest are our deals with CNOOC. CNOOC is perhaps most predisposed to work with multinationals due to its origin. We signed an agreement to supply them with LNG, and, last October, we moved one step further and provided them with a floating LNG terminal, a first for China.

Coming to the CIC deal: CIC is an investment organization, and for us, they are a financial partner. Their target is to invest by taking minority positions, and generating adequate returns, in various assets worldwide. You can see that the way they spend their money is a bit like hedging their different positions by utilizing capital from the reserves of the Chinese state. First and foremost, CIC’s stake in GDF SUEZ is a friendly, minority position.

GDF SUEZ offers a very interesting and different platform for investment. Why? Because we are active in many different businesses, and we are present in 70 different countries worldwide. We decided therefore to engage in a global partnership.

There are three pillars to this partnership.

The first pillar is that we look, on a regular basis, at their pipeline of projects and our pipeline of projects, as well as what is going on in our markets, and decide if we can do something together that is going to be beneficial to both parties. This covers all geographies, and all our GDF SUEZ businesses.

The second pillar is that CIC grants us access to financial
resources or partners. This means that they can offer capital themselves, or they can link us to other possible sources. This summer, we signed for instance a deal with ICBC, China’s largest bank—and this is a direct consequence of our work with CIC.

The third pillar involves the fact that, at this juncture, CIC knows us very well. We have had extremely regular exchanges for a year. CIC understands exactly which kinds of technologies we have, and which kinds of projects we are capable of. They also know where China itself stands, as they have close links to domestic companies at home. They have therefore accepted to give us access to various people, with the understanding that we can partner with these people to do projects here, and later partner with them outside of the country. If we go outside of China with such partners, CIC can join the group as financial investor.

Looking at the global development of Chinese companies in the gas industry, they want to secure upstream resources. The National Development and Reform Commission now wishes for domestic players to not only have the right to purchase LNG, but to be part of the project upstream if there are to build an LNG terminal in China. This is an aspect of energy security. GDF SUEZ has discussions with various partners for upstream operations, naturally including Chinese. Whether CIC will come alongside us or not, as we work with major Chinese oil & gas and power enterprises abroad, is to be discussed. The first project we have done out of our partnership involves CIC who takes 30% equity in our upstream E&P business.

Our rationale in that deal was to look for a sound financial partner and CIC is a perfect one.

GDF SUEZ wants to double the size of its Asia business over the next five years. How will you achieve your share of this mandate to expand?

You are touching on the right issue: gas expansion is indeed the name of the game. In China, we have started by delivering gas to the shores. However, our competence spans over the full gas chain, from the LNG terminals to the end users—and the gas market, as we have noted, is booming here. What, therefore, are the different access points for our expansion? Gas users, and everything that is related to gas infrastructure.

Another of our business lines is concerned with delivering energy services. This involves both heating and cooling networks, and all of the related management for industrial zones and buildings. In that, you have a lot of gas use. So we tackle it and, for instance, in heating and cooling, we have a trigeneration project that is starting in Chongqing—one of the first large projects of this kind in a downtown city in China—with Chongqing Gas as a partner. This is one axis.

A second axis is Tractebel Engineering: the engineering arm of our Group. With 3000 staff members it has experience all over the planet.

We are now developing engineering services in China, and are in discussion with different partners. I mention this because we signed, last September, a large partnership with Beijing Gas—covering all of our areas of mutual competence.

A third axis relates back to our conversation about gas infrastructures: storage, modulation, ... We are number one in such areas in Europe, and we believe that our experience—not only from the technical side but also from the operational side and the regulatory side—can be very interesting for China, at a time when China is thinking of how it can develop its storage capacity. Once again, this is not only a technical issue, but also a question of how to develop while utilizing sound business models, and creating appropriate regulation. Looking at this last point, our conversations in China are, therefore, not only with major companies, but also with the authorities. It is a matter of getting further into the China gas market.

We believe that we can really get something out of what is going on here - there is so much development! And when I say “get” it means also learn. When you are developing a segment practically from scratch in a market, you are always in a position to develop projects with the latest technologies and the latest ideas. What we are developing here builds on our past experiences for sure but also is very modern and thus we use what we do in China as examples for later projects elsewhere.

I will give you an example: in Shanghai, we treat all the waste of the petrochemical zone. There, we have our most modern global incinerator worldwide—because it is one of the last ones that we have built!
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