9. China National Petroleum Corporation in Sudan

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This case examines the internationalisation strategy of China National Petroleum Corporation (CPNC) in Africa, a state-owned Chinese oil company. It describes the unique competitive advantages of Chinese state-owned multinational enterprises (SOMNEs), and how the Chinese government plays a crucial role in the internationalisation strategy of Chinese SOMNEs. The case of CNPC's investments in the Sudan provides material for tackling a scope of questions relating to the international strategic decisions of multinationals from emerging markets. The case delves into the following issues:

- host country – the challenges of operating in the least developed countries such as Sudan
- home country effects – the role played by the Chinese government in influencing the investment location choices of Chinese SOMNEs
- the difficulties in investing in extractive sectors where international investment opportunities are restricted because of geographic constraints
- how the internationalisation strategy of Chinese SOMNEs like CNPC differs from their counterparts from developed economies
- the distinctive resources and capabilities of CNPC
- the limitations of the classic theory of the multinational enterprise (MNE) in explaining the foreign investment activities of Chinese SOMNEs.

For guidance on how to write a case analysis please refer to Chapter 1, 'Business cases: what are they, why do we use them and how should you go about doing a case analysis?'.

A teaching note for this case is available to bona fide educators. To request a copy please email roger.fon@northumbria.ac.uk

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Introduction

The need to ensure access and control of international petroleum reserves is imperative for China to satisfy the demand of its growing economy. Apart from merely purchasing crude oil on the international market, Chinese SOMNEs now seek access to and control of oil fields around the globe. Sudan was the seminal testing ground for China's global pursuit of energy resources in an adventure where the investing company and its home government acted as one.

In December 1996, Canadian oil company Arakis sold most of its interest in the Greater Nile Petroleum Operating Company (GNPOC). In its evaluation of the bids made by international oil companies, the Khartoum government had three main priorities: keeping the favourable terms of the Arakis contract to the government; ensuring adequate finances to develop the oil resources; and the construction of an oil export pipeline in a rapid fashion. After satisfying all key conditions of the Khartoum government – and offering to build an oil refinery, CNPC became the leading player in the GNPOC in 1997.[1] At the time, this investment represented the largest overseas oil project ever carried out by a Chinese company.

Unlike their Chinese counterparts, the companies from the west represented at the table found it difficult to compete as their business logics are primarily guided by the financial rewards of a business agreement. This highlights the softer budget constraints large Chinese SOMNEs face in comparison to their counterparts from the west.

A few years later, CNPC's position in the Sudanese oil industry became even more entrenched when in 2001 it bought a majority stake in the Petrodar Operating Company (PDOC) in Blocks 3 and 7 of Upper Nile State. These investments in Sudan form part of an overarching regional strategy of Chinese SOMNEs, setting the tone for subsequent entry into more oil- and gas-producing African countries like Angola, Algeria and Nigeria. In this strategy, the Chinese government plays an influential role in the location and direction of corporate strategic behaviour.

The influence of the Chinese government is largely owing to its unquestionable ownership and control of CNPC. Moreover, the close diplomatic relations between the Chinese government and the Khartoum government were a catalyst for the legitimacy of CNPC in Sudan – and significantly leveraged its position vis-à-vis its western competitors. Such close ties between the home- and host-country governments can potentially influence the strategic behaviour of SOMNEs.

Investing in emerging and least-developed countries can be risky because of relatively weak institutional frameworks. Firms operating in developing economies, including most African economies, tend to face a high degree of institutional, economic and political uncertainty. In Sudan, the existence of underdeveloped institutional frameworks is compounded by the fact that the country is mired in civil conflict. For MNEs, the capacity to navigate opaque political constraints and cumbersome regulations is pivotal.

It is under such an atmosphere that western MNEs – with relatively high expectations of corporate responsibility – were forced to abandon the Sudanese oil sector because of human rights pressures from western governments and non-governmental organisations (NGOs). How did the unique corporate character of CNPC help its strategic entry and operation in Sudan? To what extent did the role of the home government influence the strategic location of CNPC in Sudan? In what ways did CNPC's experience in Sudan alter the competitiveness and future global strategy of the company?

The company

CNPC began its operations as the Ministry of Petroleum Industry in 1978. The company signed its first offshore oil project with foreign oil companies in 1980 and onshore oil cooperation projects in 1985. The Ministry of Petroleum Industry was dissolved, and CPNC was established in 1988. In 1989, exploration and production activities started in the Tarim Basin in northwest China.

CNPC's international operations began in the 1990s. In 1993, CNPC won a contract to explore crude oil in Peru after winning the bid for the Talara oil project. This project marked the first foreign investment activity in oil exploration and production. The investment in Peru was closely followed by the signing of an oil contract with the Sudanese government in 1997. CPNC was incorporated in 1998.

A separate company, PetroChina, was created in 2000 with CNPC as its parent company. PetroChina was listed on the Shangai Stock Exchange (SSE) in 2007. In 2011, the company's global projects produced the equivalent of 100 million tons of crude oil for the first time.

Civil war and oil in Sudan

The Anglo-Egyptian treaty of 1899 recognised Sudan as an Egyptian possession – administered by Britain on behalf of the King of Egypt. The former Anglo-Egyptian colony gained independence on 1 January 1956[2] and, almost immediately, fell into a civil conflict. The failure of the Arab-led government in the north to fulfil its promises to the south of the country to create a federal structure, compounded by continuous economic and political marginalisation of the south, resulted in a mutiny by the army in the south, sparking the First Civil War which lasted 17 years (1955–1972).[3] Thus, the First Civil War was primarily a war of secession. March 1972 marked the end of the First Civil War following the signing of the Addis Ababa Agreement.[4] This agreement provided 11 years of relative peace in the country.

However, tensions still existed after the Addis Ababa agreement, as regional marginalisation persisted. This led to the outbreak of the Second Civil War in 1983, when a group of rebels in the south fighting under the banner of Sudan's People's Liberation Army (SPLA) fought an ever-distrustful Khartoum government. Although other reasons exist for the outbreak of the Second Civil

War, such as poverty and religious and ethnic tensions, the major cause was consistent regional marginalisation by the Khartoum government and the exploitation of social divisions in the south. For instance, the dissolution of the Southern Regional Assembly and the alteration of the southern borders was a major bone of contention. From a religious standpoint, the forceful establishment of sharia law in the predominantly Christian south proved problematic. The sentiment that the Khartoum government neglected the south contributed to a growing rebellion in the Darfur region, triggering a full-fledged civil conflict.

The Second Civil War also had a significant economic dimension, following the discovery of oil along the traditional north-south border. It is hardly surprising that the discovery of oil coincided with the outbreak of the Second Civil War. Following the development of oil – predominantly in the south – the Khartoum government, led by President Jaafar Mohammad al-Nimeiri, altered the southern boundaries to ensure the northern part of the country would have access to future oil earnings. This ensured the economic impact of oil on the Second Civil War was far greater as oil production by large MNEs increased considerably. Thus, the economic dimension of the war (mainly about 'who' controls the oil fields) was also important. Consequently, oil development led to high-level military decisions to gain control of oil-producing regions, thereby escalating the civil conflict – later empowering the Khartoum government's brutal military campaign.

In summary, the discovery and development of oil escalated the north-south Second Civil War in Sudan as it represented an economic reward for the Khartoum government that had aggravating consequences for the conflict. Government advances to capture territory in oil-producing regions and protect extraction activities were interrupted by disruptive activities by the SPLA, leading to a substantial rise in the economic logic of the civil conflict.

Oil development in Sudan

The first MNE to explore and develop Sudan's oil sector was the American energy company Chevron. Chevron's exploration activities laid the ground for future oil MNEs in Sudan by showing how the inherent character of the MNE would have to navigate extreme institutional conditions if oil resources were to be developed and extracted. Chevron was granted the right by President Nimeiri to explore Sudan's onshore oil potential two years after the signing of the Addis Ababa agreement in 1972.

The perception of Chevron as an ally of the repressive government in Khartoum made the company a target. In 1984, its facilities were attacked by the rebel group Anyanya II, killing three workers and resulting in Chevron suspending operations to bring Sudanese crude to the market. The insecurity in the south became too risky for Chevron. However, Chevron's operations in similarly risky environments in the oil region of Cabinda in Angola made the Khartoum government sceptical of its suspension of production – and it threatened to terminate the company's contracts if it did not resume operations. As a major private oil company seeking considerable profit margins, Chevron viewed the legacy of civil war, political uncertainty and unstable economic environment in Sudan as highly unattractive for business.

More importantly, the relationship between the Khartoum government and the United States was an uneasy one, which did not help Chevron's already weak bargaining position. Washington became worried about the establishment of sharia law in Sudan, and its welcoming attitude towards terrorist groups such as elements of Al Qaeda. This led the United States to impose sanctions and to place Sudan on the list of countries sponsoring terrorism. This, coupled with pressure from the Khartoum government for Chevron to restart production or face being expelled from Sudan altogether, led to the complete deterioration in relations between Washington and Khartoum and sealed the company's fate in Sudan. The MNE finally pulled out of Sudan in 1992.

Chevron's withdrawal and the deterioration of relations between Washington and Khartoum meant that US oil companies were barred from operating in Sudan. Other major oil MNEs like Royal Dutch Shell, British Petroleum and Total had avoided engaging in oil exploration in Sudan because of the continuing civil conflict. The lack of available options in the early 1990s placed the Khartoum government in an awkward financial position. Although the improvement of its worsening finances was significant, Khartoum was also obsessed with keeping control and finding a partner that did not interfere or question its war practices in the south.

The experience and financial strength of Chevron were replaced by a far less experienced private Sudanese company, ConCorp, that purchased concessions from Chevron at Unity and Heglig, Blocks 1, 2 and 4 for a bargain price of $US23 million. However, they lacked experience, and so sold its concessions to State Petroleum Corporation, which was eventually taken over by Arakis – a Canadian company – in 1994. Like most of the companies that operated after the withdrawal of Chevron, Arakis lacked the necessary capital, experience and technology to explore Sudanese crude successfully.

Arakis' financial difficulties led to its takeover by a Canadian counterpart, Talisman, which provided the finances needed to exploit Sudan's oil. As oil production grew, so also did oil revenues rise for the Khartoum government, which allowed them to upgrade their military capabilities through arms purchases from China.[5] Increased arms for the Sudanese army led to further destruction of villages in the south. In the case of Talisman, its shareholders were determined not to be associated with the human rights abuses perpetrated by the Khartoum government.

In the west, MNEs operating in the Sudanese oil industry were viewed as accomplices in the deaths of thousands of civilians. These pressures had significant reputational damage for Talisman. However, it was the threat by the US government to delist Talisman from raising capital on the New York Stock Exchange (NYSE) that eventually forced the company to stop its operations in Sudan. The threat of barring Talisman from raising capital in US financial markets was part of the Sudan Peace Act passed by the US Congress, alongside humanitarian support in the country.

Extreme institutional conditions and human rights pressures, therefore, had adverse effects on the western MNEs. In the end, the disinvestment outcomes of western MNEs did not weaken the Khartoum government. On the contrary, the government's financial lifeline would remain largely unchanged. Increasing demand for energy resources from China protected the Khartoum government from the effects of criticisms by western governments. China's most urgent energy demands meant CNPC would eventually dominate the oil industry in Sudan and South Sudan as western MNEs pulled out. Besides the escalating demand for energy resources, the role played by the Chinese government in outward foreign direct investment (OFDI) contributed to CNPC's high propensity for risk and consequent domination of the oil industry in Sudan.

The role of the Chinese government in outward foreign direct investment

Since the advent of the 'go global' policy at the beginning of the millennium, Chinese OFDI abroad has grown at a fast rate, making China the second-largest outward investor in 2018.[6] This high growth in Chinese capital abroad is due to the role of the Chinese government in influencing the corporate strategy of its SOMNEs.

China is home to a very high number of SOMNEs. The Chinese government's policies and influence can impact the investment location strategy of Chinese SOMNEs through ownership and control. The direct ties to and dependence on the Chinese government can lead to a high-risk propensity by Chinese SOMNEs when engaging in value-added activities across national borders – especially in locations with weak institutional frameworks.[7]

Compared to their private counterparts, Chinese SOMNEs are the largest group of investors in greenfield foreign direct investment (FDI) projects in terms of capital expenditure.[8] There is a tendency for them to invest in highly risky environments because they face only soft budget constraints given the policy objectives of the Chinese government. This means capital is available to these firms at below-market rates, with Chinese SOMNEs receiving financial support in conditions of losses, thus eliminating the possibility of bankruptcy. Higher levels of capital availability help offset the higher transaction costs that usually accompany investments in African countries with extreme institutional conditions.

Second, their direct ties to and dependence on the Chinese government mean Chinese SOMNEs engage in FDI abroad for non-market objectives of the Chinese government.[9] Geopolitical and nationalist objectives of the Chinese government are important factors driving the investment location strategy of Chinese SOMNEs, irrespective of the institutional conditions of the host location.[10] Chinese SOMNEs in the extractive sectors make investments in highly risky environments largely to secure energy resources for the home country. Furthermore, the Chinese government's selection of countries along the Belt and Road Initiative is carried out irrespective of the institutional conditions of chosen locations, thus influencing the internationalisation strategy of Chinese SOMNEs carrying out investments in these locations.

Third, direct ties to the Chinese government mean that Chinese SOMNEs also benefit from government policies that provide certain advantages that can impact their internationalisation strategy. Official government visits by Chinese leaders to African countries – a phenomenon that has steadily increased since President Jiang Zeming's seminal tour of Africa in 1995 – benefit the operations of Chinese SOMNEs. The Chinese government has also steadily increased the number of African countries that maintain good diplomatic relations with Beijing.

Good home- and host-country diplomatic relations provide an advantage for Chinese SOMNEs as their close ties to the Chinese government provide them with better access to diplomatic networks than their peers in the private sector.[11] This is particularly advantageous for Chinese SOMNEs in conditions of a high risk of expropriation of assets or expulsion by the host-country government.

The strategic entry of CNPC into Sudan following the exodus of MNEs from developed economies was greatly influenced by the unique role played by the Chinese government in the internationalisation strategy of Chinese SOMNEs. However, a key foreign policy principle of the Chinese government that ensured CNPC won market share and eventually dominated the oil industry in Sudan is the policy of non-interference.

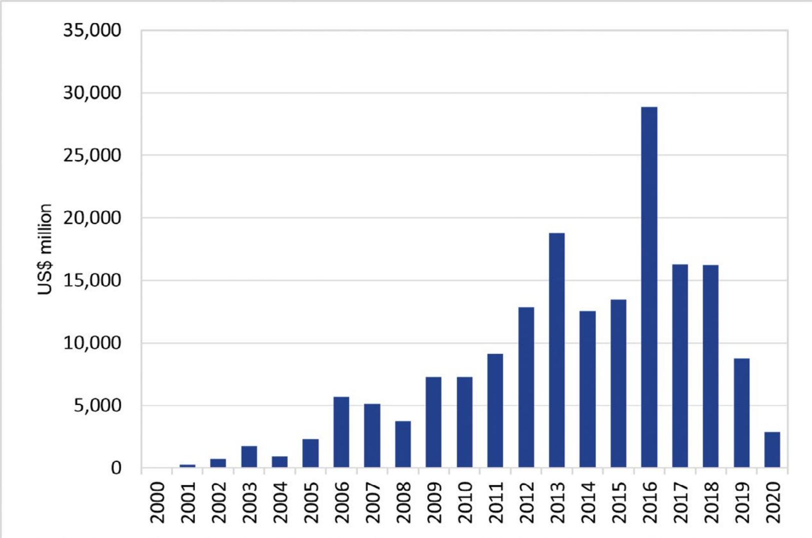
The Chinese policy of non-interference

China's engagement with Africa since the first Afro-Asian conference in Bandung, Indonesia, in 1955 is centred on Beijing's policy of non-interference in what it considers the sovereign affairs of African governments.[12] This policy implies that decisions on government-sponsored FDI projects carried out by Chinese state-owned enterprises in African countries are made without considering the quality of institutions in African countries.

The policy of non-interference is also employed in the allocation of Chinese loans to African countries, which has been on the rise since the turn of the millennium. Loan allocation decisions are made without consideration of the political institutions of recipient (borrower) countries.[13] The growth in Chinese loans to Africa in the pre-pandemic years is shown in Figure 9.1.

Applying this policy to Chinese FDI, the Chinese government uses loans to facilitate the entry and operations of Chinese SOMNEs in African countries to compensate for the 'latecomer status' of Chinese SOMNEs vis-à-vis their counterparts from the west. Notably, Chinese aid to African countries tends to be strategically integrated with FDI projects with most loans provided by the China Export-Import Bank.

Figure 9.1: Chinese loans to Africa (2000–2020)



Source: data from Chinese Loans to Africa Database, Boston University, Global Development Policy Centre

The Chinese government's policy of non-interference is in sharp contrast to the conditionality approach of western donors and Bretton Woods institutions like the World Bank and the IMF.[14] Consequently, western observers claim the Chinese policy of non-interference helps to prop up rogue political regimes and provides a rationale for Beijing to pursue its economic interests by providing aid and encouraging investments in African countries with governments with poor human rights records.

The strategic entry of CNPC into the Sudan

In the early 2000s, the withdrawal of western MNEs from Sudan's oil industry, starting with Chevron, provided a fitting opportunity for China. CNPC gradually took over Sudan's oil industry. The Chinese government's ownership and control of CNPC are clearly reflected in the firm's information to its shareholders.[15] This control was exemplified by the support granted to CNPC by the China Export-Import Bank – a state-run bank – to cover its initial oil exploration.

Considering the close ties between the Chinese government and CNPC, the Chinese state provided the financial leeway for CNPC to win oilfields in Sudan by tabling significant bids. The Chinese government has developed a close diplomatic relationship with Sudan. The relationship is also deeply economic, mainly through Beijing's provision of soft loans and grants throughout the years. From a political standpoint, China supported the Khartoum government in the UN Security Council against political and economic sanctions. In combination, deep economic and political relations between the Chinese government and the Khartoum government ensured that CNPC dominated Sudan's oil industry in the two largest oil-producing consortiums, PDOC and GNPOC in Sudan before the partition of the country in 2011. In 2000, CNPC contributed to the construction of oil infrastructure, pipelines and a large refinery near the capital Khartoum.

Like the western oil MNEs before it, CNPC had to deal with the violence and the overall insecurity of armed conflict in Sudan to access its oilfields. A case in point was the kidnapping of CNPC employees, coupled with an attack on a drilling rig by the SPLA that inhibited CNPC's activities and oil development.[16] However, despite these high levels of insecurity, government-appointed executives of CNPC, who were motivated to explore and acquire energy resources for the home market, persevered. The difficult relationship between the Khartoum government and Washington added to CNPC's woes. In line with the Sudan Peace Act, Washington limited CNPC's access to capital offerings on the US financial markets when the company decided to list shares on the NYSE in 1999 through an initial public offering. However, failure to include capital market restrictions in the Sudan Peace Act eventually allowed CNPC to gain access to US financial markets.

Although the insecurity in Sudan and initial difficulties in accessing US financial markets slowed down CNPC's international expansion, the pressures of human rights had a minimal impact on operations in the country. On the contrary, the only significant impact human rights pressures from the west had on CNPC was in helping the company avoid competition from major western oil MNEs. Indeed, accusations of human rights directed towards CNPC were met with no response, which reflects CNPC's protected position as a state-owned MNE.

The influence of Sudan on the internationalisation strategy of CNPC

Sudan was one of the first major international investments for CNPC and it had a significant impact on the company's global strategy. Sudan accounted for over 40 per cent of CNPC's overseas oil production between 2003 and 2007. However, CNPC's operations in Sudan went beyond economic rewards.

CNPC's operations in Sudan played a significant role in improving the firm's global competitiveness. Sudan provided CNPC with an opportunity to improve supervision over its subsidiaries across the different crude oil activities – ranging from the upstream activities of oilfield development to the pipeline and downstream activities of oil refining. These opportunities helped CNPC adopt an overarching strategy that exploits CNPC's strengths as an oil and construction company.

Sudan also provided a venue for CNPC to realise its comparative advantage by offering host countries oil development and infrastructure-building capabilities at a low cost. This competitive advantage was imperative to CNPC in its later acquisitions of oil fields in Niger and Chad. CNPC also improved its competitiveness by developing its technical and managerial staff in Sudan. The company benefited from its collaboration with its international partners, which included Malaysia's Petronas and the Canadian oil company Talisman, thus helping CNPC build an international labour force to manage other international activities in the future.

CNPC's operations in Sudan meant it gained valuable experience in bidding for international contracts and preparing agreements for sharing production. For some of CNPC's oil development and construction companies, Sudan was their first significant international experience. For example, the China Petroleum Engineering and Construction Company (CPECC), its main construction service company, carried out its first significant construction of oil infrastructure for Sudan's oil pipeline and refinery.[17] In addition to providing valuable experience, Sudan also augmented the organisational capabilities of the assortment of CNPC's oil and construction companies.

CNPC's experience with extreme institutional conditions in Sudan was also an important factor in altering its global strategy by diversifying its global investment portfolio towards less high-risk locations. Diversification does not mean CNPC has stopped investing in countries immersed in civil conflict, which allows the company to avoid competition from traditional oil companies from the west. However, it has ensured the company was less exposed to uncertainty in conflict-affected locations by investing in more politically stable countries. For instance, in 2012, CNPC purchased a large share in the Canadian oil firm Encana for US$2.2 billion.[18] Similarly, the China National Offshore Oil Corporation (CNOOC) made the largest investment by any Chinese oil company by acquiring the Canadian oil company, Nexen for US$15.1 billion.[19] Such acquisitions by Chinese National Oil Companies (NOCs) acted as a 'springboard' in helping them to close the technological gap with major oil companies from developed economies.

Preparing the case

In preparing the case, you might like to consider four specific questions:

1. *Firms' resources and capabilities*. How would you describe CNPC's core resources and capabilities in China? Are these transferable across national borders? Think about transferability to developed and developing economies.
2. *Host-country institutions*. Why were multinationals from developed countries unable to maintain their operations in Sudan and what were the main challenges in operating there?

3. *Role of home government*. In what ways did the Chinese government influence the entry of CNPC into Sudan?
4. *Post-Sudan*. What has been CNPC's internationalisation strategy to date? How did its investments in Sudan influence its future internationalisation strategy?

Further reading

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