GLOBALIZATION OF THE CROATIAN OIL INDUSTRY

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ABSTRACT

Over the past years oil companies from Central European countries have gone through a difficult market transformation process. They are mainly privatized, have mostly reconstructed and modernised their production and market capacities and have reorganised their businesses. By entering into mutual alliances, they try to defend the position in their respective domestic markets from take-overs from the east and west alike, and through strategic alliances such companies also strengthen their own competitive position in neighbouring markets in South Eastern and Eastern Europe.

By its character and far-reaching consequences privatization of INA has been one of major strategic decisions of the Croatian society. This has been the most important decision since the incorporation of INA. Final success of this process depends on global trends in the energy market, success of transition processes in Croatia and neighbouring countries. Croatia could not have avoided cooperation with the closest neighbours with which we share physical and territorial continuity. INA has adopted a strategy characteristic for small size integrated companies and must follow global trends; it has got a strategic partner and continues with technological development.

INA privatization concept has been defined to meet criteria imposed by the globalization process, or its European derivative – market liberalization.

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1. INTRODUCTION

Modern world can be viewed as a world of capitalism, characterised by market unification, but at the same time different from society to society depending on cultural particularities. However, the power of market and economic interests gradually makes cultural patterns and life values uniform across the world.

Global is the most frequently used word when referring to the capitalism of the last quarter of the twentieth century. Global capitalism is present in the form of globalization promoted through the ideology of neoliberalism as something which has no alternative in the modern world. Opinions about globalization vary, but they all agree on one point – it is a world process with economic and political interests of the most powerful countries in its centre.

According to many contemporary authors globalization is:

- Spread of modern technologies, industrial production and all types of communication around the world,
- Global networked economy, worldwide economic integration,
- The process of growing interdependence and connectedness of the worldwide economic activity

Globalization strengthens and develops multinational corporations having a role of a kind of invisible government which replaces the functions of national states. Modern global companies have developed and adjusted to political and other changes. Despite differences and changes in political systems, which have culminated in the modern system of political democracy, globalization and unification motives have persisted. The globalization process brings about the transfer of profit and resources for development, or wealth redistribution.

Corporation, as a form for organizing economic activity and market dispersion of capital has facilitated minimization of the investor's initial risk of investment, and has provided pre-conditions for the capital to take on its global market, financial, and development and technological role. The corporation has enabled merging private ownership of capital which provides initial capital for starting a business, and social control of private and public ownership. Corporation has provided a frame for private entrepreneurship to develop its initiative and innovation, ensuring at the same time relatively tight control of the lawful state over the corporation along with respect for public interest.

Oil corporations have traditionally fostered global approach, systematic business organization and pre-set corporative behaviour, as a regular form of business strategy and policy. In the era of electronics, computers and Internet, they have had to adapt to faster decision making and business decision implementation.

Multinational companies are real creators of globalization. Oil companies have been among the first ones to become multinational in terms of their business operations and manner of organization. The reason for such change was the fact that energy, or oil sources did not coincide with the places of major consumption of oil products. First modern corporations were established and started their development in the second half of the 19th century. The first corporation with typical features of a systematic organization was an oil company- Standard Oil. Nowadays, a century and a half after the first oil companies were established, the group of leading integrated oil corporations has again been revived. Today this group of top major oil companies comprises: Exxon Mobil, Shell, BP, and Chevron Texaco. Many countries have based the strength of their economies on the businesses of multinational companies. This applies to super forces such as the USA or Japan, and also to medium sized and small countries such as Switzerland and Denmark. Developing countries, Taiwan, South Korea, Malaysia and others have accelerated their development with the help of multinational companies opening the access to technological knowledge, organization and world market accessibility, because a national government's capability is often not enough to ensure access to technologies, raw materials, energy and market sources.

The key goal of multinational corporations is maximization of global profit. The central strategy of global corporations is creation of the world economic climate which will ensure stability, growth and high profits for such a company.

Due to the fact that the areas of oil and oil derivatives consumption mostly did not coincide with the main areas of production, since the beginning of the 20th century oil companies have overcome border restrictions and have grown into companies with global profiles. This was the time of the foundation of major oil companies, establishment of global structures, acquisition of market shares and the setting of new performance criteria.

The fact is that fossil fuels (oil, gas, coal) cover 80% of the world primary energy demand. According to projections, until 2050 the world population will reach 11 billion, and, today already, more than two billion people do not have access to modern forms of energy. Recent estimates show that until 2030 primary energy demand will increase by 55%. The highest increase – by as much as 80% is expected in the so called BRIC countries comprising Brazil, Russia, India and China.

Oil products consumption will continue to grow particularly due to the rise in the number of vehicles, from 900 million today to over two billion, mostly in Asian countries. Until 2030 global natural gas demand will increase by 43%.

Considering the above, general tendencies in the field of energy security are clear: diversification of supply routes and energy sources, greater security of pipeline oil and gas transportation and securing of sea straits for ensuring safe transport of oil and LPG.

All indicators show that in the first half of our century oil and gas will keep their top energy role involving all economic, development, military, strategic, and security consequences which will be more adverse for those having scarcer energy sources, or those not ready for urgent changes in their national strategic plans of this world's dominant industry.

General features of the world oil and gas market are: sharp increase in oil and gas demand, price growth, increasingly difficult access to oil and gas exploration licenses, growing costs of hydrocarbon reserve replacement, lack of refinery capacity.

In the globalized economy, oil industry is at the forefront in business rationalization processes which enable survival in the marketplace. Opening of markets, including also energy ones, facilitates faster growth, and the growth then enables cost reduction by leveraging the economy of scale. Small size companies from small countries adjust to these basic rules of the global market or gradually lose their positions.

2. GLOBALIZATION AND INA D.D. AS ECONOMIC ENTITY

Croatia is a crude oil and natural gas importer, but considering its own reserves, is to a lesser extent dependant on the import of these raw materials than the other South Eastern European countries. Croatia belongs to small European countries, and it is logical that in global terms INA Oil Company is among comparatively smaller oil companies. A particularity of INA's business strategy is that its market had previously been tied to the area of the former Yugoslavia, then for ten years it was primarily operating on the domestic market, and is now under changed circumstances re-entering the markets of neighbouring countries, which once comprised its domestic market.

Business strategy of a small oil company must follow global trends, particularly in the technology development. Otherwise, such companies lag behind, lose export capability, and later domestic market share, and sooner or later fall prey to takeovers, as larger and stronger neighbours eventually acquire such company that lags behind, acquiring primarily its market.

INA-Industrija nafte d.d. is the largest and the most important Croatian enterprise. INA d.d. ‘s participation in the overall Croatia’s energy production is 65%, and, therefore, the company is rightly billed as the backbone of the Croatia’s energy system. INA d.d. does business with a number of international oil and gas companies, participates in oil and gas exploration operations, provides services in exploration and development, participates in the refinery upgrade, and finally sells a rang of more than 700 own products. INA’s business strategy is characterised by the careful adjustment to the influences of the global oil market, entering the globalized oil market through international oil and gas exploration and production projects, and defence of the leading role in the refining and sales of oil products on the domestic market.

Core activities of the company are oil and gas exploration and production in Croatia and abroad, refining and wholesale and retail sale with 433 sales points in Croatia and 49 in the region.

For a number of years INA d.d. has been the top Croatian company in terms of total generated income, and export. INA d.d. parent company and INA Group employ a total of 10,290 and 16,114 people respectively.

The basis of INA d.d. business operation[1] is a focused oil and gas exploration and production portfolio, refineries which are strategically positioned in attractive markets, first-rate retail network, good financial results, an experienced strategic partner – MOL.

[1] Idem

Table 1 Financial results of INA Group for 2007/2008

INA Grupa - financijski rezultati (IFRS)	2007. mil kn	2008. mil kn
NEPREKINUTO POSLOVANJE		
Neto prihod od prodaje	24.095	27.144
EBITDA	3.305	3.564
Dobit iz osnovne djelatnosti	1.537	1.310
Neto financijska dobit (gubitak)	105	(780)
Dobit financijske godine od neprekinutog poslovanja	1.278	352
Gubitak financijske godine od prekinutog poslovanja	(409)	(1.450)
Neto dobit/gubitak	869	(1.099)
Neto novac iz poslovnih aktivnosti	2.416	2.629

Source: INA, www.ina.hr (Accessed 01.03.2010.)

Domestic and Russian gas cover 60% and 40% of Croatia's gas consumption respectively. In addition to other consumers, around 600 households use natural gas. INA refineries process and refine around 700 thousand tons of domestic oil, which covers approximately 20% of the demand, the rest is imported oil.

INA d.d. competitors are large petrochemical companies which are present in the entire South Eastern Europe including MOL, OMV, Lukoil and Hellenic petroleum. Regional players – INA, d.d. Group, NIS and Petrol generally hold major position in refining and sales in the domestic market, and to a lesser extent in foreign markets. Major international oil players do not have significant position in the said region.

Table 2 Financial results of regional companies for the first three quarters of 2009

Ukupni prihod (mil €)*	'08	1Q'09	2Q'09	3Q'09
OMV	25543	4291	4113	4719
PKN ORLEN	22531	4375	3769	4440
MOL	14066	2147	2442	3397
HELLENIC	10131	1593	1567	1729
INA	3758	608	665	678
PETROL	2900	555	549	614
Neto dobit (mil €)**	**'08**	**1Q'09**	**2Q'09**	**3Q'09**
OMV	1374	40	144	283
PKN ORLEN	- 179	- 245	263	224
MOL	563	- 390	624	48
INA	49	- 77	148	- 94
HELLENIC	- 108	35	107	62
PETROL	- 54,8	11	14	10

** Aggregate turnover (mil Eur)*
*** Net income (mil Eur)*

Source: Data taken from financial statements of the companies

3. STRATEGIC INA-MOL PARTNERSHIP AND FUTURE COMMITMENT

At the beginning of 1990s most Central European countries had national oil companies which were state-owned. During the wave of the oil industry privatization and reconstruction which was taking place in the circumstances characterised by low oil prices in the middle and at the end of 1990s, most Central European oil and gas companies were privatized until the beginning of the 21st century. Companies privatized until 2002 include: Austrian *OMV*, Polish *Orlen*, Czech *Unipetrol*, Slovakian *Slovnaft,* Hungarian *MOL* and Slovenian *Petrol*. Each of the mentioned companies is the leader in its respective domestic market, although other companies also operate on each of these markets. Thus, each of the Central European countries can be said to have a relatively privatised and regulated oil products market. [2]

Therefore, in its production structure, INA is the most similar to an integrated oil company, with strong upstream segment, oil refineries producing a range of oil

[2] Central and Eastern European Refining and Petrochemical 5th Annual Roundtable- Proceedings, World Refining Association –INA- Industrija nafte, Zagreb, 1-2 October 2002.

products and lubricants, and the petrol station network. According to its size and the scope of operations it is a medium sized integrated oil company.

Main route for supplying oil to most Central European countries is import from Russia, except for Austria, Slovenia and Croatia, which all meet their import needs on the Mediterranean market with oil mostly coming from the Middle East (Dekanić et. al., 2003, 470).

Oil companies from Central and East European countries are spreading their influence, either by participation in the privatization process in neighbouring countries or by entering into formal or non-formal strategic alliances. This shows further determinants and energy market privatization. In such a privatization governments typically retain a significant ownership with the so called golden share, by which they ensure decisive influence of the government in preventing full take over of the national oil company and avoid a loss of identity. In addition, the companies carry out business restructuring accompanied by cost reduction, business quality improvement and technology development, particularly in the refining segment. Central European oil companies announce their penetration into the markets of South Eastern and Eastern European countries (Bosnia and Herzegovina, Serbia, Montenegro, Ukraine, Bulgaria). By strategic partnership and alliances the companies try to defend their respective domestic market from the expansion of major players from the east and west alike. In the wave of economic development they have managed to basically reconstruct their businesses and prepare for further expansion which is expected in the future.

Central European region does not have any significant energy reserves, or potential resources, and oil companies are primarily focused on refining and marketing. INA is a company which has strong capacity in oil and gas production, and is increasingly oriented towards exploration in other parts of the world.

INA was 100% owned by the Republic of Croatia which proposed the model of privatization with strategic partnership. The privatization rules included the obligation of the partner regarding acceptance of INA business strategy, instead of any voluntary and unannounced business decisions of the strategic partner after the purchase of shares. The strategic partner had to accept allocation of funds to investment projects of vital importance for development of INA. The main precondition for carrying out privatization was determination of INA's asset value. For this purpose at the beginning of 2001 a consulting consortium was retained for the value assessment and privatization model recommendation. During June 2001 in

Croatian mass media it was published that according to the foreign consultants' assessment the value of INA increased by hundreds of millions of USD in the period between 2000 and 2002. The reasons for such value increase were favourable country' credibility with effects on risk and interest reduction, rise in oil prices, elimination of oil products price disparity and successful business restructuring, and cost reduction along with income growth. INA entered the year of privatization with such favourable results. INA share capital was divided into 10,000,000 ordinary shares (nominal value of one share was HRK 900.00).

When on 10 July 2003 public offers were opened at the Ministry of the Economy it was a surprise: for 25 per cent plus 1 share stake OMV and MOL offered 420 million and as much as 505 million dollars respectively. Moreover, they both stated that they accept the so called Social Clause stipulating that in the following three years there will be no firing in INA, and furthermore that they accept the survival of both INA refineries and strategic plan of development envisaging a billion dollar investment in the development of core businesses of INA. By acquiring 25% plus one share MOL became INA's strategic partner, and INA become a part of an integrated regional partnership in the oil and gas industry, which consists of MOL, INA, Slovnaft and TVK. October 2008 was deadline of MOL's public offering to take over INA. By the payment of cash to shareholders and transfer of shares deposited during the public offering MOL has increased its ownership stake to 47.16%.

MOL-INA strategic partnership has a unique position in the Central European oil market, with leading market shares in Croatia, Hungary, Slovakia, but also in Bosnia and Herzegovina and the Czech Republic, and is strategically positioned for further development in the entire Central Europe. MOL, INA and Slovnaft aggregately have refining capacity of 450,000 bbl / day and more than 1,200 petrol stations in nine countries.

MOL helps INA with advice from a company which has undergone transformation from a state owned company into an effective, market oriented and competitive company. Coordination of market activities, exchange of know-how, and implementation of joint projects will help INA and MOL Group's potential growth in the region.

3.1. Joint projects:

• Support to the Refinery Modernization Programme

Strategic partners have launched an extensive project for modernization of INA's Sisak and Rijeka refineries. This 900 million dollar worth development project will facilitate implementation of the state-of-the-art technology according to standards applied in the Slovnaft and MOL refineries. After the Sisak and Rijeka refineries modernization, the quality of products will conform to the highest European standards. This project, which should ensure INA's place among the technically most advanced refiners in the region, comprises refinery capacity expansion and reaching EURO V quality standard. MOL's experiences gained through the modernization of own refineries are a valuable contribution to INA in implementation of the programme for the modernization of its two refineries.

• Development of the regional retail network

Mutual acceptance of fuel payment cards which can be used on INA and MOL petrol stations. The partners have designed a marketing strategy for the entire South Eastern Europe region which includes the overview of the regional retail status.

• Integrated SAP system

In 2007 INA stabilised the SAP system and improved process and organizational pre-conditions for more quality SAP support, also relying on MOL's previous experience regarding the implementation of an integrated SAP system.

By the SAP system implementation INA, d.d. has become stronger and more successful in terms of knowledge and capabilities. In the last four years it has significantly increased its goodwill, and has become more competitive and more competent for the fight with other regional players.

• Other areas of cooperation

INA and MOL are jointly considering possibilities for future cooperation in international projects in the field of oil and gas exploration. Cooperation of the two companies has lead to the joining of human and financial resources which then results in improved effectiveness. In exploration and production activities MOL supports the use of INA's expertise accumulated on domestic and international upstream projects.

4. CONCLUSION

In the volatile oil market, in tough competition with oil giants which are still the leaders of global industrialization, and in the climate of general geopolitical insecurity, small and medium sized oil companies must implement carefully considered business strategy. Under such circumstances effectiveness, constant struggle to cut costs and careful choice of strategic partnerships and regional market appearance become survival imperative.

By its character and far-reaching consequences privatization of INA has been one of major strategic decisions of the Croatian society. This has been the most important decision since the incorporation of INA. Final success of this process depends on global trends in the energy market, success of transition processes in Croatia and neighbouring countries. Croatia could not have avoided cooperation with the closest neighbours with which we share physical and territorial continuity, and possibility for strategic alliances, strategic partnerships and consequently the possibility of the model of joint business operation at an economic optimum in the globalised environment in which the economy of scale has revised some historical paradigms about the importance of national borders. The so called liberalization process is not a breeze, but a hurricane of quick changes which in countries in transition hits the entire energy market (Dekanić et al., 2003, 494).

INA has adopted a strategy characteristic for small size integrated companies and must follow global trends; it has got a strategic partner and continues with technological development. Otherwise, such companies lose their export capability and then also domestic market share, and sooner or later they fall prey in take-overs, because a larger and more competent neighbour sooner or later acquires a company which lags behind, taking over primarily its market.

Over the past years oil companies from Central European countries have gone through a difficult market transformation process. They are mainly privatized, have mostly reconstructed and modernised their production and market capacities and have reorganised their businesses. By entering into mutual alliances, they try to defend the position in their respective domestic markets from take-overs from the east and west alike, and through strategic alliances such companies also strengthen their own competitive position in neighbouring markets in South Eastern and Eastern Europe. INA privatization concept has been defined to meet criteria imposed by the globalization process, or its European derivative – market liberalisation. However, how to fully use such processes to the benefit of the company and the country is still an open issue.

Privatization of energy companies is closely connected with the energy market deregulation. Energy market deregulation and privatization of energy companies represent two segments of a unitary energy market regulation system which had carefully been developed in the European Union for many years now. Its acceptance and integration in the national economy, is perhaps the most sensitive part of the transition process and preparation for joining the European Union.

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