

McKinsey Quarterly

OIL & GAS PRACTICE

The outlook for Libya's oil sector: An interview with the chairman of the National Oil Corporation

Shokri Ghanem explains his hopes to expand the role of the private sector and to separate the functions of regulator and operator.

Ivo Bozon and Giorgio Bresciani



Since the day in 1968 when Dr. Shokri Ghanem took a post at Libya's Ministry of Petroleum, he has maintained a high profile in the Middle East energy scene. An economist, professor, and veteran of the oil industry and the public sector, he currently serves as chairman of Libya's National Oil Corporation (NOC). Director of OPEC's¹ research division from 1993 to 2001, Shokri Ghanem also led the organization's secretariat for three years. He then returned to Libya, where he was prime minister before returning to the energy sector. In this interview, conducted in his office in Tripoli, he spoke with Ivo Bozon, a director in McKinsey's Amsterdam office, and Giorgio Bresciani, a director in McKinsey's Milan office, about the future of energy pricing, the operation of national oil companies, and their changing relationship with the international oil majors.

The Quarterly: *How do you view the fundamentals of the oil market, given the recent volatility of oil prices?*

Shokri Ghanem: As you say, the price has been very volatile over the last couple of years—it hit a high of \$147 in July 2008 and it has been as low as \$30 during the [recent] global economic crisis. Over the last six to nine months, however, it has stabilized, with the help of OPEC intervention, in the \$60 to \$80 range. Today, the short-term price level is less about fundamentals—though supply and demand obviously play a part—and more about issues like politics, the threat of terrorism, speculation, the price of other commodities, and the dollar–euro exchange rate.

For these reasons, it is hard to predict the immediate future, but I think the price is likely to stay in the \$60 to \$80 range, probably near the top or just above, until the end of 2010, after which I can see it back over \$100. True, there is excess capacity at the moment, thanks to the economic crisis—demand has been falling in many countries, particularly for gas—but there are offsetting factors. China has many needs, notably in the transportation sector, and India and other emerging markets are also increasing their demand. The role of renewables, biofuels, hydroelectric, and other alternatives is limited. And though wind and solar may be the future, there is as yet no breakthrough to make them cost effective.

The Quarterly: *The gas market has been through even bigger peaks and troughs. How do you see the outlook for gas?*

Shokri Ghanem: With the fall in the spot price from \$16.00 per BTU² to \$2.50 to \$3.00—currently around \$4.00—I think we have entered a new era. It is not just that demand for gas has fallen, and by as much as 12 percent in some countries. In the United States, discoveries of shale gas have had a knock-on effect on the rest of the world. Qatar has opened a number of regasifying plants in Europe and is increasing its LNG³ capacity

¹The Organization of the Petroleum Exporting Countries.

²British thermal unit.

³Liquefied natural gas.

by buying new ships. All this has served to depress prices, and it will be some time before we see \$16 again. Gas, of course, is a potential substitute in power plants and has certain limited uses in transportation, on top of the familiar household demand. The spot price, moreover, only represents 15 percent of the market, and long-term contracts are still, to some extent, pegged to oil. However, I think we can expect more decoupling from oil prices in future.

The Quarterly: *What other big discontinuities do you see ahead—either on the political or corporate front—that will affect oil exploration?*

Shokri Ghanem: Well, I'm not expecting big discoveries, new fields with reserves of 10 billion to 20 billion barrels. I think the big fish have already been caught. There will be other, smaller finds that could enable the world to produce more than 100 million barrels a day in the future. The threat of political embargoes is creating a lot of uncertainty: we don't know what's going to happen with the Middle East conflict, in the Gulf, or in Iran. It will be a catastrophe if Iran is attacked.

The Quarterly: *Do you see the role of OPEC or the composition of its membership changing?*

Shokri Ghanem: Without OPEC's role, oil prices would be much lower than they are today, and that prospect is not something anyone should be happy about. A low price discourages investment, slows new discoveries, and leads to a crunch some time in the future. OPEC has been misunderstood since its inception: it used to be called a cartel, but in fact it is a group of competing nations that have to abdicate a little bit of their sovereignty. The organization has stuck together during some very bad times—when, for example, Iraq invaded Kuwait, when Iraq was at war with Iran, and when the Gulf countries were supporting Iraq against Iran. OPEC is very important, economically, to its member countries, but in the last 10 to 15 years even the West has started to understand that the organization is an instrument of stabilization.

The Quarterly: *There has been a lot of speculation about a similar group emerging for gas producers. Do you see that happening?*

Shokri Ghanem: Well, it's already established,⁴ in Qatar. Libya is a member, and I attend its meetings. So are Russia and Algeria and Trinidad. But it's a different matter as to whether it will ever have the same power and clout as OPEC. Given the importance of long-term contracts, the quantity of gas that goes to the market is limited—controlling supply and demand is therefore not easy. This new organization, though, will be a good forum to exchange information and coordinate long-term policies.

⁴Gas Exporting Countries Forum.

The Quarterly: *What role do you see for the international oil companies and national oil companies in the future?*

Shokri Ghanem: The IOCs played an important part in the history of the oil industry, going back to Rockefeller,⁵ Standard Oil, and the Seven Sisters.⁶ The emergence of national oil companies has subsequently altered the picture, with perhaps close to 85 percent of oil production now in their hands. IOCs, as a result, are now more concentrated downstream, in distribution and marketing. But their role in exploration and production remains very important because of the technology they bring. As for national oil companies, I don't think they can continue to act like government bureaucracies waiting for a budget to be handed down. Finance ministers have other priorities. In, say, 10 to 15 to 20 years, I see some sort of merger between NOCs and IOCs. NOCs will become stock companies, and IOCs will own part of them, and vice versa, with governments merely playing the role of tax collectors. The confrontation between IOCs and NOCs will diminish little by little, and the two will end up more integrated or merged.

The Quarterly: *How important are the major international oil companies to Libya?*

Shokri Ghanem: We depend on the international companies for exploration. When it comes to development, we go on our own. These are our basic policies.

The Quarterly: *Tell us more about your aspiration as a country with oil and gas production.*

Shokri Ghanem: The first small oil shipment only left Libya in 1961, and at one point we produced 3 million barrels a day. We even surpassed Saudi Arabia at that time. If that had continued, I don't know where we would be now. Then came the revolution, the embargo, sanctions, loss of investment, and nationalization. Today, we produce only about half of what we used to.

Some people say we should bump up our oil production quickly, others that we should move more gradually and leave something for the next generation. But we are determined to realize our potential. With this in mind, we have opened our doors wide, and we have signed exploration contracts with around 40 to 50 companies. About 15 have already discovered oil or gas, leading us to think we could lift our production from 1.3 million to 1.5 million barrels to perhaps 2 million. By 2015, our plan is to reach 3 million, but we will be limited by budget constraints, given that we are a government entity and depend

⁵John D. Rockefeller (1839–1937), founder of the Standard Oil Company.

⁶The seven most important oil companies in the aftermath of World War II: Standard Oil of New Jersey (Exxon), Standard Oil Company of New York (Mobil; merged with Exxon in 1999 to form ExxonMobil), Standard Oil of California (Chevron), Texaco (merged into Chevron in 2001), Gulf Oil, Royal Dutch Shell, and Anglo-Persian Oil Company (became the British Petroleum Company in 1954; now BP).

on a government allocation, and therefore will not reach that target. The potential is particularly exciting in offshore areas, where we have discovered a lot of gas already.

The Quarterly: *As a fast-growing country, how do you think your energy and power system should evolve to satisfy the growing needs of the nation?*

Shokri Ghanem: We have a number of problems. Firstly, we are completely dependent on oil income for the country, and this makes us very vulnerable. Whatever happens to oil is reflected the next day in our economy. Secondly, when our governments have a lot of money from oil, they spend it quickly. We should have learned to keep some of the proceeds of the fat years for the lean years. But most oil-producing countries, not just Libya, are guilty of having done this. Whenever they see gold glittering, they spend it.

Another problem for us at home is what people see as apparent contradictions. You sometimes invest abroad, reducing your profits. You invite foreign companies into your country and employ almost two million foreigners, yet 300,000 Libyans have no job. The government cannot be responsible for everything. Personally, I would love to see government's role as more of a regulator than an owner. That is my aim—to allow the private sector to work, in association with international companies, and to get rid of the artificial walls in the economy.

The Quarterly: *What is your vision for the Libyan NOC? How do you want to change it?*

Shokri Ghanem: We have already made a lot of changes in the Libyan NOC, including things that happened before my time. Libya is different from many other countries in that the NOC as an organization is responsible for the whole oil sector, including its policies

Shokri Ghanem



Vital statistics

Born October 9, 1942, in Tripoli, Libya

Married, with 4 children

Education

Graduated with a BA in economics in 1963 from the University of Libya

Earned an MA in economics (1972), an MA in law and diplomacy (1973), and a PhD in economics (1975) from Tufts University's Fletcher School of Law and Diplomacy

Career highlights

General People's Committee of Libya (1963–present)

- Chairman, National Oil Corporation (2006–present)
- General secretary (prime minister) (2003–06)

OPEC

- Leader of secretariat (1999–2001)
- Director, Research Division (1993–2001)

Arab Development Institute

- Chief economist and director, Energy Studies Department (1977–88)

Fast facts

Held multiple positions within Libya's Ministry of Petroleum between 1968 and 1977

and practices. There is no separate ministry, so it in effect plays a sovereign role as well as an operational one. This ought to change through the creation of a separate government ministry that would be in charge of regulation, while the NOC would become something like a holding company that owns the individual businesses. A first step should be to turn it into a stock company owned by the government; then you could divest part of it in the market. Of course, there is resistance and a variety of views—some people want a ministry, some don't; others want the stock company, others don't. So we go two steps forward and one back.

The Quarterly: *What will these changes mean for the people in the NOC—for its performance culture?*

Shokri Ghanem: The biggest challenge is capacity building. The oil industry in Libya is 50 years old, but we still need more people. And the problem is exacerbated because many of the foreign companies that have come into the country are able to pay more and are recruiting some of our best talent. But we are happy with that because whether they are working with their company or with us, it is still for the benefit of the Libyan oil sector. We put a lot of emphasis on training. In higher education, for example, we send about 100 people every year to different countries, including China, the United States, and Russia, so as to understand better the different political and economic systems.

One of the biggest problems is that over the last 20 years, our education system has become very nationalized. It stopped teaching English. So we have embarked on a huge program to teach people English in the afternoon.

The Quarterly: *In terms of technical and operational capacity as well as performance culture, how do you think the Libyan NOC compares internationally?*

Shokri Ghanem: Well, we are not Shell or ExxonMobil. But I think our performance is good. We built a very good staff in the '60s and '70s; they were highly educated, most of them in England and America, and have been working in the industry for 30 to 40 years, initially in the field, then in administration. These people were exposed to international best practice. There is probably a talent gap among the 30- to 50-year-olds, mainly because these people grew up at a time when Libya had a lot of international problems, and most of them were not able to get the right education in the West.

The Quarterly: *How important is leadership to the process of change?*

Shokri Ghanem: Leadership—notably an ability to take decisions and bite the bullet—is critical in our business. This is not something our people are always good at. During the time when we had sanctions, they were not able to mix with people from other countries, and as a result our management cadre got rather old and insular. We were not able to

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send so many people abroad. We are now trying to push younger people into the higher positions, and I think we are succeeding. The average age of our board used to be 60 to 65, but it is now somewhere in the 40s.

The Quarterly: *On a personal note, you’ve fulfilled many leadership roles in Libya. You’ve been prime minister. You’ve been a minister. What has been the biggest change in the role of chairman of the Libyan NOC?*

Shokri Ghanem: As chairman of the Libyan NOC, I’m in charge of the business that is probably the most important company in Libya, that controls or oversees the income of the country. And as I’ve said, it is in charge of the policy as well as the practice. That means a lot of problems. One is that people want to interfere, so I have to spend a good part of my time fighting or chasing people away. We are also striving to pursue an independent policy built on competition and transparency. Some people don’t like that very much, but as the chairman of this company my job is to realize the potential of the country. It is an uphill fight. Even [boxers Mike] Tyson and Mohammed Ali only fought so many rounds—you cannot keep fighting all the time.

The Quarterly: *How do you actually spend your time in the role of chairman?*

Shokri Ghanem: I would say that maybe 70 percent of my time is spent in-house, dealing with people, the policies of the NOC, and so on. Maybe 5 to 10 percent is with the top decision makers of other organizations in Libya, including the Cabinet and others in the government, whom I have to persuade to give us our budget. But in the spirit of trying to make the NOC independent, I aim to keep this to a minimum. About 15 to 20 percent of my time is spent on international business—visiting international symposia and forums, speaking to the press, that sort of thing.

The Quarterly: *What tips would you give new chairmen?*

Shokri Ghanem: The most important thing for me is transparency. And be prepared to speak your mind. Be honest in your views, and if you believe in something try to make it happen. Don’t just fight to keep hold of your job and apologize for your ideas. If you cannot implement them, you should leave. Do not fight for the chair or a position in the company. Fight for your principles. **o**

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