



Cross-border mergers and acquisitions by oil and gas multinational enterprises: Geography-based view of energy strategy



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ABSTRACT

Given that global crude oil prices are significantly dropped and business consolidation transactions are markedly increased in recent years, this paper, to date, is the first to examine the cross-border merger and acquisition strategy of oil and gas multinational enterprises. Using a fine-tuned sample of 150 large-scale oil acquisition transactions (US\$535 billion) announced by oil and gas enterprises from over 50 countries during the period 2005–2015, we endeavor to answer four fundamental research questions: *who is where, what for; who is there, why; who is where and there; and who is a serial acquirer*. To do so, we propose an integrated framework of geography-based view of energy strategy by leveraging theoretical insights from the energy, economic geography, international business strategy, and corporate finance literature. On top of that, we discuss the dynamics of the oil and gas industry, and show the remarkable trends in the crude oil prices over the past three decades, 1990–2016. Our geographic analyses highlight that state-owned oil companies from Asia and a less extent Europe have rapidly expanded into resource rich countries such as Canada and the US to secure oil reserves as well as acquire industry-specific strategic assets. This research contributes to the geography-based view of energy strategy, and discusses policy and managerial implications to sustain the world oil and gas industry.

1. Introduction

1.1. Research motivation

The Oil and Gas Industry is the most important underpinning of the world economic system for strategic reasons, such as the industrial production, transportation sector, and diplomatic security. At the same time, oil is one of the highly export traded commodities in the international market, accounting for over 10% [1,2]. In 2014, the volume of crude oil exports has accounted for nearly 8% of world exports, worth over US\$1.45 trillion [3]. The industry would foresee the incidence of sustainable investments for over US\$25 trillion (37% of world energy) during the period 2015–2040 [4]. The oil and gas trade receives a great attention from geopolitical environment of the world system, especially exporting vs. importing countries and developed vs. developing countries [5]. On the one hand, the industry is a highly capitalized sector, employing the thousands of technical forces, engineering the sophisticated petro-technologies, greatly capturing the asset and sales base, and remarkably dominating the market capitali-

zation. According to *Forbes*, there are 91 oil and gas corporations from 27 countries ranked in the global 2000 biggest public corporations–2015. In the top 20, the US-based ExxonMobil is ranked by 7th, Chinese PetroChina 8th, Netherland's Royal Dutch Shell 13th, and the American Chevron 16th, valued approximately US\$357 billion as the market capitalization, US\$335 billion, US\$195 billion, and US\$201 billion, respectively [6]. On the other hand, the industry is characterized by the minute-less speculative oil pricing, heavy sunk costs, low-margin business, high trade risk, and severe regulatory scrutiny. For instance, our simple calculations reveal that the top 10 oil MNEs earned only 5.3% of profit against their sales, which is significantly lower than the top 10 companies (excluding oil) of 18.4%, and the top 10 companies (excluding finance and oil) of 9.3% [6].

Historically, the industry has been evidenced several shocks and consolidation waves due to unstable crude oil prices, low economic growth, transaction cost of upstream and downstream divisions, and importantly, geopolitical influence. First, the industry has significantly affected and stimulated the business consolidation activities around the major oil price shocks in 1980s and 2000s. In the time, oil price shocks

Abbreviations: BRIC, Brazil, Russia, India, China; IEA, International energy agency; LSE, London stock exchange; M & A, Mergers and acquisitions; MNE, Multinational enterprise; NYSE, New York stock exchange; OECD, Organization for economic co-operation and development; OPEC, Organization of the petroleum exporting countries; POE, Private-owned enterprise; SOE, State-owned enterprise; UNCTAD, United Nations conference on trade and development; WTI, West Texas intermediate

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and economic conditions are the main causes of the stock market crash [7]. For instance, the Black Monday of October 19, 1987 was the single largest one-day decline in the US stock markets' Dow Jones Industrial Average [8–10], and the timing of the market crisis was preceded by the drastic collapse in the crude oil prices in 1986 [11]. In this direction, several energy scholars have examined the impact of global crude oil price shocks on the speculative behavior of industrial commodity prices such as aluminum and copper, and precious metal prices such as gold and silver [e.g. [12]]. Second, the industry has evidenced by the large-scale M & A deals in the western space in 1999 when there was actually a market-force toward 'rising crude oil price'. According to financial economics literature, the higher stock price valuations [13], economic shocks of different industries [14], and instability in the oil prices and other increased risks [1] drive significant amount of business consolidation transactions in the oil and gas industry. For Canadian oil takeover deals, scholars find that both energy reserves and prices affect the takeover incidence, value and performance. Acquiring companies prefer to purchase oil reserves, while target firms motivate to sell based on the market timing [2]. A classic example here is the megamerger transaction between Exxon and Mobil in 1999 for US\$83 billion, and the combined entity's subsequent acquisition of XTO Energy for US\$31 billion [15]. There are similar deals like Chevron-Texaco, BP-Amoco, and Royal Dutch-Shell.

Third, the industry has indicated an unpredictable crude oil price signaling in recent years, especially from 2010. This volatility behavior, coupled with rising production costs and negative cash flows, has intensified the market for cross-border M & A transactions in the oil and gas sector. In other words, the sector has been reported by a massive amount of oil and gas deals since 2010 when there was actually a significant drop in the crude oil price. The upshot is that, the low oil price has a negative effect on overall cash flows and employment, and also creates intense costs for both upstream and midstream oil companies. A recent example is that in April 2015, Netherland's Royal Dutch Shell has announced a merger offer to consolidate UK's BG Group for US\$70 billion [16]. In the scenario of the low oil price shocks, big oil companies will have the opportunity to improve operational efficiencies, strengthen financial indicators, and gain strategic assets and critical capabilities [see comments by industry professionals and consultancies: [17–23]]. For *A.T. Kearney* [19,20], the "geopolitical challenges and escalating costs for more complex projects have made life difficult for producers ... those companies with strong cash flow and healthy balance sheets will be able to leverage opportunities, while others will need to define strategies just to survive". In *PwC's* view [23], the "depressed commodity prices, existing leverage constraints, and deteriorating availability of debt and equity financing will encourage more companies to merge or sell off assets to strengthen their balance sheets".

1.2. The market for cross-border M & A sales of the mining, quarrying, and petroleum sector

According to the UNCTAD [24], the worldwide cross-border M & A market for the 'mining, quarrying and petroleum sector' in terms of the transaction value (number of deals), has markedly increased from US \$6 billion (204) in 1990 to US\$48 billion (366) in 2001, and further escalated to US\$154 billion (990) in 2011 but surprisingly declined by US\$28 billion (432) in 2015 [see Table 1, Fig. 1]. The sector has contributed nearly 28% of value to the world market in 2011, though it has dropped by 4% in 2015. Overall, the market has witnessed over 13000 announced transactions for US\$774 billion during the last twenty-six years, 1990–2015. Even more interesting, over 60% of transactions and nearly 80% of value have actually reported in the last decade, 2005–2015. For *Kearney* [19], number of deals (value) in the oil and gas industry has significantly increased at a rate 17% (64%), from 2072 transactions (US\$282 billion) in 2009 to 2418 deals (US \$463 billion) in 2012, and further reported by 1826 deals (US\$440

billion) in 2014 [see Fig. 2]. These lines suggest that the industry has received a significant attention not only from the price analysts and academic researchers, but also from the international press.

1.3. Objectives of the study

Although the elite body of M & A research in the finance, economics and international business literature has examined different strands of theoretical and empirical issues for mixed samples [see, for instance, excellent review papers: [25,26]], the extant literature has largely overlooked the oil and gas industry consolidations, ranging from the fundamental issues to announcement returns, post-merger financial performance, and comparative market dynamics.¹ Therefore, this paper, to date, is the first to examine the large-scale cross-border oil and gas acquisition transactions announced between 2005 and 2015. We specially consider large-scale oil deals because many investors react well to big deals [13,22] and those deals often receive a huge public attention through the popular international media (e.g. *The Economist*, *The Wall Street Journal*). Using a fine-tuned sample of 150 deals worth over US\$530 billion, announced by multinationals, national governments and investor groups from over 50 countries, we answer four fundamental research questions. Our first question, *who is where, what for*: analyzes the number (value) of acquisitions by a company from home country completed in other geographies. Second, *who is there, why*: answers the number (value) of acquisitions hosted in a country by firms from other geographies. Third, *who is where and there*: explores the effective matrix of geography-based view by unpacking the sample countries into three groups, namely, acquirer (home) and target (host) countries, only home country, and only host country. Fourth, *who is a serial acquirer*: examines the number of successive deals by a company from home country completed in host countries. In addition, we show the top 30 megadeals to deepen our understanding of the impact of global oil and gas acquisitions. To do so, we propose a new integrated framework of geography-based view of energy strategy by leveraging theoretical inputs from the energy, economic geography, international business strategy and corporate finance literature. In so doing, this research enhances our knowledge on the geographic patterns of oil and gas acquisition transactions, and contributes to the energy strategy and M & A literature.

1.4. Organization of the paper

The remainder of this paper is organized as follows. Section 2 presents several intriguing facts on the oil and gas industry dynamics, illustrates the speculative behavior of the world crude oil prices, and discusses the importance of corporate ownership and control.² In Section 3, we propose a new theoretical framework—geography-based view of energy strategy, which framed through resources, markets, institutions, and the interdisciplinary perspective of geography and international business strategy. Section 4 explains the rationale, database and selection procedure, and reports the top 30 oil deals. In Section 5, we show comprehensive results for the four fundamental research questions. Section 6 discusses contributions and implications of the research. Finally, Section 7 concludes the paper.

2. Background of the study

2.1. Oil and gas industry dynamics

Broadly, oil and gas industry encompasses three value chain activities: exploration (upstream), refining and production (mid-

¹ See, for instance, a few country-specific empirical and case studies [1,2,15,28,29].

² Owing to the 'Renewable and Sustainable Energy Reviews' journal guidelines and reader's specialization, we discuss the motives and determinants of large-scale cross-border acquisitions.

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