YPF: An argentine case of State demonopolization

By Ing. José Estenssoro

Argentina's hydrocarbons industry is undergoing essential changes stemming from a political project backed by the National Government that was once defined in terms of staging a "productive revolution" in the country. The aim of this policy, in the oil industry, is to streamline performance, encourage growth, and integrate it with the international markets. ● One substantial part of the process of change promoted by the Government is a plan to reform YPF. Created in 1922 under the name of Yacimientos Petrolíferos Fiscales ("State-owned Oil Fields"), the company was the first state-owned oil concern on the American continent and played a central role in the oil industry's development ● YPF reforms now underway have become a test case for the country as a whole. They put to test the decision-making capabilities, the will to change, and the leadership qualities of those in charge of the program. ➡

The process of deregulation of the oil industry being implemented since January 1, 1991, based on new legislation passed during the second half of 1989, entails a complete about-face in Argentina's traditional policies regarding hydrocarbons. In the case of YPF this change means returning this company to its function as a business enterprise and freeing its management from political ties and union interference. For this reason the aim of this reform is to establish YPF as a competitive, efficient enterprise on an open, deregulated market with a greater degree of competitiveness.

A New Balance

To meet those requirements, YPF will have to continue to be an integrated oil company, with its operational areas balanced and its whole organization geared towards maximum benefits. A balance to must be struck to make future profits, exploration programmes and production and refining capacity adjust to the markets the company expects to serve.

This strategic position involves important consequences for YPF: The company cannot continue to bear the weight of inefficient or non-strategic areas within its management, and this is the criterion behind the decision to offer part of its assets to private interests as well as closing, eliminating, or cancelling areas that do not add value to business operations.

All these decisions have been backed by a new legal framework drawn up by the country's constitutional authorities. Its foundations were laid by the State Reform Act (Law 23696) approved by Congress during the third quarter of 1989, a few weeks after the new administration came to power.

Three decrees (1055, 1212 and 1589) signed later by President Menem pointed to the inevitability of the change YPF had to go through, although at the time this legislation made no specific mention of full-fledged reform.

These decrees basically established the following:

(1) Marginal production areas (less than 1200 barrels/day per month) must revert to State ownership so as to be offered through competitive bidding as concessions to private firms.

(2) Some central areas, with substantial production volumes, would be offered in association with YPF to be operated by firms in a position to contribute know-how and capital in order to increase production.

(3) Production agreements between YPF and private companies must be reconverted so that contractors assume business risks, with oil produced by them remaining "freely disposable" for marketing.

This new legislation was aimed at attaining production volumes sufficient to compete on a free oil-supply market -a basic condition for industry deregulation-.

From January 1, 1991, and despite the conditions and uncertainties emerging from the Gulf War, the Argentine oil market began to operate under deregulated conditions with no governmet intervention to fix prices either for crude oil or for oil products. In accordance with this new situation, on December 31, 1989 the Executive sanctioned Decree 1778 for YPF Reform.

Recovering Muscle & Preventing Cancer

The YPF reforms aim basically at efficiency and economic common sense.

To define the reform program the starting point was a plan for analyzing the company's basic activities: Exploration, Production, Refining, Marketing, Transportation by Pipelines, the Fleet, and the Central Administration.

Assessment of each one of these areas led to the conclusion that the company as a whole suffered from a number of management, financial and technical shortcomings hindering its normal performance.

All of these obstacles lumped together resulted in an overall loss which reduced the company's market value to 4,000 million dollars, in economic terms, based on a program of re-structuring, this sure would be recoverable on the market by oil companies of a comparable size.

A thorough area-by-area study showed that all areas of the company, with the exception of Exploration, whose contribution was regarded as nil, destroyed value in different proportions and profitability potential of operations as they suffered from various levels of inefficiency. Thus reform plans do not aim at making YPF "smaller". Considering the new market conditions in which the firm must operate, the projected performance analysis showed that the company's growth had been in fat rather than muscle.

The same analysis suggested that if this fat wave to be allowed to remain, it could easily became a cancer that, as with any organism, would end by causing death.

The criteria established for the analysis of YPF's performance, therefore, made it possible to distinguish between those areas of the Company whose grouth made them effective on the market, and those which were "fat" which could end by destroying a Company exposed to market forces.

The decision to retain given assets, or to seek association in other cases with a view to securing capital and know-how from third parties, eliminating those which are a threat to survival, was based on elementary principles of business strategy and economic feasibility.

Strategic Need & Economic Value

For each one of the basic areas mentioned above it was then asked whether its activity was strategically necessary. Also whether the particular activity contributed a measure of profitability. For this second analysis an economic and financial model was developed that projected the company's performance on a deregulated market and its operation in conditions of free competitivity.

The results of these analyses made it possible to draw up a plan that including basic decisions for each one of the company's areas.

In the area of Exploration, YPF will have to concentrate its activities on the Golfo San Jorge and Neuquina basins -and on important projects.

The Cuyana basin will have to be returned to the State and YPF will have to seek association with, or assignment to, third parties for exploratory activities in the Austral and Noroeste basins.

At the same time the Company must forfeit its drilling equipment and transfer it to private hands. The same applies to geophysical equipment.

Internal improvements to be introduced in the exploration scheme must guarantee higher efficiency levels which will be expressed in a higher rate of discovery and in cost reduction per barrel of oil found.

These changes will have to yield a 20 percent profitability in exploratory activities -a figure far higher than the achieved in the past.

In relation to Production, activities will have to concentrate on the two basins mentioned above plus the Cuyana basin. Association or sale of fields in the Austral and Noroeste basins will be promoted. Internal improvements in costs, productivity and investments will have to adjust economic results of management in these fields to international standards of performance.

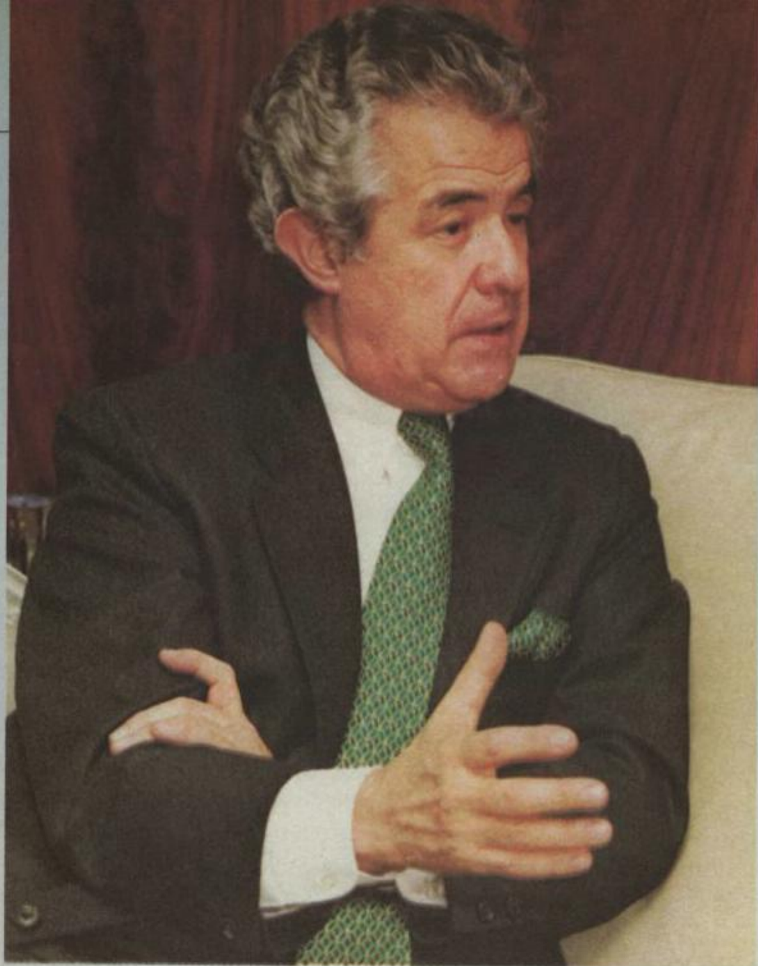
The increase in corporate value of this area is estimated at 2200 million dollars, including some 700 million dollars for income from the sale of assets.

In Refining, the proposal involves association or sale of refineries at Campo Durán, San Lorenzo and Dock Sur.

At the same time a production optimization program will be developed with a substantial increase of production capacity at the La Plata, Luján de Cuyo and Plaza Huincul refineries, with special attention given to the management program to be carried on in La Plata.

These programs must allow average cost reduction for present processing (more than 30 dollars per processed m^3) to values similar to those in US refineries.

For the area as a whole, transformation will allow an increase in business worth 540 million dollars.



The reforms will cover all of the Company's activities in the Marketing area.

The idea is -through association and the transfer of assets and operations- to introduce major changes in the area's profile, which up to now has had the following negative features: lack of a concern for the customer, poor knowledge with the market, little resilience and much bureaucratic red tape, lack of suitable costs and information systems, deficient debt-collection systems, lack of skill in negotiating with customers, and a limited product development capability. The area's transformation is aimed at eliminating distortions in the distribution system through a scheme of concessions to large distributors, the sale and/or association in storage plants and air-plants, concentrating marketing on the handling of distribution channels and major customers.

The economic impact expected from the area's reform plan will eliminate its present negative profitability, prevent losses, and result in an improvement of 600 million dollars in the company's market value.

For major ducts (oil pipelines and product pipelines) whose management has not adversely affected the company's economic performance, association with private companies at a maximum proportion of 50 percent is proposed. This sale will have no economic impact on the company's value.

As for the fleet, the proposal involves the sale of 26 oil tankers as well as the river fleet, the shipyard shop, and association or sale of the port and buoy systems. The positive impact will make it possible to increase the company's overall value by 370 million dollars, including 70 million dollars for the sale of assets.

Finally, the transformation plan foresees major restructuring of the company's central administration system, whose negative effect on the company's value has been estimated at 1,250 million dollars.

Proposals in this respect include re-designing the managerial decision-support systems; decentralization, delegating accounting and management control systems to other areas; and optimization of human resources in accordance with the company's newly planned profile. Commissary stores, clubs, movie theaters, printshops, airplanes, housing units, welfare services and similar propietary activities up to now directly under YPF managements should be sold or leased to others.

It is estimated that these changes will have a positive impact of 625 million dollars on the company's value.

More Value & Fewer Conflicts

Essentially the transformation plan proposes through all the courses of action summarized above for each one of the basic areas which go to make up the Company at present -to increase the its market value from 4,000 million to 8,000 million dollars. At the same time, the restructured company will be in a position to double its cach flow over the first five years after 1991.

Under these conditions, with a free cash flow of 13 percent, YPF will come closer to the 15 percent of companies like AMOCO, Arco, Texaco or Shell (according to data from their consolidated balance sheets) although it would still be at a low production ratio per company employee.

Obviously this transformation plan is not a target as such but rather a precondition for YPF to cease being a State-owned company and become a Stock Corporation not only legally bound by Private Law rules but also integrated into the country's overall economy. On a deregulated, demonopolized market open to the world economy and with many companies operating in the same business area, YPF too will open its capital structure to private participation and have its shares dealt on the local and the international Stock Exchange markets.

According to this program's provisions, there will be an initial placement of 20 percent of the block of shares by 1993 and then a gradual transfer of the company's control to private shareholders.

To reach this final target the Executive has submitted a bill to Congress whereby YPF's reform and privatization program is confirmed and at the same time solution proposals are contributed in response to the justifiable demands of the oil producing provinces. This project protects the vested rights of YPF, private companies, YPF contractors and concession holders, and at the same time assures the provinces of their ownership of hydrocarbons still to be found and exploited, as of the date of when the law is approved and in the areas transferred by the State to their ownership.

At the same time, the bill establishes a detailed system of payment to the provinces of all of their demands against the Central State for royalties unpaid or incorrectly paid. Once the total amounts of these debts have been agreed they will be paid in special bonds which the provinces will be able to exchange for YPF shares amounting to a maximum of 39 percent of those owned by YPF.

In any case, both YPF and the shareholding Provinces must sell these shares within a period of three years and at a proportion of at least 50 percent of the company's share capital.

What Has Been Done & What Remains To Be Done

Some of the objectives outlined at the beginning of this account have been fully achieved while others are on the way to completion.

For the first time in the country's economic history the oil market operates in a completely deregulated way, without the authorities intervening in the fixing of crude oil or oil product prices. For the first time there is a free supply of crude oil for companies operating in the refining and marketing areas. For example, during the first quarter of 1991, (that is to say, after deregulation) YPF's supply to the refineries market was 1.5 million m^3 whereas the private sector contributed 800,000 m^3. But in the third quarter in the same year, YPF's supply declined to 400,000 m^3 and the private production sector contributed 1.7 million m^3.

Up to 1990 more than 90% of Argentina's oil production came from YPF, produced by YPF itself or through private contractors.

In 1991 YPF will produce 16.5 million m^3 and the private companies some 12 million m^3 of freely disposable oil which they will be able to place on the local or the international market as they wish. YPF has returned all the marginal areas of production to the State, and most of this, in turn, have already have been transferred to the private sector which is already operating them. In all four central areas selected for partnership with large national and international firms the pertinent contracts are being implemented, and forecast investments over the next 5 years amount to at least 500 million dollars.

The deadline for the Cuenca Austral competitive bidding is supposed to fall within the next few weeks, and in March 1992 the same scheme will be initiated for the North-Western basins.

YPF's "voluntary retirement" plan has made possible a reduction of more than 7,000 members of staff without violence or major disturbances, as compared with the rest of the labor force, and with no union conflicts.

A substantial proportion of workers separated from the company were able to find new employment in productive activities. Moreover, in the process, YPF has changed from being a company with no participation in the international oil trade to becoming Argentina's first exporter company. Sales of crude oil and oil products abroad during 1990 have amounted to more than 600 million dollars. The US is the main buyer but already there are contracts with Chile and Paraguay which will make it possible for the company to become an outstanding regional hydrocarbon supplier to neighboring countries.

In the present circumstances it is possible to conclude that "self-sufficiency" as a goal in not any longer YPF's main concern. As one of the contributors to this issue of Petrotecnia has pointed out, Argentina has 1.8 million Km^2 of sedimentary basins, and most of them have not been explored. In those in which exploration has been conducted, the areas actually in production are extremely small compared to the tremendous potential of areas where searches have not yet been carried out.

YPF's restructuring is, therefore, part of a plan aimed at taking vast areas of Argentina that have not been explored or have only been partly explored, to a productive level with the participation of national and international firms able to invest capital and know-how.

A YPF that is efficient, competitive, with an open-capital structure, and also directed towards an optimization of performance, is the profile sought in the major restructuring plan now under way within a fully deregulated market.

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