

# ***SCENARIOS FOR THE VERTICAL INTEGRATION MODEL IN THE OIL INDUSTRY***

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## **Keywords**

[vertical integration, oil companies, value chain, business model, scenarios]

## **Overview**

The vertical integration is a worthy attribute to oil companies that produce low quality oil and have a complex refining park which can produce high added value products using cheap raw material. Its commerciality is characterized by a low liquidity degree. In this context, the splitting plan of one of the greater and more traditional oil companies in the world, ConocoPhillips, into two separated companies of *upstream* and of *downstream*, surprised the market and the other agents of the industry. The announcement happened few months later another great U.S. oil company splitting, Marathon, which implemented a similar spin off strategy. The oil industry chain integration consolidated itself as a remarkable strategy of great international oil companies as a strengthening mechanism in order to face the activity intrinsic volatility and to guarantee cash flows to bear long maturation investments. Nevertheless, changes that have occurred in the business environment over the last years seem to call the integration logics into question under determinate circumstances. This article presents scenarios that unfold themselves from the current industry panorama, considering opportunities, risks and the integration model. The work focuses on strategies of the main oil companies in the world in relation to the business model which provides the shareholders greater gains, concomitantly with the management capacity which enables better conditions to hold up the activity cycles.

## **Methods**

The adopted methodology in this work is the exploratory scenarios one. The choice for a quality approach choice is due to the fact that we are discussing discretionary decisions motivated by multiple inter-related conditionings. In our purpose of constructing “future histories”, we will be reading sights, but not exploring data. The two scenarios or alternative worlds we arrive at consist in two contrast mental maps, though realist, constructed from the tendencies reading and current uncertainties, of deductive and inductive implications. The hypothesis construction on the future is based on an ordinate perspective, challenging one of the most rooted paradigms of the oil industry, the vertical integration. At first, we define the outlines of our “problem”, that is, the integrated model key factors, in their economic, financial, political, geopolitical, environmental and fiscal aspects. Then, state variables and influence variables (or driving forces) are identified in order to select critical uncertainties. Through a morphologic investigation matrix, the behavior of each of these variables is analyzed in order to compose the scenarios. At last, each scenario presents a consistent history, through adopted hypothesis and consolidated tendencies of the industry, in a descriptive essay. As a methodological support for analyses, we will use the SWOT matrix, Porter’s Competitive Forces models, Bain’s Structure-Conduct-Performance model and Web Delphi’s method.

## **Results**

The results indicate two antagonistic scenarios, revealing different strategies in relation to the integration decision in the oil industry chain. In the BIG OIL scenario, the oil companies deepen themselves in the integration model, motivated by the tax

incentive interruption to the companies spin off, as a portfolio optimization mechanism. The global economic recovery, associated to the environmental regulation flexibility, particularly to the refining segment, pushes *majors* back to downstream. In the DEEP SPLIT scenario, economic growth occurs slower due to increasing worries with the environment and population greater awareness of consumption standard of energy and durable goods. The fall of fuels demand is followed by the increasing of environmental rigor, resulting in refineries high operating costs and business environment deterioration, mainly in the OCDE countries. The tax incentives to specialization are consolidated in U.S. and practice is replicated in Europe, evoking the integration model splitting in several international oil companies.

## Conclusions

There are evident signs the integration model is present in the *majors* strategies, being a concern for shareholders. Decisions related to the integration model splitting are being noticed, as well as a movement of *majors* adaptation towards the restructure of their assets; the movement is accelerated by the 2001 crisis effect. The downstream sector is facing great adversities, imposing radical changes in the *majors* portfolio management, which have been the most affected by the profitability drop. The financial market has showed a generous appetite for the integration model splitting, deflecting on ConocoPhillips and Marathon's shares behavior after the spin off announcement. It indicates a perception that the business segments are worthier than the whole (integrated company). At the upstream front, the incessant battle for the R/P indicator sustenance was joined towards the new and challenging exploration frontiers. In the *majors* case, the access to the reserves becomes even more challenging when considering possible effects of regulatory reformulations originated from the Deepwater Horizon accident. The dichotomy between short term, in which pertinent evaluations of financial performance lie, as well as speculating fads and fiscal opportunisms, and long term, in which energetic, geopolitical, environmental scenarios, for instance, are included – this is the analysis focus of this paper. The scenarios hereby constructed map and guide the paths to the movements' comprehension in the short term; they are not perceived by the agents, several times, since they present themselves through weak signs of a possible new tendency to the oil industry.

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