Why Oil and Gas Development Company Limited (OGDCL) Should Not Be Privatized

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Abstract
There is so much criticism of this decision of government to privatize the OGDCL. Motivated by this scenario that either OGDCL should be privatized or not, this research was conducted. Purpose of this research was to estimate and predict the future performance of OGDCL. In this research, major focus was on the historical financial and operational performance of the oil and gas development corporation of the Pakistan in the last decade. Different analysis on OGDCL like financial ratio analysis, competitor analysis, horizontal analysis, vertical analysis, common size analysis and trend analysis have been conducted. Although oil and gas industry is a growing and emerging industry in Pakistan and oil and gas companies are earning very attractive profit, but government of Pakistan wants to privatize the oil and gas development corporation of Pakistan limited (OGDCL). With the help of previous data and analysis, it is concluded that oil and gas development corporation of Pakistan should not be privatized as it will be not in the favor of the state as a whole and it may affect the impressive performance of OGDCL. This study provides information that why organizations which are performing well like OGDCL, should not be privatized. It also recommends that what other measures should adopt to sustain performance of such companies.

Keywords: OGDCL, PPL, financial analysis

Introduction
Oil and Gas Development Corporation Limited (OGDCL) is the national oil and gas company of Pakistan and sole responsible for oil and gas discovery and exploration activities in Pakistan. It was created under an ordinance on 20th Sep. 1961 with the funds and help of USSR experts. OGDCL was incorporated as a public limited company from 23rd Oct. 1997. It is not only registered on all three national stock exchanges but also on the London stock exchange. It is the market leader and pioneer in natural gas exploration and production. According to the 2013 statistics, OGDCL has largest exploration acreage which covers 21 % of the total exploration acreage of Pakistan. It also holds largest recoverable reserves of oil and gas in the country. It poses 37 % of total oil reserves and 30 % of total gas reserves in the country. In 2013, OGDCL contributed 54% share in Pakistan’s total oil production and 26% share in total natural gas production. OGDCL has a strong business history. It has never suffered a loss throughout its incorporation. Its last 10 years operational performance is highlighted here which shows its efficiency and profitability.
OGDCL has a rapid and continuous growth in its sales volume. Its sales revenue was at its highest 223.37 billion in 2013. It has earned its record net profit after taxation in 2012 which was 96.91 billion, which is the highest ever in its history. Earnings per share are also increasing with the growth of sales and profits. EPS was Rs. 22.53 in 2012 which was also a record in its history. OGDCL has paid Rs. 8.25 as cash dividend per share in 2013 which is 39% of earnings per share and 13% more than the 2012 dividend which was Rs. 7.25. On the basis of its strong performance and history, OGDCL is a safe organization for investors to invest their savings. Investors are so much encouraged to invest in OGDCL which can be shown with the help of the market price of its share. The OGDCL’s share has a par value of Rs. 10 and it was at Rs. 254.81 in 2013 which is highest ever. (ODGCL, 2014).

Competitor Analysis
In this section comparison of the ratios of oil gas and development (OGDCL) and PAKISTAN PETROLEUM LIMITED (PPL) have been given. Pakistan Petroleum Limited (PPL) is one of the most established and biggest Exploration and Production (E&P) Company in the Country. The Company was joined on 5th June, 1950 after the proclamation of the Pakistan Petroleum Production Rules in 1949. Pakistan Petroleum Limited is the second largest exploration and production company in terms of both production and reserves. After June 2004, the Government of Pakistan sold around 15% value (i.e. 102.873 million shares of Rs.10 each) through an Initial Public Offering (IPO). The legislature plans to privatize the PPL, and, the IPO was a huge step towards this goal. As of June 2008, the government claimed 78.4% stake of PPL, International Finance Corporation (IFC) had 3.43% shareholding and the rest 18.17% is on free-drift. Since 16 September 2004, the organization has been recorded in all the three stock trades in Pakistan. PPL offered around the "Main 25 Companies" of the Karachi Stock Exchange (PPL, 2014). The ratio comparison has been given below.

Financial Ratio Analysis

<table>
<thead>
<tr>
<th>Year</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (Billion)</td>
<td>223.37</td>
<td>197.84</td>
<td>155.63</td>
<td>142.57</td>
<td>130.83</td>
</tr>
<tr>
<td>Net Profit (Billion)</td>
<td>90.78</td>
<td>96.91</td>
<td>63.53</td>
<td>59.18</td>
<td>55.54</td>
</tr>
<tr>
<td>EPS (Rs)</td>
<td>21.11</td>
<td>22.53</td>
<td>14.77</td>
<td>13.76</td>
<td>12.91</td>
</tr>
</tbody>
</table>

Source; (OGDCL, annual reports 2004-2013)

Current ratio tells that how much current assets we have to meet our short term obligations. A current ratio of OGDCL shows that it has more current assets than PPL. It can be see above that OGDCL current ratio has
upward trended in all year. The higher current ratio of OGDCL is due to only reason that company short term assets like cash, marketable securities and other cash equivalents are in enough amount to meet its short term liabilities. **Quick Ratio** is an indicator of company's short-term liquidity. OGDCL has the high quick ratio, but in 2013 it has a less QR as compare to previous years. OGDCL has high quick ratio comparatively to PPL. From 2009 to 2012 OGDCL has increasing trend in working trend. Ideally, quick ratio should be 1:1. If quick ratio is higher, the company may keep too much cash on hand or have a problem collecting its accounts receivable.(investopedia, 2014).

**Debt to equity ratio, Interest coverage ratio and Debt to total assets ratio** is not applicable as the Company does not have debt besides lease financing for the procurement of vehicles and computer equipment which forms a very small part of its capital structure. **Average collection period (days)** represents the average number of days it takes the company to convert receivables into cash. From above ratio we can see that average collection period OGDCL is lower in 2013 than PPL which shows that company management is very effective to collect its receivables. In all other years PPL ratio is better than OGDCL. **Receivable turnover (times)** is an accounting measure used to quantify a firm's effectiveness in extending credit as well as collecting debts. A low ratio implies the company should re-assess its credit policies in order to ensure the timely collection of imparted credit that is not earning interest for the firm. The greater this ratio shows that the company is very effective. In 2013 OGDCL ratio is higher than PPL while in all other years its ratio is lower than OGDCL. **Payable turnover and Average payment period** is not applicable in view of the nature of Company’s business.

**The total assets turnover ratio** is the amount of sales or revenues generated per dollar of assets. In 2013, 2012 and 2010 OGDCL have higher ratio, but in 2009 and in 2011 its ratio is lower than PPL. Companies with low profit margins tend to have high asset turnover, while those with high profit margins have low asset turnover (boundless, 2014).

**Gross profit margin** is a measurement of how much from each dollar of a company's revenue is available to cover overhead, other expenses and profits. The OGDCL gross margin is much higher than the gross profit PPL. Higher gross profit of OGDCL is due to lower fixed cost. **Net Profit Margin** is a key financial indicator used to assess the profitability of a company. The net profit ratio of OGDCL is fluctuated in every year. In 2013 it has less NP Margin as compare to previous years. OGDCL has a low net profit ratio as compared to PPL in 2013 and in 2009 while in all other years, the company has a higher or equal ratio. Net profit margin provides clues to the company's pricing policies, cost structure and production efficiency. **Return on investment (ROI)** is a ratio which measures the return on an amount which is invested by a company in any project. ROI of OGDCL is higher than PPL in 2013 and 2012, but in 2011 and in 2009 ROI of PPL is higher than OGDCL, readyratios.com. The reason behind higher ROI of OGDCL is that, the management of OGDCL is very efficient in utilizing assets of the company and vice versa. **Return on equity** ratio indicates the profitability of shareholders after all expenses and taxes. From above all ratios, we can check that OGDCL has strong return on equity ratio than PPL. In all year’s ratio of OGDCL are better than PPL (yahoo finance, 2014).

It can easily be shown that overall OGDCL is performing much better in the industry and sector. It benchmarks for its entire competitors and it is maintaining its position as market leader over the years.

**Annexure 1**

**Competitor’s analysis, graphical representation**

<table>
<thead>
<tr>
<th>Quick Ratio</th>
<th>Current Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>OGDCL</td>
<td>PPL</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Quick Ratio</th>
<th>Current Ratio</th>
</tr>
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<tbody>
<tr>
<td>2009</td>
<td></td>
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<td>2011</td>
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<td></td>
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<tr>
<td>2012</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td></td>
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</tbody>
</table>
Common Size Analysis

It is clear from the trend analysis of OGDCL; it has a positive trend in its operation. If balance sheet is checked then it can be seen check that it has a positive and significant increasing trend in its capital reserves that were
increased 20.86% in 2012 and 17.33% in 2013. The company is controlling its deferred tax, which is increasing at a diminishing rate. In 2013, company’s deferred taxation has increased by 6.73%, which almost half than the previous year rate that was 13.28%. Trends in total non-current liabilities are also favorable. In 2013, non-current liabilities were increased by 13.77%, which is much better than the increase in 2012 which was 18.02%. Total current liabilities of the firm were increased in last two years. In 2012, it was increased by 12.94%, but in 2013 it was almost 57.52% increase in current liabilities. It was due to increase in the level of business and purchasing and payment policy of the firm. To some extent it shows the goodwill and better relationships of the firm but it will have a negative impact on short term liquidity position of the firm.

If assets side is checked, it is clear that see that firm is increasing its investment in fixed assets at an increasing rate over the period of time. In 2011, firm’s fixed assets were increased at 2.32% that were increased to 9.44% in 2012 and 15.93% in 2013. It shows the expanding and growth of the firm over the time. Every asset is increasing at a normal rate except two items which has a major change in rates. First is a total non-current asset which has increased by 126% in 2013. It is due to a change in investment policy. 2nd major change is in long term investment which is 3421% than the previous year. The reasons for this huge change in the trend are two investment decisions. Firstly, the company has invested 53.165 billion rupees in Pakistan investment bonds issued by the govt. of Pakistan. Secondly, the company has purchased Term Finance Certificates amounted 82 billion rupees. These TFC are also backed by Govt. of Pakistan. Another major change in trend is due to change in interest accrued. Interest accrued is increased by 1801%. The reason for this major change is that there is an increase of almost 10 billion rupees in interest accrued. This interest is accrued due to investment of almost 135 billion, made in bonds and certificates in 2013. A negative trend can be seen in current assets of the firm that have decreased by 37% than the previous year. Firstly, it was due to trade debts payable by the different oil companies and refineries operated by the govt. of Pakistan, which were adjusted by circular debt amounted almost 83 billion rupees. Secondly, the company has decreased its level of short term investments in term deposits by 12 billion rupees. If overall trend of the company is checked, it has increased its total value by 29% in 2012 and 23% in 2013 which shows high growth rates and expansion of the company.

By trend analysis of profit and loss account of the firm, it shows a balanced and increasing trend in its accounts except 2012 which shows an extraordinary change in accounts specially in sales and profits due to a significant control on the direct cost specially on operating and transportation expenses. 2012 was a period of extraordinary performance for the firm due to many external factors so it will not be appropriate to blame the firm for performing bad in coming years and compare this performance to 2012. Firm is still in growing trend which shows the efficiency of the firm. Its sales are almost 13% more than 2012. If increase in cost of goods sold is compared with increase in gross profit, it is clear that increase rate of gross profit is 4% greater than the increase rate of cost of goods sold. But profit for the year is 6.32% less than the previous year 2012. There are different factors behind this like low other incomes, higher exploration charges, higher general and administration expenses and high finance cost which has negatively impact the profit for the year.
Short Term Liquidity

Through horizontal analysis it can be checked that in 2010 current assets are less than 2009, while current liabilities are more than 2009. In 2011 current assets are increased significantly than last year, but current liabilities are decreased than last year. In most recent year 2013 current assets decreased than previous year and current liabilities increased significantly than last year. This overall trends shows that short term liquidity of firm is not up to the mark. From horizontal analysis we can check that the proportion of current assets in total assets has been increasing year by year like in 2010 proportion of current assets has increased to 52% compared to 48% in 2009. Similarly there is increasing trend till 2012. But in 2013 proportion of current assets has decreased to 32% compared to 63% in 2012. This trend has effect short term liquidity. Graphical representation of horizontal analysis given below.
Profitability
There is upward and downward trend in gross profit. In 2012 gross profit of the company is at top but in 2013 gross profit decreased significantly than last year. Same trend is followed by net profit. Below graphical representation is shown. From vertical analysis it is observed that proportion of gross profit in total sale has been increasing trend except in 2011. In 2011 gross profit has decreased to 66% compared to 70% in 2010. In 2013 the proportion of gross profit has been decreased to 70 % compared to 69 %.

Cost Management
Cost management shows that how management of company is efficient to control its cost. From this trend we can check that till 2011 company cost is increasing with very significant rate but after that cost goes down in 2012 and 2013 which shows that management of company had paid more concern on efficient management to control increasing trend of cost.
Efficiency and Operation Management
Operating expenses have same trend in all years. There not any significant change in operating expenses except 2011. This shows that company management is very efficient to control its expenses which lead towards higher profit. On the other hand in 2011 there is significant increases in total assets of company but after those assets go down. This trend is shown through graph.

DuPont Analysis of Oil and Gas Development Corporation of Pakistan
DuPont analysis is conducted on the basis of following formula,

\[
\text{ROA} = \text{NPM} \times \text{TAT} \times \text{A/E}
\]

A DuPont analysis of OGDCL and PPL is shown in the table below. The story told by the DuPont analysis is similar to the story told by analysing ratios: OGDCL must focus on controlling operating costs. Relative to the PPL as a whole, OGDCL has a disadvantage in its leverage ratio (Assets to Equity of 1.28 compared to 1.42 for the PPL) and OGDCL has an advantage in its use of assets (Total Asset Turnover of 0.59 compared to 0.53), yet has a poorer return on equity (30.67% compared to 39.828% of PPL) due to its low equity multiplier. In the OGDCL case there are apparently other operational inefficiencies impacting the equity multiplier because the overall return on equity is less than the PPL average.

<table>
<thead>
<tr>
<th></th>
<th>OGDCL</th>
<th>PPL</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROE (Return on Equity)</td>
<td>30.67%</td>
<td>39.828%</td>
</tr>
<tr>
<td>NPM (Net Profit Margin)</td>
<td>40.64%</td>
<td>41%</td>
</tr>
<tr>
<td>TAT (Total Asset Turnover)</td>
<td>0.59</td>
<td>0.53</td>
</tr>
<tr>
<td>A/E (Assets/Equity)</td>
<td>1.28</td>
<td>1.425</td>
</tr>
</tbody>
</table>
Large variable and fixed expenses (relative to the level of sales) are negatively impacting ROA, and these expenses, especially variable expenses (selling, general, and administrative expenses) since they are perceived to be more easily controllable, need to be closely evaluated. Increases in sales revenues may also help the ROA situation.

New exploration and drilling investments must be closely evaluated to assure that OGDCL is discovering reservoir that will be valued in the marketplace. However, competition in oil and gas sector is so much high in Pakistan. There are many local and international firms that are searching for reservoirs of oil and gas in the country. These competitors will not simply let OGDCL gain sales and market share at their expense. OGDCL has an edge over its competitor on two bases. 1st it is market leader in the country with highest acreage. 2nd it is listed in London stock exchange. So it has an edge over its local competitor. OGDCL must develop a product and business strategy to increase sales in the midst of these threats as well as conduct a huge research and exploration to discover new reservoirs as there is a large mismatch between demand and supply of the oil and gas in Pakistan which is a greatest opportunity for OGDCL. At the same time OGDCL should work for controlling variable and fixed expenses to maximize its profit and returns.

**Conclusion**

OGDCL, the largest petroleum Exploration and Production (E&P) Company in Pakistan, was listed on all three stock exchanges of the country in November 2003 and its Global Depository Shares (GDS) were issued on London Stock Exchange in December 2006. According to the 2013 statistics, OGDCL has largest exploration acreage which covers 21% of the total exploration acreage of Pakistan with a portfolio of 33 exploration licenses. It also holds largest recoverable reserves of oil and gas in the country. It poses 37% of total oil reserves and 30% of total gas reserves in the country. In 2013, OGDCL contributed 54% share in Pakistan’s total oil production and 26% share in total natural gas production. Currently all production volumes are being realized from onshore areas of Pakistan, however, the Company also has working interests in Pakistan’s offshore exploration blocks. OGDCL had a net profit after tax of Rs 90.78 billion for the year ended 30 June 2013. Along with all this, a ratio analysis for the previous years was conducted to predict the future performance of OGDCL.

All the statistics and ratios are favorable and show a growth prospective for the company in coming years so it is suggested for the company that it should be remained to the government as it is already performing well and it doesn’t need any change in management or policies. It should be operated under the previous plans and policies which made it market leader and a benchmark for the industry. History of the privatization in Pakistan never showed positive outcomes. Following table shows the results of privatization in Pakistan.

<table>
<thead>
<tr>
<th></th>
<th>Better</th>
<th>Same</th>
<th>Worse</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>PMEs *</td>
<td>9</td>
<td>13</td>
<td>16</td>
<td>38</td>
</tr>
<tr>
<td>Misc.</td>
<td>3</td>
<td>10</td>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>Ghee Mills</td>
<td>2</td>
<td>12</td>
<td>5</td>
<td>19</td>
</tr>
<tr>
<td>Rice Mills</td>
<td>2</td>
<td>-</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Banks</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>18</td>
<td>37</td>
<td>28</td>
<td>83</td>
</tr>
</tbody>
</table>

Percentage: 22 | 44 | 34 | 100%


*Public Manufacturing Enterprises.*

With the help of these results, it can easily be concluded that privatization mainly impacts negatively on the performance of the firm. In short it can be said that there should not be any major change in the company as it may affect its impressive performance and its high growth in the future.

**Recommendations**

**Don’t privatize OGDCL:**

By concluding all the discussion it can be said that privatization of OGDCL is not a better option. OGDCL is neither a loss making unit, not facing any strict competition in the country. So, Instead of privatizing it, govt. should focus on the expansion, efficiency and growth of the OGDCL as it will provide much better results than the privatization of OGDCL.

**National interests should be focused.**

Govt. should focus on national interest instead of just increasing revenue by privatization. If OGDCL is privatized, it may lead some sort of cartels and family businesses which will harms the consumer rights and price
index. Secondly, if it is acquired by any foreign company, its decisions will not match the national interests.

Maintain and Accelerate Production Growth:
Govt. and Management of OGDCL should focus on continuing accelerate production growth by allowing the Company to utilize its significant reserves base and capitalize on the strong economic growth and accelerating energy demand in Pakistan. Company should also be provided with latest technology to boost up its drilling activities.

Maintain Low Cost Operations:
OGDCL’s operating environment, namely the geographic concentration of its reserves base within Pakistan, will be a major factor in allowing it to control its low cost structure. Within Pakistan, the Company’s leading position also enables it to access economies of scale.

Pursue Selective International Expansion:
While domestic expansion remains OGDCL’s core focus, the Company intends to grow and diversify its portfolio through selective international expansion in the medium to long-term.

Control cost:
Management must take necessary action to control costs i.e. administrative and selling expenses and other expenses.

Sale of Share:
OGDCL should sell their share worldwide in order to get a huge amount of capital to expand its operations.

High Taxation:
OGDCL pay high tax as compared to the profit, Government should provide relaxation in taxation.

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