The perils of Petrobras

How Graça Foster plans to get Brazil's oil giant back on track

Brazil's discovery of oodles of offshore oil in 2007 felt like a transformative moment. For Petrobras, the state-controlled oil company, it raised the prospect of pumping 5m barrels a day by 2020, up from around 2m—meaning a windfall for the government and juicy returns for minority investors. Under Graça Foster (pictured), Petrobras's boss since February, the find may yet prove a boon to both. But they and she face a white-knuckle ride first.

Recent history is less than encouraging. Investors who bought in during Petrobras's share issue in 2010 have lost more than a quarter of their money at current prices. In August the firm posted its first quarterly loss in 13 years; the most recent quarterly results were limp. Meanwhile Colombia's Ecopetrol has knocked the company into second place in South America by market capitalisation.

What went wrong? Back in 2007 Petrobras's main worry seemed to be finding a way to pump the new oil, known as pré-sal ("beneath the salt"), which is buried under rock and salt in ultra-deep waters. But its engineers quickly cracked that problem: Petrobras produced 71,000 barrels a day of pré-sal last year. The world's biggest corporate-investment programme is taking the oil from the sea bed to market. Instead of know-how, the glitches have included poor management and ballooning costs.

The main difficulty, however, has been political meddling. Since 2006, the government has capped petrol prices to combat inflation. To meet rising demand, Petrobras has been obliged to top up what it produces with imports, which it must then sell at a loss. Legal requirements to hire and buy parts locally—to support Brazilian jobs and industry—have played havoc with budgets and schedules.

The problem is a decade old. By Latin American standards, Petrobras is a model state oil company; nevertheless Brazil's government has used it as an all-purpose policy tool. As well as keeping prices low, and helping the broader economy, it has been told to build refineries in the poor north-east to promote regional development. Rising resource nationalism meant that a previously liberal licensing regime was tweaked to make the firm the only principal operator allowed in pré-sal fields. That left other outfits frustrated and Petrobras overstretched. Ms Foster will need sharp elbows if she is to turn around Brazil's biggest company—which (with its suppliers) contributes around 10% of GDP, and on which the country's industrial development largely depends.

Ms Foster is a career engineer who worked her way up through Petrobras; a famously demanding manager; and a big change from her predecessor, Sergio Gabrielli, who was a smooth-talking politician first and an oilman second. She is diplomatic about her predecessor, but has replaced some of his acolytes and is reviewing many of the deals signed during his tenure. Her five-year corporate plan, launched in June, cut his production target for 2020 by 11%. In future, she promised, the firm would be "more realistic".

She describes her approach as "a very intense management adjustment." That has four parts, she explains: asset sales abroad, individual performance targets for each platform and manager, better maintenance and rigid cost control. Simply introducing scheduled maintenance shutdowns, she says, took "re-education—a new mental model, obvious as it may seem." By the end of the year, every Petrobras employee will receive a signed letter from her setting out the cost-cutting goals.

Investors may wonder why such measures are only now being introduced—and whether, given the political interference, they will be enough. Ana Ares of Fitch, a ratings company, says the crucial test will be whether Ms Foster can negotiate a petrol-price rise. Having to sell imported fuel at a loss puts the firm in the odd position of doing better with lower international oil prices. Another sign will be whether she persuades the government to relax the rigid local-content rules. "The market likes the way Graça talks," says Adriano Pires, an energy consultant. “But realistic goals and good management get you nowhere if your majority shareholder won’t let you do what you need to do.”

Such meddling can be worryingly myopic. For instance, the anti-inflation drive means that, at the pump, petrol undercuts ethanol, which is not regulated by price (most Brazilian cars can run on any mix of the two). As well as costing Petrobras billions in extra petrol imports, the price differential encouraged Brazilians to stop buying ethanol. That drove domestic investors towards other businesses—which in turn meant Brazil was ill-prepared to capitalise when the United States scrapped tariffs on foreign ethanol at the start of the year. A shift from petrol back to ethanol would be the simplest way to put an end to pricey foreign oil imports, says Ms Foster, and “extremely welcome to Petrobras.”

Ms Foster says the board—which is dominated by government-appointed directors—now understands that the firm needs to concentrate on pumping oil if it is to generate the revenues to invest in job-creating refineries and terminals. She rejects the idea that Petrobras is run for Brazil’s good, rather than its own. “Petrobras does not see developing the country as its core business,” she says. “Not every project that would be great for the country will be undertaken, because not all are economically justified.” It is in Brazil’s long-term interests, as well as Petrobras’s shareholders’, that she makes that line stick

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