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The unseen hand that moves the world's oil

By Brian O'Keefe with Doris Burke @FortuneMagazine February 28, 2013: 9:08 AM ET

PHOTO: TY COLE

Vitol built this state-of-the-art storage terminal in Cape Canaveral, Fla. Open since 2010, it supplies the nearby port, the Orlando airport, and gas stations across central Florida.

(Fortune)

The man who runs the biggest, most important company you've never heard of bounds into the room with a grin. In his elegant navy suit, and with his cheerfully self-effacing personality, Ian Taylor is the very model of a British executive. The 57-year-old is bald on top and graying on the sides, yet he sparkles with boyish enthusiasm. It almost goes without saying that he's eloquent, having studied politics, philosophy, and economics at Oxford. His firm is just one player in a "whacking great" industry, he explains. But he's happy to discuss his business. Simply put: He buys oil in one place and sells it in another, hoping to make a profit. In reality, it's a bit more complicated than that.

Taylor is CEO of the Vitol Group, the world's largest independent oil trader. According to results provided by the company, Vitol, which is a private partnership, racked up revenues of $303 billion in 2012. That would make Vitol the biggest private company in the world by sales, ahead of commodities industry peers such as Cargill and Koch Industries. If Vitol were publicly traded, its reported revenues would have ranked it No. 7 on last year's *Fortune* Global 500, ahead of Chevron and Toyota. Margins in the trading business are razor thin, but the company's profits are divvied up among just 350 or so shareholders.

Despite those jaw-dropping numbers, Vitol is a mystery even to many in the oil business. Dan Yergin, the chairman of IHS Cambridge Energy Research Associates and the foremost chronicler of the oil industry's rise in his books *The Prize* and *The Quest*, says that while he knows Vitol's name, "I must admit that I don't know too much about them."

How vital is Vitol? Think of the company as an unseen hand that helps steer global energy markets. The company is primarily engaged in the physical trading of oil -- moving it from places of surplus to areas of deficit. That means that Taylor and his associates do a lot more than use derivatives to make bets on the future direction of crude prices. The company buys and sells more than 5 million actual barrels of oil each day. "Our basic function, I suppose, is being an incredibly important connecting pin to making sure that oil is delivered to where it's required," says Taylor.

That takes remarkable logistics capability. Last year Vitol chartered more than 5,400 ship voyages. At any one time, it has about 200 tankers on the seas hauling cargoes worth tens of millions of dollars -- ships that are potentially vulnerable to everything from pirates to typhoons to more mundane, but still costly, mechanical or weather delays.

Vitol is the largest of a group of trading companies that fill in the gaps between the big oil companies, such as Shell and Exxon, state-controlled producers, and hundreds of smaller players around the world. This trade has grown over the past few decades as the original, integrated system has broken down. "Once upon a time oil flowed from the wellhead all the way to the gasoline pump within a single corporation," says Yergin. "That began to change after the first oil crisis in the 1970s." Consider that today Vitol sells gasoline to Saudi Arabia and supplies crude to Exxon for refining.

The volume of energy Vitol trades -- in addition to crude oil, it buys and sells everything from gasoline to natural gas to jet fuel to coal -- has more than doubled in less than a decade. (The company also happens to trade about 5% of the world's sugar supply.) Rising energy prices have driven even faster growth in revenues. In 1995, the year that Taylor took over as CEO, Vitol had revenues of around $13 billion. Ten years ago it was still less than $50 billion. Since then it's exploded.

Vitol's highest-profile rival in this great game is Glencore, the Swiss commodity trader formed by former partners of Marc Rich, which went public two years ago and ranks No. 14 on the Global 500 list. In its most recent fiscal year, Glencore reported $115 billion in energy trading, but it is better known for its heft in the metals markets. Other privately held competitors -- such as Gunvor, Mercuria, and Trafigura -- more closely mirror Vitol's focus on energy trading, but none match its scale.

To get their hands on new product, Taylor and his traders compete with their rivals for the favor of government officials and executives in former Soviet republics, Arab kingdoms, and unstable African countries. Taylor oversees the far-flung operation from the company's London office, across the street from Victoria Station. The company has offices in 30 countries, including major regional centers in cities like Houston, Moscow, Dubai, and Singapore.

Because of Vitol's size and its confidence in its own ability to manage risk, the company is often willing to deal with customers that more conservative companies shun. Vitol, for instance, has done business over the past couple of years with customers in Greece, Egypt, and Yemen, despite serious credit issues in those nations. When the rebels in Libya were desperate for gasoline and diesel, Vitol, urged on by several governments, was for a time the only trader willing to risk supplying them.

Not surprisingly, Vitol's dealings have sometimes drawn criticism. Notably, in 2005 it was one of many companies identified in an independent investigation led by Paul Volcker as having paid "surcharges" to the regime of Saddam Hussein to buy oil through the United Nations' "oil for food" program. As part of the fallout, in 2007 Vitol pleaded guilty to grand larceny, a felony, in New York County Supreme Court and paid $13 million in restitution and a $4.5 million fine.

More recently some U.S. lawmakers have raised questions about Vitol's trading with Iran and whether Vitol should be allowed to buy oil from the U.S. Strategic Petroleum Reserve. The U.S. and the European Union have imposed trade sanctions on Iran, and Vitol says it has fully complied since President Obama issued an executive order authorizing additional sanctions on July 31, 2012. But last September, Reuters reported that Vitol had bought fuel oil from Iran. Taylor says it was a single cargo that a Vitol trader in Asia agreed to buy weeks earlier. Vitol, he adds, won't trade with Iran as long as sanctions apply. "Not another drop," he says.

Taylor says there is an inherent tension built into the company's role as a global connector of dots. "Because we're going to trade everywhere around the world, we will occasionally be trading in countries where people feel maybe we shouldn't be," he says. "Now, okay, we do have our own internal moral sort of values that we do occasionally apply to this. But in general, we feel it's the right thing to do, which is to carry on participating in most countries, providing there are no sanctions, in which case we immediately will abide by them, obviously. Or providing there's not a situation which we feel is bluntly not acceptable, according to our values."

In recent years Vitol has begun to acquire or develop physical assets -- refineries, terminal facilities, pipelines -- around the world, including in the U.S. Taylor sees these investments as a way to boost his business in an increasingly competitive trading market. Though Vitol's sales for 2012 were up marginally over 2011, its oil-trading volumes were down. "There are not huge, great pockets of freely traded oil that we can unquestionably still add on," says Taylor. "We fight very hard to do that, but there's not great chunks, really."

Vitol's move into owning assets is also part of a larger story in the oil industry. The major oil companies continue to try to shed low-margin "downstream" businesses to focus on higher-margin upstream exploration projects. And Vitol and its trading peers are snapping up many of those properties to give them added flexibility -- a concept they call "optionality." What it means is that Vitol and its peers are likely to have an even more important role in energy markets. To understand Vitol is to gain insight on how the gasoline really gets in your tank and on how the world of big oil is evolving.

One day last spring a Vitol trader in Geneva agreed to buy a cargo of 720,000 barrels of "Urals" crude oil from a seller in Russia. As part of the deal, the Vitol trader would send a tanker to Russia to collect the oil, worth roughly $80 million, in early May. The two parties agreed that the price of the cargo would be finalized based on the average price of Brent crude, the most common benchmark for crude oil in Europe, over the entire month of May.

A Vitol trader is like a quarterback of a well-coached team. As soon as a trader agrees to a deal, he kicks off a chain of activity from the rest of the squad. Contracts must be sent out. Inspectors must be appointed to make sure the oil is loaded properly. A letter of credit must be obtained from a bank to guarantee payment. A ship must be chartered and vetted. And every aspect must be monitored because the details can make or break the profitability of a deal. Often the margin may depend on managing freight costs. Each purchase or sale must be hedged to limit risk.

Shortly after buying the Urals crude, the Vitol trader agreed to sell it to a buyer in the Caribbean and deliver it a few weeks after picking it up in Russia. The sale price would be determined by a formula based on the average price of WTI crude for a five-day period in May. WTI is the most common benchmark for North American crude prices. At the time of the deal, it was trading for about $15 less than Brent.

The fact that the trader bought the oil priced in Brent and sold it priced in WTI added an extra layer of complexity to the hedging. For each of the 23 trading days in May, Vitol had to sell futures against the Brent price to hedge its purchase price. And it had to buy futures against the WTI price for the five pricing days to hedge the sale price. During the course of May, the price of oil plummeted -- Brent prices dropped from $120 to $103 a barrel -- adding to the trickiness of the hedging.

The headquarters of Vitol's trading business is located in downtown Geneva, on two floors of an eight-story building above a nightclub. The traders and their assistants sit in clusters of desks in an open space taking up just over half a floor. On the morning I visited, there was a muted buzz as the traders pondered a sharp drop in the price of Brent crude the day before.

"What does a trader do?" says David Fransen, a tall, thin, bespectacled Brit who heads up Vitol's trading unit. "He's not just thinking, 'Oh, I believe oil is going to go up, so I'm going to buy some.' It's more like, 'I'm going to buy something here, and I'm going to hedge it there. And what are my costs? How's my P&L? How was my hedging yesterday? So, the market went up. I thought I was hedged. Did I make or lose any money? I'm long Europe vs. New York -- did my spreads go the right way? Do I need to change it?' That's what the traders do. Decide on how to react."

The margins in physical trading are thin -- a profit of 1% or less is typical. Of course, a small margin on a giant gross revenue number can still create big profits. In 2010, for instance, Vitol had $206 billion in revenue and $1.5 billion in net income, according to figures from Thomson Reuters. That's a margin of just 0.7%. A better year was 2006, when Vitol got a boost from selling a refinery and earned $2.2 billion in profit on $116 billion in revenue, for a margin of 1.9%, according to figures from Dun & Bradstreet.

Still, it's a lot of work to earn a buck. "It does beg the question of why on earth we play around with something so complex," says Fransen. "Because the more we talk about it, the more it seems like it would be an awful lot easier just to buy futures and sell futures. But that's far too risky for us. This is where our skill is."

The company has been developing its skill set since it was founded in Rotterdam in 1966 by a pair of Dutchmen, Henk Vietor and Jacques Detiger, who traded barges of petroleum products up and down the Rhine. (They came up with "Vitol" by combining Vietor's last name with "oil.") A couple of years later, they opened the office in Geneva, which was becoming a hub of commodities trading. Taylor remembers them as courtly gentlemen who liked to play dominoes.

Taylor joined the company as a trader in 1985 from Shell, where he had been learning the craft of trading oil. In part to move their production and supply their refineries, Shell and BP run trading operations that are even larger than Vitol's and that have long served as training grounds for Vitol and the other trading houses.

After nearly 30 years at Vitol, Taylor has accumulated more than enough wealth to retire and live the easy life. Married, with four children ranging in age from 11 to 24, he sits on the board of the Royal Opera House. Six years ago he swooped in as an angel investor to help save the Harris Tweed industry on the Outer Hebrides islands at the behest of his friend Brian Wilson, a former British trade and energy minister who lives there. But get him talking about the details of his trading business, and it's clear that he's deeply engaged.

The CEO describes Vitol's approach to risk management as "relatively informal," in the sense that there isn't a dedicated risk-assessment group. But because the company is a partnership, everyone is engaged in scrutinizing and evaluating risk at all times. "A lot of people are involved in every change of direction that we make," says Taylor. Every trade can be tracked through a proprietary trading and operations system that Vitol designed in the late 1990s. Twice a day it generates risk reports that the traders can use to, say, assess exposure to certain counterparties or to a particular country.

Vitol's risk tolerance was put to the test in 2011 when Taylor received a call from the Qatari government asking Vitol to supply the rebels fighting Muammar Gaddafi with gasoline and diesel in exchange for crude from rebel-controlled oilfields in eastern Libya. Urged on by a coalition of governments, including the U.S. and Britain, Vitol took a calculated risk by supplying the rebels, and continuing to supply them even when payment was slow in coming. Eventually Vitol was fully paid with oil from the rebels as well as funds released by the UN. "It was a bit hairy," says Taylor. "There were one or two sleepless nights, I can assure you."

Not every trade is a winner. The trader who bought the cargo of Urals crude in Russia sold it in the Caribbean and ended up losing $5 million on the physical trade. With hedging, the deal turned a profit of $5,430. To make the trade happen, Vitol had to produce 391 regulatory filings. It sounds as if it was hardly worth the trouble. But we don't know how it played into the trader's overall strategy. He might have sold the cargo in the Caribbean so that there would be less Urals crude available in Europe, which might have boosted the value of another cargo and netted a big profit.

It's a humid, overcast morning in South Florida, and I'm standing on 100,000 barrels of jet fuel. To be precise, I'm on the roof of T-150-9, one of 24 storage tanks at the Seaport Canaveral terminal facility in Cape Canaveral. The tank is 150 feet in diameter and about two-thirds full. Inside, an aluminum "roof" floats on top of the jet fuel to suppress vapors and prevent evaporation. The actual roof of the tank, where I am, is made of thin steel and it feels surprisingly, um, non-solid.

"That's where the space shuttle used to take off, right there," says Juriaan Steenland, the 36-year-old Dutch general manager of the facility, pointing at the nearby NASA launch site. "First, we would see the rocket fire. Then, after a couple of seconds, we'd feel this roof vibrate under our feet. Can you feel how bouncy it is?"

I've come to the terminal to learn about "optionality," the current buzzword in commodities trading. It denotes traders' desire to take maximum advantage of changing circumstances. That might mean re-routing a cargo of crude bound for New York if there's a spike in demand in Europe. Or it might mean storing diesel in a terminal for a month while waiting for prices to rise.

If you've visited Disney World lately or taken a Disney cruise, or even bought gasoline anywhere in central Florida, there's a good chance that your plane, ship, or car used product supplied by Seaport Canaveral. The terminal, which opened in 2010, was built by Vitol and is now the largest in the state. From its high-tech control room, a worker can move gasoline or jet fuel from any tank to any other tank to blend or consolidate stocks. It is run by 26 employees, compared with hundreds at a traditional terminal. When tanker trucks arrive from companies that have purchased supply from a Vitol trader, they swipe an ID card for verification. It's like visiting a gasoline ATM. They load the truck in about 25 minutes and head off.

Seaport Canaveral is owned and operated by Vitol Tank Terminals International, or VTTI, a subsidiary that Vitol formed in 2006. Three years ago Vitol sold 50% of the business to Malaysian shipping giant MISC for $735 million. The joint venture now runs 13 oil and gas storage terminals on five continents with the equivalent of about 54 million barrels of storage. Through a separate joint venture, Vitol is also building a new storage terminal in Midland, Texas.

Beyond the storage business, Vitol in the past few years has acquired refineries in Belgium, the United Arab Emirates, and Switzerland. It has a growing upstream business, with two subsidiaries exploring for and producing oil in the former Soviet Union and western Africa. And in late 2011, Vitol formed a joint venture to acquire some 1,300 Shell gas stations across 14 countries in Africa. If you pull into a Shell station in Burkina Faso today, you're doing business with Vitol. Put it all together, and Vitol begins to look a bit like the integrated oil companies that it trades with.

Vitol's rivals are following a similar strategy. The consulting firm Oliver Wyman, in a recent report called "The Dawn of a New Era in Commodity Trading," says the industry is on the verge of its "largest transformation in 30 years" as traders bulk up their assets. "Traditionally, trading was very much an asset-light business," says Graham Sharp, one of the founders of Trafigura and a co-author of the report. "Your assets were your people. That's one of the reasons why they were always private companies, because those sorts of companies are not very well valued in the public markets. And to be honest, you don't need a lot of long-term financing to do that activity. Now the companies are becoming more like corporations with long-term assets, which need long-term financing. Suddenly the public markets look more attractive."

That raises a big question: Will Vitol follow Glencore down the IPO path? The answer for now is no, says Taylor. The company has plenty of capital to invest, and the partners aren't eager to answer to shareholders or analysts. "We're primarily a trading business," says Taylor. "With public markets, we have to always ask ourselves, 'Is it the right place for a business which will be very difficult to explain, and doesn't go in a very simple trend, ever moving upwards?' "

It may not always go straight up, but Vitol's business has grown big enough that Taylor and his partners realize that they can't remain such a hidden power. Whereas a pure trader can always flip a cargo and move on, a more integrated energy company that owns long-term assets needs to be understood by regulators, lawmakers, and the public. Taylor would like Vitol to be known as a company that plays a "reasonably useful role" in making the energy business function more efficiently, not a firm to be feared. "It's very easy when gasoline goes up for people to say, 'My God, who do we blame? Maybe traders, maybe somebody.' " Having made his point, Taylor needs to get back to running his business. "Good luck, yeah?" he says, and bounds out of the room grinning.

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