



The Effect of Oil Price Volatility, Board of Directors Characteristics on Firm Performance of Iraq Listed Companies: A Conceptual Framework

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ABSTRACT

Economies all over the world need the effective and efficient performance of business units both financial and non-financial firms because they are the engine of economic development of nations. Furthermore, many companies around the world try to improve their performance for the purpose of getting fund from investors in order to expand and to grow. On the other hand, investors need to have confidence that the company is being well managed and will continue to be profitable investments. The poor performance of listed firms around the world has been attributed to ineffective Corporate Governance (CG). Additionally, the performance of Iraq listed firms is discouraging given the declining nature of its price index performance from 2011 to 2015. Besides, the Iraq's economy is a strong member of OPEC which is an association major oil exporting countries which are oil dependent economies. The adverse effect of oil price volatility can have negative consequences on the Iraqi firms' performance in spite of strong board's characteristics while a favorable oil price changes can have the reverse effect. Therefore, the effect of board of directors' structure on firm performance is among the CG primary mechanism which drawn the attention of many researchers. Despite these, researches have given little attention to the joint effect of oil price volatility on the effect of and board characteristics on firm performance. Therefore, aim of this paper is to propose a framework that will investigate the moderating role joint effect of oil price volatility and board characteristics in influencing firm performance of Iraqi listed companies. It is anticipated that this study and the proposed framework will have wide generalization to economics constrained by weak firm performance that are mostly associated with volatile oil price and weak CG that deteriorates economic development.

Keywords: Board Of Directors, Firm Performance, Government Link of the Board, Oil Price Volatility

JEL Classifications: G38, M40, M41.

1. INTRODUCTION

The role of effective and efficient performance of both financial firms and non-financial firms is central towards economic development (see, for example, Levine, 2004; Sunday and David, 2011). Consequently, for countries around the world to achieve sustainable economic development it becomes paramount for these firms to attract investments, grow and develop to remain the cornerstones of economic growth. However, investors are most interested in firms that are financially secured and stable in maximizing stakeholders' and corporate values (see, for example, Al-Manaseer et al., 2012). Nonetheless, where the firms' performances do not generate sufficient return on investment (ROI) and maximize corporate values it becomes less attractive

to investors hence adversely affect the business industry and the economy at large (Al-Matari, 2014).

Furthermore, the performance of firms has come more under investigations after the 2007-2009 Global Financial Crisis (GFC) that affected large corporations such Arthur Andersen, Enron, Global Crossing, Lehman Brothers, Parmalat and WorldCom (Achim et al. 2015; Agyei-Mensah, 2016; Salehi and Shirazi, 2016; Ahmed and Hamdan, 2015; Alzahrani, 2014). Besides, the performance of Iraq listed firms is discouraging given the deteriorating nature of its price index performance between 2011 through 2015 as exhibited in Figure 1. Therefore, the issue of control of listed firms is subject of public interest where the government is making concerted efforts to remove administrative

and financial corruption which has penetrated into the Iraqi economy (Al-Maryani, 2015).

Figure 1 indicates the declines in the price index performance in Iraq. It also shows that the performance of listed companies on ISX declined from 2012 to 2015 (ISXAR, 2016). Studies have opined that the reason for such poor performance can be specifically traced to the fall in the confidence level of the investors due to ineffective Corporate Governance (CG) in Iraq. Consequently, many investors have transferred their hard earned income and invest it in safer economic and business environment (Paruchuri and Misangyi, 2015; Alnaser et al., 2014). Importantly, a number of recent scholars have attested to the fact that poor CG practices among Iraq companies as identified by the current and would be investors is negatively affecting the Iraq’s company performance (Allawi, 2015; Aboud, 2014; Jazrawi and Khudair, 2014a).

Hodgdon et al. (2008; 2009) stressed that the poor performance of listed firms around the world are attributable to ineffective CG thereby putting the efficiency of Board of Directors (BoD) at question. In the last two decades, debates on the significance of CG have continued to increase especially among academics and practitioners. Importantly, the current globalized business market and upsurge in competitive pressures have altered the corporate management scenario in the developed, emerging and developing economies (Arora and Sharma, 2015; Obembe and Soetan, 2015).

Furthermore, there were numerous studies conducted on the relationship between firm performance and CG but the problem still exists especially in Iraq. Even though some of the variables have been discussed by past scholars, the majority of the literature emanated from

developed nations and of which their results may not be generalizable to the Middle East countries in general and Iraq in particular because of differences in an organization setting, cultural affiliation, and geography. In the same vein, new corporate independent variables such as board member’s. Also, the problem of oil price volatility is another key issue that might improve or retard firm performance in an oil dependent economy such as Iraq. However, the literature gave little attention to the effect of oil price volatility.

In this regard, it is the objective of this paper to substantially contribute to CG literature by investigating the joint effects of oil price volatility and BoD’ characteristics on performance of the company. The remaining of the paper is organized as follows. This article proceeds in the following order: Section 2 highlights related literatures on firm performance, BoD’ characteristics and oil price volatility, and presents the proposed theoretical framework of the study. The last section states the anticipated policy implications of the proposed study and the conclusions offered.

2. REVIEW OF THE RELATED LITERATURE

BoD is an important mechanism that influences the interest of business owners and every other stakeholder. In view of its importance, the attentions of academia and practitioners have been drawn to the characteristics of the board and how it influences firm performance in the last few decades (Hassan et al. 2015; Vo and Nguyen, 2014). Importantly, evidences from past studies have equally indicated that effective board is an important ingredient for firms in developed and developing countries as it often brings about efficient managerial excellence (Nkundabanyanga, 2016). The function and the importance of the BoD has also been recognized as such ensures that their organizations adhere strictly to good CG practices while the board itself is regarded as one of the most important mechanisms in every medium sized family businesses (Sarbah et al., 2016).

Moreover, the board effectiveness or the lack of it has also become a global concern. For instance, cases of recent corporate scandals and fraud cases, questionable long term decisions by members of the board, and shareholders suit are attracting the attention of scholars. Importantly, the board characteristics and its composition which includes, the tenure of the board member, number on board, the size of the board, as well as their diversity with respect to age, gender, ethnicity, nationality, educational background, industrial experience and organizational membership, have been argued to have a lot influence on firm performance (Hassan et al., 2015).

In view of the significance of CG as discussed above, Jazrawi and Khudair (2014b), argue on the imperative of adopting CG as internal mechanisms by Iraqi companies as this will assist them to shield the shareholders and others stakeholders interests. This is also in line with the position of Al-Shammari, (2008), who articulates that the adoption of CG will help to reform economic and financial performance of companies in Iraq.

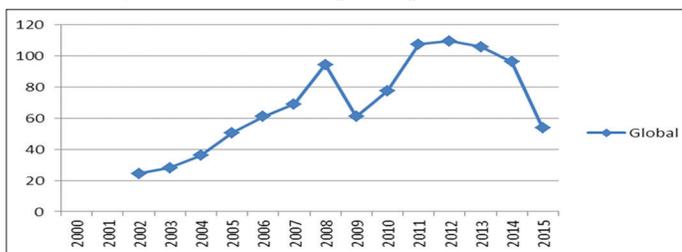
Furthermore, CG is an important mechanism that governs the relationship between shareholders and the BoD. Ultimately, it

Figure 1: Price index performance in Iraq (2010-2015)



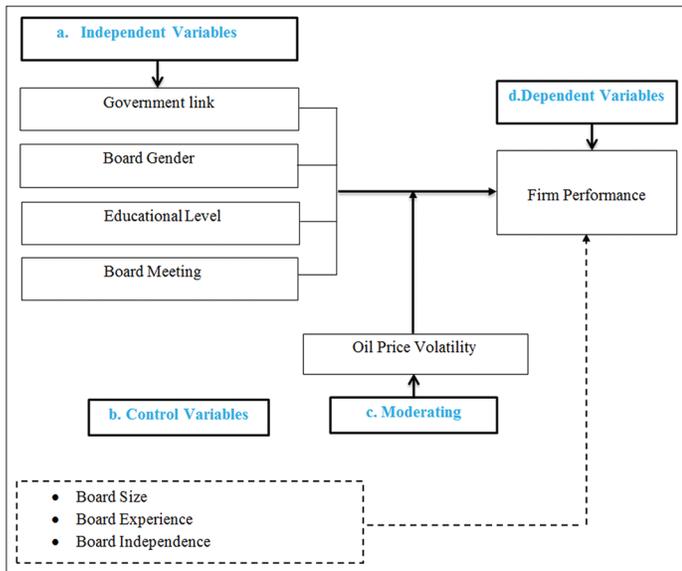
Source: Iraq stock exchange (ISX) 2015

Figure 2: OPEC Basket prices spanning 2002-2015



Source: OPEC (2015)

Figure 3: Proposed theoretical framework



Source: Developed by the authors for this study

assists and assures the shareholders whether the BoD is directing the affairs of their company rightly. Additionally, it helps to decrease the gap between the interested parties and the corporation represented by the BoD. The Board also assists in resolving conflict of interests between shareholders and managers while it also protects the rights of the stockholders inside the corporation (Emile et al., 2014). The main motivation of this conceptual study is to propose a framework for firm performance of Iraq listed companies with a good CG practices and the effect of oil price volatility.

2.1. Dependent Variables

2.1.1. Firm performance

Current and prospective investors have given much priority to companies' performance because it serves to connect their interest and that of the firm. In this regard, managers are saddled with the responsibility transparency and accountability aimed to improve the performance of their organizations. This is done through the adoption of new strategies and procedures formulated by the BoD and other board committees such as risk management committee to assist in keeping the firm running (Al-Matari et al., 2014a).

Previous scholars have investigated the role to form performance as a dependent variable using agency theory (Bauer et al., 2010; Haniffa and Hudaib, 2006). These theorists agree that the main concern of the firm is long run survival through effective and efficiency of the company (Bachiller et al., 2015). Firm performance has also been adjudged by scholars and practitioners to play a positive influence for economic growth and reduction of social problems such as unemployment (Palacios-Marques et al, 2013). However, most the previous and recent studies on the firm performance were conducted in developed countries (Garanina and Kaikova, 2016; Darko et al., 2016; Fernández-Gago et al., 2016; Sarbah et al., 2016; Akbar et al., 2016) while little attention has been paid to such issue in developing countries like Iraq (Alabdullah, 2016; IMF, 2015; Allawi, 2015).

Many scholars have employed different measures to examine firm performance (Ittner and Larcker, 2003; Cochran and Wood,

1984). For instance, majority of prior studies that examined the firm performance employed static models such as return on assets (ROA), return on equity, ROI, earnings per share, Tobin's Q ratio, Market-to-Book Ratio, return on sales (ROS), net profit, net sales (NS). Empirical evidence has equally shown that no consensus has been reached about any measure being perfect indicator of financial performance (Bhagat and Bolton, 2008; Haniffa and Hudaib, 2006).

However, there is very little studies that used dynamic models to account for the persistent poor performance of listed firms. Therefore, this paper proposes the adoption of dynamic Tobin's-Q and ROA as a market and accounting based measures of performance. This is also in line with the extant literature that suggested that future researchers should combine the two measures (Wijethilake et al., 2015; Al-Matari et al., 2014c). Moreover, measuring firm performance through a combination of the two measures could give a clearer comprehension of the relationship that exists between performance and selected variables of this study.

2.2. Independent Variables

2.2.1. Government link of the board

The degree of firm success can be influenced greatly by the presence of board members. In line with resource dependence theory, the existence of the government-linked board members is an important mechanism which a number of scholars have established to be instrumental to firm growth (Haniffa and Hudaib, 2006; Hillman et al., 2009). Hillman, (2005) for instance, opined that the presence of a government-linked board member such as cabinet ministers, undersecretary ministers, royal family members, or government employees is expected positively influence performance of organizations. In line with these assumptions, it is expected that organizations will take an advantage of such board members to have access to low cost funding (Khwaja and Mian, 2005) as well as have first-hand information about government policies, strategic plans and projects regarding the industry in which the organization is operating (Pfeffer and Salancik, 1978). In a study conducted by Goldman et al. (2009), it was reported that some selected US firms that support the winning party had higher opportunity of procuring government contracts.

Moreover, Boubakri et al. (2012) in a recent study of the association between politically connected public listed firms and organizational performance find that political connection increases both firm leverage and performance. This is in line with the position of resource dependence theory that asserts that politically connected board members will give ample of opportunity to an organization to access government resources (Pfeffer and Salancik, 1978). This finding has been supported by Hillman (2005) who also reported a positive association between firm performance and ex politicians as board members using Tobin's Q. This indicates the positive influence of government-linked directors. Furthermore, Goldman et al. (2009) find that the announcement of a politically connected board member brings an improvement in the share price of selected firms in US thereby confirming the assumptions of signaling theory.

Despite the importance of government linked board on the performance of firm, experience has shown that there are different schools of thoughts in this regard. Based on the position of first

school of thought, firms that are government linked are better governed (Kole and Mulherin, 1997; Ramírez and Tan, 2004; Ang and Ding, 2006). Specifically, these companies are under the watch of the investors, shareholders and the government. Consequently, management of these firms is conscious of managing, maximizing and protecting the shareholders' assets over personal interest of managers. Contrarily, the second school of thought opined that firms being managed by private hands are competitively managed and have more motivation to engage in innovation and reduce costs (Dewenter and Malatesta, 2001; Sun and Tong, 2002; Wei and Varela, 2003).

In this regard, such an individual who becomes a director or a member of the board may assist in reducing uncertainty that the firm may face by linking the firm to influential politicians and other government top officials as well as bringing skills, legitimacy and essential information to the firm (Hillman, 2005). While series of studies have been conducted on the performance of executive across countries (e.g. Firth, Fung, and Rui, 2007; Kato and Long, 2006), none of them have explicitly examined the effect of politically connected directors on firm performance. Yet, in the case of Middle East countries, where the economy has achieved spectacular growth despite minimum political reform, a deeper understanding of the role played by political connections in business is necessary (Chizema et al., 2014).

2.2.2. Board gender

Gender diversity is one of the larger concepts of board diversity (Milliken and Martins, 1996). Scholars and advocates of board diversity argue that the boards should be an amalgam and a reflection of the composition of the society through which the ethnicity, professional backgrounds and gender are adequately represented as such right composition will assist in providing diverse perspectives (Milliken and Martins, 1996; Walt and Ingley, 2003). Board diversity is adequately supported as it will help to fulfill the yearnings of shareholders (Carver, 2002), corporate philanthropist (Coffey and Wang, 1998), other stakeholders (Keasey et al., 1997), and for the purpose of meeting commercial obligations to business partners (Mattis, 2000; Daily and Dalton, 2003). Burton (1991) however argued that the board diversity should not just ensure fair representation but must also be done on the principle of merit. This fact has been corroborated by Robinson and Dechant (1997) who postulates that through board diversity better understanding of market place is well understood, creativity increased, leadership within the organization is enhanced while effective problem-solving skills are developed.

Based on the previous discussions, many researchers across developed countries have found a positive relationship between women directors and firm performance. Such scholars include, Vintil et al. (2015); Garanina and Kaikova (2016); Toumi et al. (2016); Estapé-Dubreuil and Torreguitart-Mirada (2015); Hyun et al. (2016); Ellwood and Garcia-Lacalle (2015); Lucas-Pérez et al. (2015); Isidro and Sobral (2015); Khaw et al. (2016); Byron and Post (2016). While In the developing countries Strøm et al. (2014); Fidanoski et al. (2014); Hassan et al. (2015); Das and Dey (2016); Solakoglu and Demir (2016). Some studies however report a negative correlation between gender diversity and firm performance (see, for example, Gregory-Smith et al., 2014; Chapple and Humphrey, 2014; Garanina

and Kaikova, 2016). Lastly, the empirical studies which found no relationship between gender diversity and firm performance in developed countries and developing countries include, Zemzem and Kacem (2014); Sila et al. (2016); Alm and Winberg (2016); Garanina and Kaikova (2016). Empirical studies have equally shown that research on women directorship in relation to corporate value creation in a developing country like Iraq are scarce as most previous studies only focused on the association between family ownership and the number of female directors (Moulin and Point, 2012; Nekhili and Gatfaoui, 2013).

2.2.3. Board's educational level

A number of questions have been raised about the relationship between level of education of board members and firm performance. While some schools of thoughts believe that level of education matters in board effective performance (see, for example, Francis et al., 2014; Mahadeo et al., 2012) other schools of thoughts advocate otherwise (see, for example, Lindorff and Jonson 2013). For instance, Gottesman and Morey (2006) opine that intelligence of the individual board member may be gauged with their educational qualification as such more intelligent managers are expected to be better than their peers. This is also in line with the position Francis et al. (2014) who believe that firms with directors from academia have higher performance as such performance is driven by academic qualification on the board. Moreover, in light of agency theory the educational backgrounds also assists in ensuring effective monitoring of top management boards (Al-Maghzom et al., 2016; Allini et al., 2016; Inkinen, 2016).

Darmadi (2013) on the other hand notes that superior managerial skills are not always obtained from a high level of educational qualification. The author argued that unobservable characteristics, like leadership and entrepreneurial skills, may significantly count in boosting performance. However, recent and past evidences have shown that in many cases, high-performing and fast-growing firms are established and are effectively managed by people who are not highly-educated. Hence, it is considered important to examine whether the educational qualifications of the Iraqi board members influence firm performance as empirical studies underpinning this are relatively sparse (Darmadi, 2013; Mahadeo et al., 2012). This is in line with the argument of Al-Musali and Ismail (2015) and Sahu and Manna (2013) who opined while a few of the previous studies have focused on characteristics of the board such as ethnicity of the board members, majority of others have not paid attention to diverse educational level of the board thereby ignoring the calls of previous scholars.

Considering the importance of the board member's level of education, the results of very few studies that investigated the relationship between this variable and firm performance in developed and developing countries reveal a positive association. For example, Toumi et al. (2016); Francis et al. (2014); Cho et al. (2015) and Hassan et al. (2015).

2.2.4. Board meeting

Board meeting is another important characteristic of the board. The meeting reflects the number of time which the board members meet in a year to discuss and resolve issues concerning the affairs of the company. With respect to Iraqi Codes of CG, the BoD are

required to meet at least six times in a year based on the chairman invitation at the request of any of its other members.

Importantly, most of the previous studies have majorly discussed board independence and board size while a little thought has been given to board meetings as an important variable that can improve company performance (Al-Manaseer et al., 2012; Kang and Kim, 2011). Essentially, the meetings are important avenues through which issues bordering on the performance of the firm are collectively discussed and through which resolutions are quickly passed in order to obtain desired results (Khan and Javid, 2011).

In essence, the board effectiveness is determined via its meetings as its frequency can bring about improvement that is desired since the frequency is often translated to added opportunities to observe and evaluate the management performance (Hsu and Petchsakulwong, 2010). In line with this argument, Evans et al., (2002) argued that the frequency of board meeting may be increased for the purpose of resolving issues pertaining decline in the firm performance.

2.3. Control Variables

2.3.1. Board size

One of the important characteristics of a firm's BoD is the board size. Hence, for a board to function effectively, its size matters (Huang and Wang, 2015). This is essential as such size determines or influences the process of decision making. Prior studies have linked the board's size with an effective firm's performance (Huang and Wang, 2015). However most of these studies were conducted in the developed countries of the USA (Cheng, 2008), Japan (Nakano and Nguyen, 2012) and New Zealand (Koerniadi, Krishnamurti, and Tourani-Rad, 2014) with very limited studies from the Middle east countries in general (Al-Matari et al., 2014b).

However, what should be the accurate size of the board is still debatable as the results of previous studies are inconclusive. For instance, Lipton and Lorsch (1992) suggest a board with limited number of seven or eight members. Their argument is based on the fact that if the members are more than ten, the directors may find it difficult to express their opinions effectively. This argument was later supported by Barnhart and Rosenstein (1998) who opined that firms with smaller sized board members perform effectively than firm with bigger sized board members.

Recently, Topak (2011) re-echoed the positions of Lipton and Lorsch (1992) and Barnhart and Rosenstein (1998) by concluding that large board size has severe cost implications on the firm and negatively influences the process of communication and coordination among the board members. However, Chaganti et al. (1985), Dalton et al. (1998) and Dallas (2001) are of the position that large board size improves the board decision making process since such size avails the board more expert members, and it is more effective in preventing corporate failure. More so, the results of previous studies are mixed. Many researchers from developed nations have found a positive relationship between large board size and firm performance.

2.3.2. Experience of the board

The experience (either community influence or business expertise) of the board member is one of the factors that is important in

board-firm performance relationship but has been grossly under researched (Gantebein and Volotene, 2011). While few of the past studies concurred that work experience of the appointed board members counts in discharging their oversight functions effectively (Johl, Kaur, & Cooper, 2015; Vo & Phan, 2013), a number of others opined that experience is one of the least factors that is required in the success of firms undertaking (Hamori & Koyuncu, 2015; Elsaid, Wang, & Davidson, 2011). Considering scarcity of literature and discord among the scholars on this variable, this study will examine the relationship between experience (as one of the characteristics of the board) and firm performance.

Though conflict exists with regards on the view of experts about the relationship that exists between firm performance and a board's level of experience, a theory on restrained resources submits that board members who are highly experienced will be able to work better in a business environment through proper adaption and will be able to positively contribute to the goal attainment of the firm (Wegge et al., 2008).

In view of the above, series of studies have been conducted on the role of finance expertise on the firm performance. For instance, previous studies have found that capital market often respond positively to the appointment of non-executive directors with financial expertise to audit committee (Nkundabanyanga et al., 2015) and which implies that finance expertise contributes to the effectiveness of the audit committee. This is in line with the findings of Kallamu and Saat (2015) who argued that directors' ability and experience goes a long way to determine the extent to which effective monitoring of risks of the companies is enhanced.

2.3.3. Board independence

Board independence is another characteristic of the board which has attracted the attention of practitioners and researchers and it has been acknowledged by stock exchange authorities and lawmakers globally. These characteristic of the board is regarded as an important element of sound CG (CG) (Liu et al., 2015). This attribute is measured by the number of independent non-executive directors on the board relative to the entire of members of the board (Lawal, 2012; Uadiale, 2010).

In particular, the independent directors are saddled with the oversight function of monitoring and control over the activities of the firm aimed at reducing the opportunistic behaviour of managers (Abdurrouf, 2011; Pandya, 2011). Similarly, the independent directors work independently without the influence or control of the management, major shareholders, or other stakeholders. This implies that independent directors act as a check in the prevention of fraud, since they are not economically or psychologically attached to the firms' management (Hsu and Petchsakulwong, 2010).

Aside reducing the opportunistic behavior of the management, it has equally been argued that independent directors can safeguard the shareholders interest effectively than their non-independent counterparts (Chaghadari and Chaleshtori, 2011), They can equally reduce agency costs which makes their monitoring and strategic planning function to be more effective (Berle and Means, 1932).

2.4. Moderating

2.4.1. Oil price volatility

Iraq is a major oil producing and exporting country whose economy significantly depends on oil proceeds which is basically oil price driven. Therefore, oil price volatility is a major source of concern to Iraq's economy as its adverse effects can undermine the smooth running of economic agents. Consequently, oil price volatility is a systematic risk which is interchangeably used with the concept of systemic risks refers to the undesirable and contagious occurrence of events in the larger business environment that adversely affect the financial system.

The Systemic Risk Centre (CSR) of the London School of Economics and Political Sciences opines that systemic risk refers to the risk of a breakdown of an entire system rather than simply the failure of individual parts (CSR, 2017). Also, De Bandt and Hartmann (2000) argue that systemic risk is now being widely accepted as the fundamental underlying concept for the study of financial instability and possible policy responses. Collier and Skees (2013) stipulate the elements of systemic risks to include triggers such as price instability, political instability and natural disasters (environmental risks).

For example, the effect of ongoing oil price instability among the OPEC members and their persistent low performance of their firms have shown very clearly that a continuous monitoring of the business activities is exposed is of utmost importance to policymakers, researchers, practitioners and investors.¹

Further, Iraq and other OPEC member states are net oil exporting countries that are oil-price sensitive¹ hence coming together to guard against oil price volatility through price settings and/or quota system of productions (OPEC, 2015). Unfortunately, most of these states have been experiencing the effect of price changes, especially the recent downward slope of oil price. The oil price changes can influence the economic units' cash flows and net worth of OPEC member states thereby affecting their general firm values. The countries under study have witnessed tremendous oil price² fluctuations as represented in Figure 2, ranging from \$24.36, \$94.45, \$61.06, \$109.45, \$105.87, and \$53.78 for the years 2002, 2008, 2009, 2012, 2013 and 2014 respectively.

The factor of oil price changes has been a major source of concern to many economies around the world due to its influence on economic growth and development. The effect of the oil price factor on economic activities can be dated back as far as 1946 (Aguiar-Conraria and Soares, 2011) and also some of the earliest studies in the area can be traced to the pioneer works of Mork (1989), Hamilton (1983) and Darby (1982). Therefore, the severity of oil price changes and its importance to OPEC member states' economies has made it an interesting factor and considered as one of the variables of interest for this study. Therefore, there is the need to investigate the moderating role of oil price volatility on the effect of the BoD' characteristics on firm performance of Iraq listed companies.

1 Price sensitivity is a major reason that led to the formation of OPEC. The organization was basically formed as a cartel to guard against falls in the price of crude oil.

2 This is the annual oil basket price per barrel provided by OPEC (in US dollars).

Figure 3 represents an attempt toward the optimal corporate board structure that fits the corporate governance model in the Arab region. The proposed theoretical framework will enable a country to reap further gains from its abundant oil resources by investing the returns from oil exports.

3. CONCLUSION

It is important for countries around the world to have effective and efficient performance of business units both financial and non-financial firms because they are the engine of economic development of nations. Nevertheless, the performance of Iraq listed firms is discouraging given the declining nature of its price index performance from 2011 to 2015. The poor performance of listed firms around the world has been attributed to ineffective CG. However, researches have given little attention to the influence of salient board characteristics on firm performance. Furthermore, there is inadequate prior studies that examine these relationships in the developing countries such as Iraq.

The main objective of this paper is to propose a framework that will investigate the joint effects of oil price volatility and salient features of board characteristics on firm performance of Iraqi listed companies. Therefore, this paper offers a proposition on the association between oil price volatility, board member gender, board members' educational level, government link of the board, board meeting, experience of the board, board independence, board size and firm performance.

Therefore, this proposition paper will contribute in bridging the identified gap and enrich the existing literature. It is anticipated that the findings of the proposed empirical research will have wide generalisation to economics constrained by weak firm performance that are mostly associated with volatile oil price and weak CG.

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