

## Internationalisation of Russia's Gazprom<sup>\*</sup>

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*This article explores the specific features of the institutional environment and their implications for business operations of Russian companies on foreign markets. The author gives some insights into the relationships between internationalisation and firm behaviour. In order to analyse how and how far internationalisation can influence enterprise behaviour, this article deals with the business activities of the Russian gas monopoly Gazprom on foreign markets. It hypothesises that the different institutional settings on the various markets influence the enterprise behaviour of Gazprom, i.e. that internationalisation disseminates international norms and practices.*

*Der Artikel beleuchtet die spezifischen Merkmale der institutionellen Umgebung und ihre Verwicklungen für Geschäftshandlungen von russischen Unternehmen auf ausländischen Märkten. Der Autor gibt Einblick in die Beziehungen zwischen Internationalisierung und Firmenverhalten. Zwecks der Analyse, wie und inwieweit Internationalisierung das Unternehmensverhalten beeinflusst, behandelt der Artikel die Geschäftstätigkeiten des russischen Gasmonopolisten Gazprom in ausländischen Märkten. Er stellt die Hypothese auf, dass die unterschiedlichen institutionellen Bedingungen auf den unterschiedlichen Märkten das Unternehmensverhalten von Gazprom beeinflussen, d.h., dass Internationalisierung die Verbreitung von internationalen Normen und Praktiken zur Folge hat.*

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# 1. Soviet / Russian Gas Exports

## 1.1. The Institutional Environment of Economic Activities

This study deals with the Soviet/Russian gas industry, i.e. the Soviet Gas Ministry and Gazprom respectively. This article will concentrate on natural gas exports, because for a firm of the extracting industry exports are the main element of internationalisation. Other aspects of internationalisation such as FDI, strategic partnerships and international finance will be considered to a lesser extent.

In socialist times the markets for Russian gas exports could generally be divided into countries with centrally planned economies, i.e. the Council of Mutual Economic Assistance (CMEA)<sup>1</sup> trading area, and the world market, which in this context means first of all Western Europe due to technical restrictions, i.e. the lack of export infrastructure for gas deliveries to other markets. In post-socialist times, Central European countries have largely adapted to the formal and informal rules of West European market economies. At least as far as Russian gas exports are concerned Western and Central European countries can be grouped together, now forming part of the world market. In the former Soviet Union (FSU) countries, however, internationalisation has so far influenced first of all the formal institutions. Informal institutions differ strongly from Western standards. Accordingly post-socialist foreign markets for Russian natural gas exports can be grouped into West and Central European market economies on the one hand and FSU economies on the other hand. In some Central European countries Gazprom's business behaviour differs not always from that in the FSU. In countries like Bulgaria or Hungary the company has repeatedly tried to reach its aims with similar methods and instruments as employed in the FSU. However, when these methods of enforcement of interests failed, Gazprom changed to business behaviour, which follows international standards and conventions<sup>2</sup>.

On the firm level the transition to a market orientated enterprise after the breakdown of the socialist systems needs a pro-active approach to acquiring complementary resources, through both investment in complementary assets and organisational learning (Meyer, 2000). Especially in the area of marketing, firms have to improve their basic competencies in terms of structure, systems and processes, organisational culture and human resources (Batra, 1997; Martin, 1999).

To sum up, both phenomena - internationalisation and institutional transition - force incremental learning from enterprises. One possibility to learn is using

<sup>1</sup> In this article the term CMEA refers only its East European member countries, i.e. Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland, and Romania.

<sup>2</sup> A good example is the dispute over Topenergo in Bulgaria (Heinrich, 1999a; Ganev, 2001).

strategic alliances to access or internalise new technologies and know-how beyond firm boundaries. The mutual dependence in the relationship between supplier and customer leaves few or no alternative counterparts to choose from. This dependence causes the firms to develop joint activities and a shared responsibility for developing their commercial activities. The more the firms depend on each other, the more they will engage in the relationship and uncover opportunities to develop the foreign market (Blankenburg-Holm & Erikson, 2000).

To the supplier such alliance means greater access to market knowledge, making the customer relationship useful for developing the foreign market. The relationship can be used as a bridgehead for a further penetration of the foreign market. Blankenburg-Holm and Erikson (2000) show that suppliers' bridgehead relationships are conditioned by the personal relations with the foreign customer which generate experimental knowledge. Experimental knowledge refers to knowledge of culture, customs, business and market structure of individual markets (Clark et al., 1997; Chetty & Erikson, 1998). Experiential knowledge is developed from within the mutual relationship and not from within the firm. It is generated within this relationship and then stored in the procedures and routines of the firm.

## **1.2. Soviet Period**

Economic internationalisation as defined in this analysis did not have a real direct impact on the Soviet Union because control of productive assets was highly concentrated in the political elite and socialist institutions mediated and buffered international transactions and price signals (Evangelista, 1996; Stent, 1984). That is why the Soviet period will be considered to a lesser extent.

Soviet gas exports to member countries of the CMEA started with deliveries to Poland after World War II. Exports to Czechoslovakia began in 1967. But deliveries to Eastern Europe remained low throughout the 1960s as increments in consumption were largely based on increased domestic production. In the second half of the 1960s, the Soviet Union became interested in developing a widespread pipeline network for natural gas. But only the oil price shock of 1973-74 brought about a reversal of the CMEA countries previously reluctant attitude towards energy integration. Soviet gas exports to Eastern Europe were expanded gradually in the 1970s. Deliveries to the German Democratic Republic started in 1973, to Bulgaria in 1974, to Hungary in 1976, to Yugoslavia in 1979 and to Romania in 1980<sup>3</sup>.

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<sup>3</sup> Exports to Yugoslavia did not reach the contracted level of around 3 billion cubic meters (bcm) per year until 1983 because of delays in the construction of distribution systems and in conversions of end-users appliance (Estrada et al., 1988; Hardt, 1984).

Natural gas exports to Western Europe were a direct consequence of the expansion of the pipeline network for deliveries to Eastern Europe. In 1968, the first deliveries to Austria were made. Soviet gas exports to Western Europe accelerated at the beginning of the 1970s with deliveries to the Federal Republic of Germany beginning in 1973 and to Italy and Finland in 1974. In the late 1970s, gas exports to Western Europe expanded threefold and extensions to the European gas grid enabled the Soviet Union to extend supplies to France in 1976 (Estrada et al., 1988; Stern, 1989).

### 1.3. Post-Soviet Period

In 1989, the Soviet Ministries of the Oil Industry, the Gas Industry and Petroleum Refining were re-organised and amalgamated to create a single Ministry of the Oil and Gas Industry. Plans were developed to establish one state company for the oil industry, Lukoil, and another one for the gas industry - Gazprom. The plan for the gas industry was realised within a few weeks, and nearly the whole staff of the ministry changed into the management of the new company, which meant personnel continuity from Soviet times. Gazprom became responsible for all enterprises directly involved in production, refining, transportation and storage of natural gas. Thus, Gazprom holds the monopoly on production, transport and export of natural gas (Kryukov & Moe, 1996; Kryukov, 1998). Exports are controlled through Gazprom's export division Gazeksport - formerly Soyuzgazeksport - and various joint venture marketing companies in all the countries to which Russian natural gas is exported (Stern, 1993).

The main activities of Gazprom outside Russia include the expansion of export capacities and at the same time access to international financial markets in order to obtain the necessary finance, the conclusion of strategic partnerships with foreign companies, the struggle for control over transit pipelines in Eastern Europe, and rivalry with Central Asian gas producers.

#### 1.3.1. *The Former Soviet Union*

The importance of the FSU as export market for Russian gas is decreasing due to the widespread use of barter and a serious non-payment crisis in most of the countries. Gazprom endeavours to find other suppliers for these countries. The most important of the companies is the US-based Itera group which has strong informal connections to the Russian gas monopoly and supplies Russian and Central Asian natural gas to customers in the FSU. Itera used sometimes tough and ingenious methods to monetise its gas deliveries. In 2000, the company was the largest intra-FSU gas trader with deliveries of 45.1 bcm compared to Gazprom's deliveries of 43.4 bcm. Itera is the single supplier for Georgia and Armenia. In 2000, it was responsible for around 25% of the natural gas deliveries to the Baltic States, for 54% of the deliveries to Ukraine, for 25% of

the gas deliveries to Moldova and for 35% of the supplies to Belarus. In addition, Itera is the operator of the gas pipeline grid in Armenia and Kazakhstan (Liuhto, 2001; Renaissance Capital, 2002; Itera, 2002)<sup>4</sup>.

Meanwhile, Gazprom is aiming to recover the FSU gas markets that it relinquished to trader Itera in the 1990s. But as the FSU economies have begun to stabilise, Gazprom wants to restore its cut of the business. Mezhhregiongaz - Gazprom's marketing subsidiary - which until now has worked only in Russia, will compete with Itera to deliver natural gas to Ukraine, Belarus and the Baltic States. In 2001, Itera earned USD 1.7 bn from supplying gas to Ukraine, plus a further USD 150 mn from Belarus and USD 100 mn from the Baltic States. Separately, Itera delivers around 38.5 bcm of gas to FSU states under 'commercial' terms of as high as USD 70 per 1000 cubic meter. And Gazprom believes it can undercut the private trader. The firm is also keen to usurp Itera's role as the main importer of Turkmen gas. Thus, Itera appears to have lost its status as the operator of Turkmen gas sales to Ukraine and may be in danger of losing its entrenched position in the Ukrainian market. An inter-governmental agreement between Russia and Ukraine suggests that Gazprom could take over responsibility for gas sales to Ukraine. This may be part of a broader move away from any official support of Itera as a gas trader in the CIS<sup>5</sup>. Gazprom officials hint that Itera will not be allowed to continue with these lucrative contracts in future. Gazprom wants to regain a key role in FSU gas transactions because we need more imported gas from central Asia, a senior Gazprom official announced<sup>6</sup>.

Nevertheless, the Western FSU states - especially Ukraine and Belarus - are important for Gazprom as transit countries to Central and Western Europe and the Central Asian FSU states are producers of natural gas with huge reserves and in so far potential competitors to Gazprom.

### *1.3.2. Problems with Transit Countries*

Until now, Russian natural gas - for Western Europe as well as for Southeast Europe and Turkey - is being exported via Belarus and Ukraine<sup>7</sup>. After the collapse of the Soviet Union, conditions for the transport of natural gas from Russia to Western Europe changed radically. The newly independent states, Belarus and Ukraine, introduced transit fees, which made Russian gas exports more expensive. In addition, the transit countries have often forced Gazprom to accept a compromise on their debts for natural gas deliveries. Especially

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<sup>4</sup> Itera company information, <http://www.iteragroup.com>.

<sup>5</sup> *United Financial Group, Russia Morning Comment*, 5 November, 2001.

<sup>6</sup> *Petroleum Argus, FSU Energy*, 14 June, 2002.

<sup>7</sup> At present Gazprom's delivers more than 80% of its gas exports to Europe via Ukraine's pipeline network (*Petroleum Argus, FSU Energy*, 14 June, 2002).



Ukraine has tried to use her near monopoly position on Russian gas transit to Western Europe to offset its weak position as a customer for Russian gas and as a debtor to Gazprom. Because of long-lasting quarrels with Ukraine about transit fees, and because of accusations that gas was being siphoned off during transit, Gazprom developed plans for alternative transit routes to break the transit monopoly of Ukraine and to reduce transit across FSU countries as much as possible.

*Table 1. Gazprom's Natural Gas Exports to FSU Countries (bcm)*

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
<b>Total exports</b>	<b>284.7</b>	<b>N/A</b>	<b>205.8</b>	<b>179.4</b>	<b>184.0</b>	<b>191.3</b>	<b>199.5</b>	<b>190.1</b>	<b>173.0</b>	<b>174.0</b>	<b>172.4</b>
Ukraine	100.8	78.1	78.1	54.7	57.0	52.3	51.0	49.3	30.5	29.6	27.2
Belarus	40.0	17.3	17.3	16.4	14.7	12.9	13.7	15.2	14.7	12.2	10.8
Moldova	N/A	3.4	3.4	3.1	3.0	3.0	3.2	3.3	2.9	2.1	1.8
Lithuania	5.8	3.3	3.3	1.8	2.1	2.5	2.6	2.2	2.2	1.8	2.0
Latvia	3.3	1.6	1.6	1.0	1.1	1.2	1.1	1.1	1.3	1.0	1.0
Estonia	1.5	0.9	0.9	0.4	0.6	0.7	0.8	0.8	0.8	0.5	0.6
Kazakhstan	5.4	2.0	2.0	1.1	0.4	0.1	0.4	0.8	—	—	—
Georgia	4.9	—	—	—	0.3	—	0.2	0.9	—	—	—
Azerbaijan	11.7	—	—	—	—	—	—	—	—	—	—
Turkmenistan	1.3	—	—	—	—	—	—	—	—	—	—
<b>Subtotal FSU</b>	<b>174.7</b>	<b>106.6</b>	<b>106.6</b>	<b>78.5</b>	<b>79.2</b>	<b>72.7</b>	<b>73.0</b>	<b>73.3</b>	<b>52.4</b>	<b>47.2</b>	<b>43.4</b>
<b>Percentage of total</b>	<b>61.4</b>	<b>N/A</b>	<b>51.8</b>	<b>43.8</b>	<b>43.0</b>	<b>37.7</b>	<b>36.6</b>	<b>38.6</b>	<b>30.3</b>	<b>27.1</b>	<b>25.2</b>

Sources: *Petroleum Economist* (1996) May, p. 82; *Petroleum Economist* (1997), special issue "Gas in the FSU and Eastern Europe", September, p. 72; E+Russia AG (1997) *RAO Gazprom*, E+Russia, Gescher, p. 7; FARCO Securities (1998), *RAO Gazprom*, Moscow, <http://www.securities.com>; Gazprom 1998, p. 25; Gazprom 1999, p. 29; Gazprom 2000, <http://www.securities.com>; *Business Communications Agency* (2000) 31 December; Renaissance Capital 2002, p. 92; own calculations.

One of the alternative transit routes is the *Yamal* pipeline from the Western Siberian gas fields on the Yamal peninsula bypassing Ukraine and instead going directly through Belarus and Poland and further on to Germany over a distance of 4105 km. The pipeline is being constructed step by step from west to east, partly via existing pipeline capacities. Capital spending on the Yamal project will total approximately USD 40 bn<sup>8</sup>. Gazprom's payment problems, causing delays in the delivery of pipes and the withdrawal of an international credit after the financial crisis in 1998, have delayed the construction works<sup>9</sup>. In September 1999, the first part of the pipeline has been completed from Germany through

<sup>8</sup> Wingas, <http://www.wingas.de/Wingas.nst>

<sup>9</sup> *Petroleum Economist* (1998) No. 10.

Poland to the Belarus-Russian border. In 2000, almost 14 bcm of gas were pumped through this new section by re-routing gas from existing pipelines. The Yamal pipeline currently carries around 20 bcm of gas annually. However, construction of the 2932 km Russian section has yet to begin<sup>10</sup>.

However, the construction of these pipelines can at best moderate the problems with Ukraine, because alternative export capacities will not be enough to stop transit through Ukraine altogether and Belarus might cause the same problems for gas transits as Ukraine does. A real solution of the transport problem could perhaps be reached through a pipeline via Finland, Sweden and Denmark to Western Europe<sup>11</sup>.

To secure control over transit pipelines will be a major task for Gazprom in the next few years. That is why Gazprom has been trying for years to swap transit countries' debts for stakes in their gas transit infrastructure. However, this strategy has been successful only in Moldavia. Ukraine and Belarus have so far ignored all related demands (Heinrich, 1999a).

### *1.3.3. Weakening the Central Asian Competitors*

Gazprom is trying to weaken the position of Central Asian gas producers, which are trying to reach the world market. Since all producers in the former Soviet republics of Central Asia need the Russian pipeline system for gas exports beyond the region, Gazprom has so far been successful. But Central Asian producers are now planning alternative export pipelines avoiding Russian territory. Most of these ambitious plans are unlikely to be realised. Accordingly, Central Asian gas producers will continue to depend on Gazprom, at least for some years to come.

In order to solve the transit problem and eliminate Central Asian competitors, Gazprom aims at the establishment of a unified energy sector within the FSU. The Russian government promotes this project. The main instrument for its realisation is the acquisition of controlling stakes in energy companies in the relevant states. Gazprom has succeeded in getting property rights to gas companies and in enforcing the establishment of joint ventures. Through pressure related to its monopoly on transit pipelines, Gazprom was able to become a member of the consortium, which exploits the *Karakhaganak* natural gas field in Kazakhstan. In the same way, Gazprom entered the gas business in Turkmenistan. In 1995, Gazprom enforced the establishment of the joint venture *Turkmenrosgaz*, with a monopoly on Turkmen natural gas exports. After Turkmenistan suspended its deliveries to Ukraine due to the non-payment crisis

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<sup>10</sup> *Reuters*, 23 September, 1999; Trafalgar (2001); *RFE/RL Business Watch*, 16 April, 2002.

<sup>11</sup> Gazprom plans to deliver natural gas to Sweden through a pipeline from Finland across the Baltic Sea (*NewsBase, FSU Oil and Gas Monitor*, 29 June, 1999; Trafalgar, 2001).

in March 1997 Gazprom put an end to the joint venture and revoked the pipeline access for Turkmen gas in autumn 1997.

At the end of the 1990s, however, Gazprom has to certain degree become dependent on Central Asian gas producers, because the Russian company has not been able to fulfil all its delivery obligation with domestic production. In 1999, Gazprom signed a deal with the Dutch gas trader Gasunie for the delivery of 80 bcm over a 20-year period starting in October 2001. To fulfil this contract, Russia signed an import deal with Turkmenistan for a one-year import of 20 bcm. In the medium term Gazprom also needs Turkmen gas for the 'Blue Stream' pipeline to Turkey<sup>12</sup>.

Because of the Russian gas deficit imports from Turkmenistan are to be continued. Experts have estimated the Russian gas deficit at 10 bcm per year, a figure that may grow to 30 bcm by 2005 due to falling extraction from Gazprom's old deposits and growing gas consumption<sup>13</sup>. This might be the reason why the Russian President Putin in early 2002 suggested creating a Eurasian gas alliance with the Central Asian gas producers. Retaining control over the Central Asian gas reserves was on Russia's agenda during most of the 1990s. Additionally, this suggestion might also be an expression of the growing concerns about Western influence in the region in the wake of the war in Afghanistan<sup>14</sup>.

## 1.4. Western and Central Europe

### 1.4.1. Expansion of Export Capacities

Gazprom has developed plans to expand natural gas exports in all possible directions. Especially in Western and Central Europe, Gazprom is trying to diversify the structure of its consumer base and to increase participation in deliveries to end-users. Moreover, the company has initiated an attempt to gain direct access to large industrial and gas-fired power generation markets in Western and Central Europe. Gazprom hopes to profit from the European Union's gas market liberalisation attempts by getting access to the downstream business in Western Europe. At the same time, the expansion of export capacities requires an increase in gas production, and with that the development of new gas deposits, and in addition provision of the necessary investment capital.

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<sup>12</sup> Gasunie, [http://www.gasunie.nl/eng/p\\_ga\\_fi\\_99.htm](http://www.gasunie.nl/eng/p_ga_fi_99.htm); *NewsBase, FSU Oil & Gas Monitor*, 2 October, 2001.

<sup>13</sup> *NewsBase, FSU Oil & Gas Monitor*, 6 November, 2001; see also Götz (2002).

<sup>14</sup> *NewsBase, FSU Oil & Gas Monitor*, 29 January, 2002; *RFE/RL Business Watch*, 29 January, 2002.



The expansion of export capacities, however, meets with both external and internal problems. Production costs will rise, problems with transit countries will continue, and prognoses of future demand on the West European gas market have been over-optimistic (Heinrich, 1999b; Götz, 2002).

*Table 2. Gazprom's Natural Gas Exports to Central & Western Europe (bcm)*

	1990	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>Total exports</b>	<b>284.7</b>	<b>205.8</b>	<b>179.4</b>	<b>184.0</b>	<b>191.3</b>	<b>199.5</b>	<b>190.1</b>	<b>173.0</b>	<b>174.0</b>	<b>172.4</b>	<b>166.0</b>
Germany	26.6	22.9	25.7	29.6	32.1	32.9	32.5	32.5	34.9	34.1	32.6
Italy	13.6	14.1	13.8	13.8	14.3	14.0	14.2	17.3	19.8	21.8	20.2
France	10.6	12.1	11.6	12.2	12.9	12.4	10.9	10.9	13.4	12.9	11.2
Austria	5.1	5.1	5.3	5.1	6.1	6.0	5.6	5.7	5.4	5.1	4.9
Turkey	3.3	4.5	5.1	4.7	5.7	5.6	6.7	6.7	8.9	10.2	11.1
Finland	2.7	3.0	3.1	3.4	3.6	3.7	3.6	4.2	4.2	4.3	4.5
Switzerland	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3
Greece	—	—	—	—	—	0.01	0.2	0.9	1.5	1.6	1.5
<b>Western Europe</b>	<b>62.2</b>	<b>62.1</b>	<b>65.0</b>	<b>69.2</b>	<b>75.1</b>	<b>75.0</b>	<b>74.1</b>	<b>78.6</b>	<b>88.5</b>	<b>90.4</b>	<b>86.3</b>
<b>Percentage of total</b>	<b>21.8</b>	<b>30.2</b>	<b>36.2</b>	<b>37.6</b>	<b>39.3</b>	<b>37.6</b>	<b>39.0</b>	<b>45.4</b>	<b>50.9</b>	<b>52.4</b>	<b>52.0</b>
Czech Republic*	14.2	12.8	13.2	13.8	8.4	9.4	8.4	8.6	7.8	7.5	7.5
Slovakia	—	—	—	—	6.5	7.0	7.1	7.1	7.5	7.9	7.5
Poland	8.4	6.7	5.8	6.2	7.2	7.1	6.8	6.9	6.1	6.8	7.5
Hungary	6.5	4.8	5.7	5.2	6.3	7.7	6.5	7.3	7.4	7.8	8.0
Bulgaria	6.9	5.2	4.8	4.7	5.8	6.0	5.0	3.6	3.2	3.2	3.3
Romania	7.3	4.6	4.6	4.5	6.1	7.1	5.1	4.7	3.2	3.2	2.9
Former Yugoslavia**	4.5	3.0	1.8	1.2	—	—	—	—	—	—	—
Slovenia	—	—	—	—	0.5	0.5	0.5	0.5	0.6	0.7	0.6
Croatia	—	—	—	—	0.3	1.0	1.1	1.2	1.2	1.2	1.2
Bosnia	—	—	—	—	1.2	0.4	0.1	0.2	0.2	0.3	0.2
Serbia/Montenegro	—	—	—	—	1.2	2.1	2.1	1.9	1.1	1.2	1.2
Macedonia	—	—	—	—	—	—	0.01	0.02	0.04	0.07	0.09
<b>Central Europe</b>	<b>47.8</b>	<b>37.1</b>	<b>35.9</b>	<b>35.6</b>	<b>43.5</b>	<b>48.3</b>	<b>42.7</b>	<b>42.0</b>	<b>38.3</b>	<b>39.9</b>	<b>40.0</b>
<b>Percentage of total</b>	<b>16.8</b>	<b>18.0</b>	<b>20.0</b>	<b>19.3</b>	<b>22.7</b>	<b>24.2</b>	<b>22.5</b>	<b>24.3</b>	<b>22.0</b>	<b>23.1</b>	<b>24.1</b>

\* until 1995 together with Slovakia (former Czechoslovakia)

\*\* until 1994 Yugoslavia included Serbia, Croatia, Bosnia, Slovenia, Montenegro and Macedonia.

Sources: *Petroleum Economist* (1996) May, p. 82; *Petroleum Economist* (1997), special issue "Gas in the FSU and Eastern Europe", September, p. 72; E+Russia AG (1997) *RAO Gazprom*, E+Russia, Gescher, p. 7; FARCO Securities (1998), *RAO Gazprom*, Moscow, <http://www.securities.com>; Gazprom 1998, p. 25; Gazprom 1999, p. 29; Gazprom 2000, <http://www.securities.com>; *Business Communications Agency* (2000) 31 December; Myers-Jaffe/ Manning 2001, p. 137; *Interfax* (2002) 29 January; *NewsBase, FSU Oil & Gas Monitor* (2002) No. 12, 27 March; own calculations.

Difficult climatic conditions, outdated technology, and the extremely long transport routes to the customers will lead to increased costs in the next few years. For these reasons, Gazprom is losing its price advantages over competitors on the European natural gas market<sup>15</sup>. This problem is reflected in the company's difficulties in attracting the financial means necessary for investment in modern technology. Estimates put the infrastructure requirements for Gazprom's existing operations at USD 3.5-6.0 bn (Moors, 1999). After the Russian financial crisis in August 1998, Gazprom has found it even harder to get foreign loans. In 2000, the loans needed for major projects could only be attracted in co-operation with foreign partners.

Most prognoses for Western Europe's natural gas demand are overoptimistic. A tendency towards a growing discrepancy between general economic development and energy demand in Western Europe can be observed: economic growth no longer leads to an equivalent rise in energy consumption. Also, in the main national markets the residential and commercial sectors are already integrated into a countrywide gas supply system. The quantitative increase in natural gas consumption will only be slow, so that there is not much room for dynamic growth. Additionally, new suppliers will make the European gas market more competitive (Heinrich, 1999b; Götz, 2002).

#### 1.4.2. The Financial Situation of Gazprom

A main problem for Gazprom's financial situation is the non-payment crisis on the Russian domestic market. The proportion of cash payments has been below 25% for a couple of years. The overall debt of Russian consumers for gas deliveries was equal to more than one year's total domestic supply<sup>16</sup>. The share of cash payments in 2000 rose to 70% from 39% in 1999 (Renaissance Capital, 2002). Gazprom has re-organised payment mechanisms in a way, which it believes will help it improve collection rates and reduce the level of receivables. The three main measures are: 1) the 1999 agreement with the electricity monopoly *RAO UES* (one of the largest debtors); 2) strengthening the role of

<sup>15</sup> WPS, *CIS Oil and Gas Report* 6 July, 2001 and Götz (2002).

<sup>16</sup> *Analytica Newsletter, Profili kompanii Gazprom*, 19 February, 2000.

*Mezhregiongaz* (which enforces payments on the regional level and reducing non-monetary forms of payment from around 80% to 10% of its turnover<sup>17</sup>); and 3) reducing or suspending deliveries to recalcitrant consumers within Russia and the FSU (O'Sullivan & Avdeev, 2000).

Because the Russian capital market is underdeveloped, Gazprom has used the international financial markets to get loans and to issue American Depositary Receipts (ADRs) for financing its expansion plans. In 1999, Gazprom paid about USD 1.75 bn on a total international bank syndication debt believed to amount to about USD 25 bn (Moors, 1999). At present, it is assumed that Gazprom has to service loans which totally amounted to USD 13 bn (Götz, 2002). In its behaviour on international financial markets, Gazprom differs less and less from the main Western companies. It works with international auditing companies and investment banks to attract loans, services its debts, issues ADRs, and publishes company reports according to international accounting standards.

After the August 1998 crisis and the fall in international gas prices, it became harder for Gazprom to attract foreign loans. The company lost its privileged position as the preferred Russian company. In 1999, Gazprom received no large foreign loan but only small ones for specific upgrading projects. As a result, the company had to reduce its investment program by two thirds. In order to finance its main long-term projects, Gazprom has had to draw on the assistance of its Western strategic partners. These long-term projects include development of the domestic gas grid, the Yamal-Europe pipeline, the building of storage facilities, the acquisition of new gas deposits, and the 'Blue Stream' pipeline across the Black Sea to Turkey.

The attempts of Gazprom and its strategic partner Eni from Italy to get loans to finance the Blue Stream project dragged on for nearly two years. In 2000, the relevant deals were finally made, providing nearly USD 2 bn in loans from Italian, Japanese and German creditors<sup>18</sup>. In March 2001, Gazprom received an additional Euro 250 mn five-year loan from European banks to finance the construction of the onshore section of its Blue Stream gas pipeline. Gazprom explained that this was the first loan it received from European banks since 1998 that was not insured by export credit agencies<sup>19</sup>.

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<sup>17</sup> *Petroleum Argus, FSU Energy*, 14 June, 2002.

<sup>18</sup> O'Sullivan & Avdeev (2000); *NefteCompass*, 11 January, 2001.

<sup>19</sup> *NewsBase, FSU Oil & Gas Monitor*, 10 January, 2001; *Nefte Compass*, 1 March, 2001. The prospect of the liberalisation of the European gas market might be another factor for Gazprom's destabilised financial situation. This liberalisation may lead to the development of a system of spot contracts for the purchase of gas lots. This would infringe on long-term agreements without which Gazprom cannot attract foreign loans to finance large-scale projects (*WPS, CIS Oil and Gas Report*, 6 July, 2001).

Since the beginning of 2002, Gazprom received several small foreign loans, which together amounted to USD 580 mn<sup>20</sup>. Additionally, Gazprom placed a USD 500 mn Eurobond in April 2002. Credit Suisse First Boston and Schroder Salomon Smith Barney acted as lead managers for the issue. First plans to issue USD 1 bn worth of Eurobonds were worked out by Gazprom during 1996, 1997 and 1998.

*Table 3. Gazprom's International Loans, 1993-1998*

Year	Amount	Partner	Project
1993	DM 1.5 bn	Commerzbank (Germany)	Pipeline construction (Germany)
1994	DM 936 mn	N/A	Construction of an ethylene plant in Russia
	USD 1.615 bn	Mediocredito Centrale (Italy)	Import of equipment and technology
1995	DM 1.3 bn	Commerzbank (Germany)	Pipeline construction (Germany)
1996	DM 1 bn	Kali-Bank GmbH (Wintershall subsidiary)	Pipeline construction ( <i>Yamal</i> )
	USD 429.27 mn	Morgan Stanley, Dresdner Kleinworth Benson	Emission of ADR at the New York Stock Exchange
1997	USD 2.5 bn	Dresdner Bank Luxemburg and 18 other banks	
	DM 1.675 bn	Dresdner Bank and Deutsche Bank (Germany)	Import of equipment and technology
	USD 265 mn	EBRD	
	USD 1.2 bn	Dresdner Kleinworth Benson and Credit Lyonnais	Loan for tax payments in Russia
	USD 60 mn	Citibank International and Commerzbank	Loan for the Gazprom Bank
	USD 3 bn	Dresdner Bank Luxembourg and Credit Lyonnais	Pipeline construction ( <i>Yamal</i> ) and re-financing of other loans
1998	USD 33.1 mn	Citibank International	Re-financing of other loans
	USD 230 mn	Deutsche Morgan Greenfell and Easkilda Debt Capital Markets	Loan for the Gazprom Bank
	USD 200 mn	Bayerische Landesbank, Chase Manhattan and others.	Export financing

Source: Heinrich (1999a, 14-15).

<sup>20</sup> *NewsBase, FSU Oil & Gas Monitor*, 16 October, 2001; *NewsBase, Russia Weekly*, 19 November, 2001; *NewsBase, Russia Weekly*, 18 March, 2002.

Yet, however, the plan had been abandoned in the wake of the Russian financial crisis. In 2001, Gazprom again had planned to issue its first Eurobonds. However, the plan was postponed for several times<sup>21</sup>. Due to the good success of the Eurobond issue the company approved in May 2002 the issue of another USD 400 mn Eurobond until the end of 2002<sup>22</sup>.

To sum up, it can be noticed that Gazprom still highly depends on international capital markets. Certainly, the Russian government has concern about excessive foreign debts of Gazprom, but due to the underdeveloped Russian capital market there is no real alternative to foreign loans for the company. The Russian Energy Minister announced that the government plans to take measures to switch Gazprom to domestic borrowings. However, Gazprom cannot receive loans from Russian banks on preferred terms<sup>23</sup>. Thus, the company's dependence on international capital markets and foreign loans will continue. Accordingly, in June 2002, Gazprom decided to borrow USD 250 mn from the French Societe Generale on the security of an export contract<sup>24</sup>.

#### *1.4.3. Strategic Partnerships*

Gazprom is engaging in strategic partnerships with leading Western natural gas companies in order to gain access to new markets and new sources of finance. It is a means of bringing in foreign companies that have their own access to loans at more affordable rates (Moors, 1999). In long-term co-operation the Russian company has proven that it is a reliable partner. In Germany, Gazprom is co-operating with Ruhrgas and BASF/Wintershall, in Italy with Eni. The company is also co-operating with the international Royal Dutch/Shell Group.

At the end of 1997, Shell and Gazprom signed an agreement on a strategic partnership including co-operation in the exploitation of oil, gas and liquid gas. The partners are also planning projects in the energy transportation sector. Through this alliance, Gazprom hopes to open up markets in Asia, the Far East and South East Asia<sup>25</sup>. Despite this alliance, both companies were competitors on the Turkish natural gas market. While Gazprom was planning a pipeline across the Black Sea ('Blue Stream'), Shell was until June 2000 involved in a project which would have delivered Turkmen gas to Turkey via a pipeline across the Caspian Sea<sup>26</sup>. In June 2002, Italy's Eni announced that it had completed laying the second line of the dual natural gas pipeline. Inauguration of the pipeline is due to take place in October of 2002 (Coe, 2002).

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<sup>21</sup> *NewsBase, Russia Weekly*, 18 March, 2002; *Energy & Politics*, 20 May, 1998; *NewsBase, FSU Oil & Gas Monitor*, 12 June, 2001.

<sup>22</sup> *BBC Monitoring, FSU & Central Asia*, 21 May, 2002.

<sup>23</sup> *WPS, Russian Finance Report*, 8 February, 2002; *Moscow Times*, 25 June, 2002.

<sup>24</sup> *Moscow Times* 25 June, 2002; *IntelliNews, Russia Today* 25 June, 2002.

<sup>25</sup> Koshkareva & Narzikulov (1997); Shell, (1997) <http://www.shell.com/library/press/>.

<sup>26</sup> *Kommersant*, 29 June, 2000; Shell (1999) <http://www.shell.com/library/press/>.



The co-operation in exploitation started in the super-giant *Zapolyarnoye* field in the Ob-Taz Gulf in the far north of Western Siberia. Gazprom hopes to extract annually at least 105 bcm of gas from the Zapolyarnoye deposit until 2003. A feasibility study for the field was prepared in summer 2000. Zapolyarnoye was made operative in October 2001 and has become the first deposit to be discovered by Gazprom since 1989<sup>27</sup>. Meanwhile, Shell's role in developing the Zapolyarnoye field, which mainly contain gas condensate, remains unclear. Shell says it is still interested in the project but that work will not be able to start in earnest until Russia delivers workable production-sharing agreement legislation. Gazprom sources say there is disagreement on the best way to develop the field<sup>28</sup>. However, Shell invited Gazprom to join the Sakhalin-II project. The Sakhalin-II project is operated by Shell, which might be stepping up co-operation with Gazprom for need of political support from a local partner<sup>29</sup>.

The co-operation with Ruhrgas - which has a market share of more than 60% in Germany - helps Gazprom to increase its access to the West European gas market and to prepare for the partial liberalisation of the EU gas market. The partnership with Ruhrgas started in 1970, when the first supply contract between the Soviet Union and Ruhrgas was signed. In the period 1973-97 Soviet, respectively Russian, natural gas sales to Ruhrgas amounted to a total of 355 bcm, worth around USD 32.5 bn (at current prices). Until 2020 an additional 370 bcm, worth USD 35.5 bn, are to be delivered according to present contracts. By the end of 2000, Ruhrgas held a stake of 5% in Gazprom and a seat on the company board<sup>30</sup>.

A consortium of Gazprom, Ruhrgas and Gaz de France has won the privatisation tender for sale of a 49% stake of Slovakia's national gas monopoly SPP. Participation in the management of SPP is strategically important for Gazprom because the company exports around 70% of its gas to Western Europe via the Slovak pipeline system<sup>31</sup>. Additionally, Gazprom expressed interest in building a new section of the Slovak part of the main gas trunk line from Russia to Western Europe<sup>32</sup>.

In 1989, Gazprom began to look for new business opportunities in the West European downstream sector. However, Ruhrgas seemed to be unwilling to grant its Russian partner access to that profitable part of the gas market. As a result, Gazprom signed a co-operation agreement with Wintershall - a subsidiary of BASF and one of the main competitors of Ruhrgas in the German natural gas

<sup>27</sup> *Interfax*, 16 January, 2001; *NewsBase, FSU Oil & Gas Monitor*, 6 November, 2001.

<sup>28</sup> *Petroleum Argus, FSU Energy*, 14 June, 2002.

<sup>29</sup> *Vedomosti*, 17 April, 2002.

<sup>30</sup> *Nefte Compass*, 14 December, 2000; Liuhto (2001).

<sup>31</sup> *WPS, CIS Oil and Gas Report*, 8 March, 2002.

<sup>32</sup> *NewsBase, FSU Oil & Gas Monitor*, 23 October, 2001.

market. The agreement includes the joint marketing of Russian natural gas, as well as the joint planning and construction of gas pipelines and storage facilities in Germany and in the neighbouring countries. The resulting tensions with Ruhrgas disappeared only very slowly. The co-operation with Wintershall offers Gazprom lasting access to the West European gas supply system in the downstream sector (Heinrich, 1999a/1999b). In March 1999, Gazprom formed a strategic alliance with BASF for exploiting oil and gas in Russia (Osetinskaia, 1999). Wintershall is carving out a role in the upstream development of Gazprom's massive *Urengoi* gas producing zone in Western Siberia for several years. By the middle of 2002, a joint venture is planned to be created for the exploitation of the *Achimovskoye* formation in *Novy Urengoi*. Wintershall may also take part in developing the deeper layers of Gazprom's *Yamburg* field in the Ural Mountains<sup>33</sup>. Gazprom's co-operation with Eni, which can be traced back to the end of the 1960s, follows similar patterns.

At the beginning of 1998, a strategic alliance was formed for the development, exploitation, transport, and sale of oil, gas, and gas condensate in different countries. Most importantly, Eni is involved in the 'Blue Stream' project. The agreement also includes the development of natural gas fields in the Russian Astrakhan region. In addition, Gazprom is trying to use its partnership with Eni in order to enter the de-monopolised Italian gas market and to strengthen its position on the Southern European gas market (Heinrich, 1999a). In summer 2001, Eni announced that it is interested in acquiring a stake in Gazprom<sup>34</sup>.

In its co-operation with West European gas companies Gazprom has acted as a reliable partner. As a result co-operation has been intensified in the last year, concentrating not only on Russian gas exports but on a multitude of strategic issues, including among others upgrading of technology, personnel training, and environment protection.

## 2. Conclusion

Looking at the development of export activities as presented in the case study above, it becomes obvious, that the stage model is too deterministic and that the choice of entry mode can be independent of a firm's previous experience in export markets. This study likewise shows that firms do not necessarily follow any particular and consistent pattern in their internationalisation process. Firms may choose different entry modes and internationalisation patterns in different countries. There seems also to be a tendency of differences between different industries.

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<sup>33</sup> *Petroleum Argus*, *FSU Energy*, 14 June, 2002; Snieckus (2001); *NewsBase*, *FSU Oil & Gas Monitor*, 4 February, 2002.

<sup>34</sup> *NewsBase*, *FSU Oil & Gas Monitor*, 14 August, 2001.

Table 4. Some Major Stakes of Gazprom in European Gas Joint Ventures

Country	Joint Venture	Stake	Activities
Armenia	ArmRosGazprom	45%	Gas trading and transport
Austria	GHW	50%	Gas trading company
Bulgaria	Topenergy (Topenergo)	100%	Gas trading and transport
	Overgas	23.2%	Gas trading
Estonia	Eesti Gaas	30.6%	Gas trading and transport
Finland	Gasum Oy	25%	Gas transportation and marketing
	North Transgas Oy	50%	Construction of a pipeline beneath the Baltic Sea
France	FRAgaz	50%	Gas trading
Germany	Ditgaz	49%	Gas trading
	Verbundnetz Gas (VNG)	5.3%	Gas transportation and marketing
	Wintershall Erdgas Handelshaus (WIEH)	50%	Gas trading company. Single trader of all the gas exported by <i>Gazekspart</i> until 2012.
	Zarubezhgas	100%	Gas trading
	Erdgashandel		
Greece	Prometheus Gaz	50%	Marketing and construction
Hungary	Panrusgaz	40%	Gas trading and transport
Italy	Volta	49%	Gas trading and transport
	Promgaz	50%	Gas trading and marketing
Latvia	Latvijas Gaze	25%	Gas trading and transport
Lithuania	Stella-Vitae	30%	Gas trading
Moldova	Gazsnabtransit	50%	Gas trading and transport
Netherlands	Peter-Gaz	51%	Gas trading
Poland	Gas Trading	35%	Gas trading
	Europol Gaz (Evropol Gaz)	48%	Gas transport
Romania	WIROM	25%	Gas trading. The stake of Gazprom is hold by WIEH
Slovak Republic	Slovrusgaz	50%	Gas trading and transport
Slovenia	Tagdem	7.6%	Gas trading
	SPP	16.3%	Gas trading and transport
Turkey	Turusgaz	45%	Gas trading
UK/ Belgium	Interconnector	10%	Pipeline which connected Bacton (UK) with Zeebrugge (Belgium)
Yugoslavia	YugoRosGaz	50%	Gas trading and transport
	Progress Gas Trading	50%	Gas trading

Sources: UNCTAD 2001, 116; NAUFOR, Company Profiles in Figures: Gazprom (2002) 15 January; company data, <http://www.gazprom.ru/>.

In the case of the Soviet/Russian natural gas industry the stage model has to be modified due to peculiarities of the gas business. Natural gas exports demand the construction of an expensive pipeline infrastructure, stretching geographically from the exporting country to the importing country. Accordingly Soviet natural gas exports to Western Europe could only start after the pipeline network in Eastern Europe had been extended to reach Czechoslovakia. Construction of the necessary export infrastructure obviously demands long-term investment and with that long-term supply contracts to justify investments.

That is why stage 1 of the stage model (no regular export activities) is not applicable to the Soviet/Russian natural gas industry. Stages 3 and 4 (the establishment of overseas sales subsidiaries and the foundation of overseas production units<sup>35</sup>) were only entered in the post-Soviet period, when Soviet restrictions on investments abroad and EU restrictions on the gas market were lifted.

The internationalisation of the Soviet gas industry and Gazprom respectively, was not subject to constant periods of entering. Instead export activities were dependent on the extension of the European gas grid. As soon as the pipeline grid was in place, deliveries started. This in fact supports the thesis, that general knowledge of internationalisation is rather more important than country-specific knowledge - at least in the Western European context (Clark et al., 1997)<sup>36</sup>.

In the beginning the process of internationalisation was limited to the export of natural gas. Payment for gas deliveries took the form of transfer roubles or - more important in this analysis - in goods (steel pipes) and services (multinational construction projects), leading to a technology transfer already in Soviet times. Only in the 1990s did the Russian gas industry enter a new stage of international activities. Gazprom established overseas sale subsidiaries in nearly all the Western and Central European countries to which natural gas was exported. The main reasons for this are market seeking (participation in the EU downstream market) as well as strategic asset or capability seeking (mainly in Central Europe and FSU in order to maintain influence and secure control over transit routes). To avoid opportunistic behaviour by its partners Gazprom is endeavouring to maintain control through a majority ownership rather than to act as a profit-seeking investor only (Liuhto, 2001).

The commitments and the long time-perspective of natural gas contracts pave the way for stable relationships between seller and buyer. Such long-term relationships promote strategic alliances, marked by mutual dependence since the exit option implies high infra-structural sunk costs. The alliance with the

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<sup>35</sup> There were only a few joint production ventures of Gazprom, like *Karakhaganak* in Kazakhstan or South Pars in Iran.

<sup>36</sup> "As a whole, the internationalization strategies of the Soviet corporations did not significantly deviate between the Western countries concerned" (Liuhto, 2001, 10).

German Ruhrgas and the resulting organisational learning has considerably increased the market knowledge of Gazprom's management. Gazprom has employed this market knowledge to increase penetration of the German natural gas market, thus using Ruhrgas as a bridgehead and for some time causing a conflict with Ruhrgas over collaboration with its competitor Wintershall. However, the mutual dependence and the long-term experience helped to solve this conflict and led to intensified co-operation. The case study thus confirms the general assumption about the role of market knowledge<sup>37</sup> and mutual dependence<sup>38</sup>.

In Soviet times energy exports had a political component. First, energy exports could be used to foster political integration. *"A widely-held goal for Soviet policy towards Western Europe is to tie these countries closer to the Soviet Union. [...] Another fairly obvious Soviet goal is to make use of any opportunity to drive a wedge into the relationship between Western Europe and the United States"* (Estrada et al., 1988, 179). Second, dependence on Soviet energy deliveries could also be used to exert pressure. *"The Soviet Union does have a reputation [...] for using energy exports to exert political pressure. In the late 1950s and early 1960s the country used cuts in oil deliveries as a political weapon against countries like Yugoslavia and Israel. However, this was in a period when Soviet oil exports were of only minor importance to the economy, indeed total Soviet foreign trade was much smaller than today"* (Estrada et al., 1988, 180).

Increasing internationalisation with the expansion of natural gas exports in the 1970s, made the Soviet Union economically more dependent on these exports as a main source of hard currency income and technology transfers. *"The Soviet motivation for exporting gas to Western Europe could be seen as overwhelmingly economic. Energy exports to the world market steadily increased in volume during the 1970s and became increasingly important as a percentage of total Soviet hard currency earnings"* (Stern, 1986, 49). These commodities accounted for just over 25% (gas = 0.7%) of the country's hard currency earnings at the beginning of the 1970s, but for nearly 60% (gas = 11.1%) by the end of the decade and 80% (gas = 16.7%) in 1982.

As a result political motives lost importance and stable economic co-operation became the main aim. The change in motives also led to a change in behaviour. *"It seems fair to observe that Soviet exporters have worked hard [...] to shed this*

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<sup>37</sup> It is rather the record of long-term trading which matters in making trading partners co-operative with each other. *"Since committed relationships incorporate mutual long-term investments, they also provide access to specific information concerning the related party's business relationship"* (Blankenburg-Holm & Erikson, 2000, 197).

<sup>38</sup> Ventures and partnerships are more likely to succeed when partners possess complementary missions and resource capabilities (Blankenburg-Holm & Erikson, 2000, 196).



*reputation and to avoid any action that could give reason for new suspicion*“ (Estrada et al., 1988, 180). Over the years the Soviet negotiators became familiar with, and experts in, the conduct of natural gas trade negotiations. The Soviet side adhered to agreements and proves to be very satisfactory trading partner (Stern, 1986/1989).

When the Soviet Ministry for the Gas Industry was transformed into the company Gazprom not much did change in this respect. Gazprom inherited the encompassing interests developed by the Soviet gas industry a long time ago. Gazprom like the Soviet Ministry of the Natural Gas Industry had to establish itself as a reliable partner of the West in order to ensure profitable gas exports. As a result Gazprom pursues a reliable and fair company policy based on the rules of international business behaviour. This is the only way for the company to get international loans, to issue ADRs, and to engage in strategic partnerships with leading Western natural gas companies. As a result, the Russian gas giant does not differ significantly from other big national or multinational oil and gas companies.

However, within the FSU, solvency, payment behaviour and loyalty to the terms of a contract differ from Western standards. Under these unfavourable conditions the Russian gas monopoly sees control over the energy sector of the former Soviet Union as an opportunity to maximise profits. The company tries to externalise costs and to weaken its competitors from Central Asia. Gazprom's strategy, though, has so far had only limited success. Neither the restrictions on the transit of Central Asian gas through Russia nor the gas debts of Western FSU countries have helped Gazprom to gain control over the natural gas sector of the former Soviet Union. Instead, the Central Asian gas producers have been looking for alternative export routes. Western countries - especially the USA - are interested in supporting these attempts as a way to roll back Russian influence in the region. Gazprom has also failed to bend the transit countries to its will. On the contrary, the transit countries, and most notably Ukraine, have often forced Gazprom to accept a compromise on their debts for natural gas deliveries because of their importance for gas exports.

In summary, it can be said that Gazprom pursues two completely different strategies at its different levels of action at least as far as the gas export business is concerned. At the international level, the company aims at further integration into a globalising world economy. At the FSU level, however, it tries to preserve regulated and hierarchical markets as a pre-condition for successful rent-seeking behaviour based on the externalisation of costs. This means that internationalisation has influenced that part of Gazprom's business, which is related to operations with foreign (i.e. non-FSU) partners and customers. In the FSU, however, internationalisation does not really have an impact on the company's behaviour. That means Gazprom has a janus-faced enterprise behaviour, which depends on the markets on which it operates.

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