Lukoil’s Global Expansion: Motives And Entry Modes

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Introduction
The Russian economy is currently highly dependent on the export of natural resources. In particular, oil and gas industry contribute to the increase of GDP and compile significant part of the country’s budget. It is estimated that the oil sector is responsible for about 20 per cent of the total revenue of the state budget and 40 per cent of total earnings from exports (Tabata, 2005). Therefore, large oil corporations significantly influence Russian economy as well as the global economy in general, due to their huge financial power and profit-oriented corporate management. Currently the exports and foreign sales remain the most common international cooperation channels, however, many of the Russian companies are already engaged in more demanding foreign operation modes. In this paper, we analyze the internationalization process of LUKOIL, which is the largest Russian private oil company. Our focal point is the motivation of LUKOIL to global expansion and its choice of entry mode. The idiosyncratic nature of Russian multinationals and specific way of their formation and development in the 1990s makes LUKOIL an exciting object of academic research.

Following are the key objectives of the study.

- To analyze the history of multinational companies’ emergence in the Russian context.
- To identify the main internal and external factors for LUKOIL’s global expansion.
- To describe LUKOIL’s modes of entry and expansion.

Throughout the history, there has been a significant number of research works investigating internationalization process. Moreover, in recent years, some researchers conducted their studies to explore global expansion of Russian multinationals in oil industry, such as Lukoil and Gazprom but still there are gaps to be filled.

The problem in the previous research is that, it is more generalized or the researchers consider only process models of internationalization. A lot of research still is required to determine motives for the internationalization process and entry modes of LUKOIL.

The paper is organized as follows. The next section focuses on a general background by tracing the history of the emergence of Russian multinationals. Section 3 presents the company’s profile. Section 4 provides some information on geography of LUKOIL’s internationalization. Section 5 describes motives for LUKOIL’s global expansion. Section 6 looks at the company’s entry modes. Finally, section 7 concludes.

Russian Internationalization
The phenomenon of internationalization in the Russian context has more than hundred year’s history. However, in this study we will focus mainly on the global expansion of the Russian companies since the collapse of the Soviet Union.

The internationalization of Soviet companies was highly limited due to the centralization of planning, central authorities’ interference in the firm’s investment decision and ideological motives. Foreign trade was the state prerogative in the Soviet area. Soviet companies used to be in the international collaboration mostly with the Council for Mutual Economic Assistance (CMEA). The CMEA was an organization created in 1949 to foster economic and technical cooperation between communist countries in Eastern and East Central Europe (USSR, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, East Germany, with Albania leaving in 1961), and, Mongolia in 1962, Cuba in 1972, and Vietnam in 1978 (Bevir, 2007). As a matter of fact, the CMEA could be considered as a successful...
attempt at common market creation, development of economic cooperation and mutual benefit partnership. All Union Industrial Associations were managed by GOSPLAN (central state planning body in the USSR) and located in the Soviet republics and in the CMEA countries. Union Industrial Associations were international organizations by nature. Moreover, there were some Soviet companies with managerial and organizational structures similar to those in multinational corporation (MNCs), however, they were not called MNCs because of political reasons. For example, “Sojuznefteexport” (currently the state transnational company “NaftaMosva”) had subsidiaries in Germany, Denmark, Switzerland, Great Britain, Italy, Finland and Belgium. Also insurance agency INGOSSTRAKH had subsidiaries, associate firms and affiliates in Austria, Germany, Great Britain, France, Netherlands and the USA (Liuhto, 2001a, b). Geoffrey Hamilton (1986) refers to such companies as “red multinationals” and observes their operations, defining that in most cases they carried out only marketing and sales operations.

During the Soviet times, most state-owned enterprises headquartered in Moscow had subsidiaries in different Soviet Republics. Such a fragmentation was deliberately developed by policy-makers in order to provide equal distribution of industrial objects across the Soviet Union and was coordinated by the Soviet Ministry for Central Planning. Moreover, due to the prohibition of competition, the enterprises were assigned with specific suppliers and customers, so that the value chain was designed on the state level. Collapse of the Soviet Union and the CMEA caused disintegration of state-owned enterprises whose assets now were located in sovereign independent states, so that the links with suppliers and customers got broken. As a result, the only way of re-establishing these links for corporate integration became the acquisition of these assets based in the Commonwealth of Independent States (CIS). Some researchers discussed the process of restructuring and transformation of these former state-owned enterprises in their studies, including King (1995) and Filatotchev (2007).

Since the trade liberalization of 1992 in Russia, Russian companies started deliberately participating in international trade. They have started emerging as an important source of outward FDI. The annual average of outward FDI flows in the 1990s constituted around $1.6bn annually, and it has reached around $18bn in 2006. Similarly, outward FDI reached 10.2 % of the gross fixed capital formation in 2006 against an average of 3.0% in the 1990s. Presently Russia is considered to be one of the leading emerging markets in terms of outward FDI. Such a position is supported not by several multinational giants but by dozens of Russian MNEs in various industries. Foreign assets of the top 20 Russian non-financial MNEs grew every year and reached USD 111 billion at the end of 2011. Oil and gas and steel companies with considerable exports are among the leading Russian MNEs.

**LUKOIL: Company’s profile**

LUKOIL is one of the largest international oil and gas companies vertically integrated, and operating in 60 Russian regions and over 30 countries around the world. It was founded in 1991 during the privatization period in Russia as the result of the merger of three state-owned oil producing enterprises (Langepasneftegaz, Urainenftegaz and Kogalymneftegaz- the first letters composing LUK). LUKOIL is active in the area of exploration and production of oil and gas, the manufacturing of petroleum products and petrochemicals, as well as in the marketing of these outputs. The company controls about 1.3 per cent of global oil reserves and 2.3 per cent of global production of crude oil, its main reservoirs are located in Western Siberia (Lukoil annual report, 2005).

LUKOIL has a balanced value chain in all three sectors of oil industry: upstream, midstream and downstream. In the upstream sector, the company has significant assets in Azerbaijan, Kazakhstan, Egypt, Iraq and Iran. The regional market of Central and Eastern Europe has refining capacity in Odessa (Ukraine), Burgas (Bulgaria) and Ploiesti (Romania). The downstream sector mainly operates distribution networks in Ukraine, Turkey, Bulgaria, Moldova and Romania. Unlike other Russian companies, LUKOIL’s securities are traded in the four countries of the world stock markets: the Russian Trade System (RTS) stock exchange Moscow Interbank Currency
Exchange (MICEX), the London Stock Exchange (LSE), the Frankfurt Stock Exchange (FSE) and the US OTC (gravitie.com). Top managers control about 25 per cent of LUKOIL shares, while about 20 per cent is owned by the American oil major ConocoPhilips; the remainder trade freely (Panibratov, 2012).

**Geography of LUKOIL’s internationalization**
LUKOIL is the best known face of the Russian oil industry overseas, it has internationalized to a very significant extent.

**Lukoil foreign upstream projects**
Oil and gas production abroad takes a small part in LUKOIL’s business, most on-going projects are exploration-oriented. The main countries being explored are the CIS countries (Kazakhstan, Uzbekistan, Azerbaijan).

In the Republic of Kazakhstan, LUKOIL has been operating since 1995 and has invested more than $4.7 billion in Republic's economy. Participating in 7 onshore production projects and producing 10% of the total hydrocarbon production in Kazakhstan, LUKOIL is fairly considered to have built up a strong portfolio in the Republic. The Tengiz and CPC projects are managed through the Russian-American joint-venture Lukarco, while other projects are managed through LUKOIL Overseas.

In Azerbaijan, the company has been active since the Exploration, Development and Production Sharing Agreement for the Shah-Deniz offshore gas and condensate field was ratified and came into effect in 1996. Currently LUKOIL enjoys its 10 per cent share in the project.

In 2004 LUKOIL started its operations in Uzbekistan and since that time the total accumulated volume of investment made by the company in the region’s economy has exceeded $2.5 billion. Moreover, Panibratov (2012) mention, that in 2008 LUKOIL acquired SNG Holdings LTD., which held 100 per cent of various production sharing agreements in the country. Currently LUKOIL participates in four major projects in the region.

The company is successfully carrying out its activities in Egypt as well. In 1995, the company joined the Meleiha project as part of the Russian-Italian JV Lukagip, and currently its share is 24 per cent. LUKOIL is a partner in the West Esh El-Mallaha project (WEEM), sharing 50 per cent with its partner Egyptian General Petroleum Corporation (EGPC).

Considering Middle East as a strategic region of development, LUKOIL joined the project in the Kingdom of Saudi Arabia. Operations in this region started in March 2004 when LUKOIL Overseas with its current share of 80 per cent joined state-owned oil company Saudi Aramco (20 per cent) in a joint venture.

Aiming to develop cooperation between Russia and Latin American countries in the energy industry, the largest Russian companies, LUKOIL, Gazprom, Rosneft and TNK-BP, agreed to establish the National Petroleum Consortium (NPC) for joint development of the Latin America oil fields in June 2009. Later PetroMiranda joint venture was established to develop the Junin-6 project in Orinoco basin (Venezuela). State Petroleum Company (PDVSA) holds 60 per cent share, while NPC holds 40 per cent.

West Qurna-2 field in Iraq was discovered and explored by Soviet exploration and service companies in the 70-80s. In December2009, a consortium of LUKOIL and Norway’s Statoil won a tender for its development. Current project participants are Iraqi state South Oil Company (on behalf of the state of Iraq) and a consortium of contractors including LUKOIL (75per cent) and Iraqi state North Oil Company (25per cent). Statoil ASA had 18.75 per cent stake in the project before May 2012 (currently transferred its share to LUKOIL).

LUKOIL operates its exploration projects in the Western Africa as well: since 2006 in the Republic of Cote d'Ivoire with the company's share 56.66 per cent, since 2009 in Ghana with 56.66 per cent stake as well.

In 2011 LUKOIL started exploration and development projects in Romania, the Republic of Sierra Leone and Vietnam. In June 2013, LUKOIL was awarded two production licenses in the Barents Sea.
International Downstream

LUKOIL’s global expansion has gone farthest in the fields of refining, marketing and distribution as well. The company currently owns oil processing capacities in Romania, Bulgaria and Ukraine and approximately 30 per cent of the company’s total refining takes place abroad. Romania’s biggest refinery Petrotel was acquired by LUKOIL in 1998 and currently the company’s interest is 93 per cent. Petrotel LUKOIL A.S. is capable of refining 2.4 mlntn of oil per annum. LUKOIL controls nearly 20 per cent of the petroleum products in Romania. The following year Russian oil giant bought Bulgaria’s NeftokhimBourgas refinery, which is now the largest refinery located in Balkans.

One more foreign oil-processing facility was acquired by LUKOIL in the mid of 2000, when it bought a controlling stake in Ukraine’s Odessa refinery on the Black Sea coast. Next year LUKOIL built up its interest to 99 per cent, and currently it has more than 180 gasoline stations in Ukraine. Later on LUKOIL started European expansion. In mid-2008, the Russian oil giant bought a 49 per cent stake in a newly established joint venture ERG SpA, that operates the ISAB refinery in Sicily. With this acquisition the company’s overall refining capacity increased by 13 per cent and its refining capacity abroad by 60 per cent. Through this joint venture Lukoil achieved significant benefits, these are: notably improved earnings via improved local networking, and supply opportunities in its intended new markets (the Balkans, Turkey, Western European countries). The strategy of Sicilian acquisition aimed at expanding in Europe from its present remit, which is limited to Europe east (Ukraine, Romania, Bulgaria). The other LUKOIL’s movement on Western Europe was the buy-in of 4 per cent of Raffinaderij Nederland of the Netherlands (Panibratov, 2012).

Moreover, LUKOIL’s image is rooted in its sizable retail network. The company owns a filling station chain carrying its own name in European countries, and it also operates under the brand names Getty (in the USA) and Teboil (in the CIS countries) (Panibratov, 2012). As of January 1, 2011 LUKOIL’s retail network in Russia consisted of 2,242 filling stations (including franchises), while in the CIS countries, Europe, and the United States the company had 4,266 filling stations (including franchises).

Motives for LUKOIL’s global expansion

In this study we use the classification of FDI developed by Dunning (1993) to investigate the motivation of LUKOIL to expand overseas. However, it should be admitted that in many cases companies pursue several goals with the same acquisition at the same time. Resource-seeking motive refers to investment which aims to acquire factors of production or natural resources. LUKOIL’s expansion to Azerbaijan can be explained by the resource-seeking motives as this country is rich in oil. Market-seeking motive refers to investments seeking for new markets or maintaining existing ones. At this point, the driving reason for LUKOIL to go abroad was the Russian government’s policy of increasing its control over domestic oil production in 2000. In accordance with the Uppsala model, firstly, LUKOIL has been expanding its presence in the neighboring markets of the CIS, where it benefited from the knowledge of local traditions and business practices as well as sharing common language. In his study Dunning (1993) suggests that efficiency-seeking investment comes sequentially after the two previous type of FDI. The goal of efficiency-seeking motive is seen as achieving the increase of a firm’s efficiency by exploiting the benefits of economies of scale and scope, or common ownership. In case of LUKOIL, the acquisition of refining assets in Odessa (Ukraine) might serve as a good example of this type of motive. Asset-seeking motive can also be defined behind the outward expansion. LUKOIL has a great interest in gaining marketing experience, modern managerial skills as well as advanced technologies. Due to the alliance that the company formed with the US giant Conoco Philips, LUKOIL got access to the latest technologies and capital.
In order to understand the internationalization strategies of LUKOIL, these four classical external factors can be complemented by internal factors. Firstly, tightening rules for licensing affect the company’s activities greatly. The authorities have the power to cancel exploration, development and production licenses in case the company does not fulfill the requirements such as the number of wells to be drilled, production volume, and the start time for commercial production.

Another internal factor is oil export taxes, which are set high along with the rising cost of oil. Russian oil companies seem not to receive the benefits from high crude oil prices, which, in turn, affects the investments to exploration, development and production sectors. Moreover, domestic oil trunks and export pipelines are controlled by the state at all cost. The crude pipeline export monopoly is currently held by two government-owned companies: Transneft (crude oil pipelines) and Transneftprodukt (oil products) (Cukrowski, 2004).

Furthermore, exchange rate appreciations and high interest rates in Russia support access to capital in the West too.

**LUKOIL’s modes of entry and expansion**

Once a company has decided to internationalize, it must determine the structural nature of its operations. Selecting a mode for entering or expanding in a foreign market is one of the most crucial strategic decisions that an international firm has to make (Root, 1994). A well-chosen firm can enable a company to gain competitive advantage, while inappropriate modal decisions have reverse effect. According to Kotler & Keller (2006), companies adopt four approaches to enter in the international market, these are exporting, licensing, joint venture, and wholly owned subsidiaries.

The most common form of international involvement of companies is exporting activities. The second entry mode firms use to enter in the international market is through licensing. Companies don’t sell their products by themselves, but issue license to a local firm to use its manufacturing process, trademark etc. The third entry mode that companies adopt to start their internationalization process is via joint venture. Firm makes partnership with foreign company to share the ownership and control of the firm. According to Kotler & Keller (2006), this type of entry mode is usually established when the firm has limited resources, market knowledge and investment to start their operation. The last method companies use to internationalize is by making direct investment in the host country. Companies can purchase a local firm or build its own production plant, in this way starting their own production facilities in the host country.

LUKOIL uses different modes of entry while implementing its global expansion strategy. Our study shows that the company’s exploration projects are mostly realized through joint ventures or acquisitions. Examples include the Luksar joint venture with Saudi Aramco for exploration in Saudi Arabia.

Due to the fact that oil and gas are enormous revenue sources, their production is often tightly controlled by the governments of the countries holding reservoirs. Many countries, like Venezuela, Norway, Saudi Arabia, have completely nationalized oil and gas sectors. Host government policies and preferences play an important role when realizing the company’s market entry strategy. Ordinarily, in order to implement its international upstream projects, LUKOIL chooses joint venture as an entry mode, when the governments often insist on holding a stake.

As for LUKOIL’s growth in downstream segment, it was implemented mostly by cheap refining acquisitions. One strategic factor that was important for LUKOIL to use this entry mode is quick execution. This mode enabled the company to act and react more quickly to build its presence in the target foreign market (Hill, 2007).

While implementing its global expansion strategy, LUKOIL often bypasses partnerships and alliances. As for the alliance that LUKOIL formed with American oil major ConocoPhilips, it can be more seen as a tactical convenience since both companies work closely together in joint ventures in Timan-Pechora region (Russia) and technological transfers as occasion may demand. Though, usually when LUKOIL needs a technology, it buys it from oil service companies such as Schlumberger.
Conclusion

The previous sections of the present paper have discussed the internationalization chronology of the Russian multinationals, provided the geography of LUKOIL’s global expansion, analyzed its motives using the classification developed by Dunning, and described its entry modes. In the paper we used different sources of data to “zoom in” to the Russian oil giant. We have discovered that LUKOIL follows various motives while implementing its global expansion strategy. Desire for secure large oil fields and profit and growth, a growing global demand, solvent foreign customers, a huge price gap between the Russian and international market, taxation planning and the opportunities in the foreign markets are the most significant pro-internationalization factors. The analyses of the Russian multinationals’ internationalization history also contributed to the understanding of the company’s motives for going global. It can be argued, that LUKOIL’s internationalization started from the post-Soviet republics, as earlier experience, logistical advantages and undervalued privatization allowed the company to recognize the potential of Kazakhstan and Azerbaijan fields as well as secure early participation in that regions.

As shown in the paper, while internationalizing LUKOIL uses various modes of entry. However, in the foreign upstream projects are mostly realized through joint ventures or acquisitions, while downstream is implemented by refining acquisitions mostly. Hence, a logical step and a promising avenue for further research is a study of factors influencing the LUKOIL’s choice of international market entry mode. Research on underlying dimensions of mode choice (Root, 1994; Driscoll and Paliwoda, 1997) has developed tools for such analysis. Besides, the present research is limited by its sample size, only private-owned oil company was studied. Therefore, for the future investigators it might be interesting to look through the internationalization process of the Russian state-owned company and to find out if the motives for going global and the companies’ foreign market entry modes differ.

References

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