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Publisher: Routledge

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Journal of East-West Business

Publication details, including instructions for authors and subscription information:

<http://www.tandfonline.com/loi/wjeb20>

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Published online: 12 Oct 2008.

To cite this article: Kari Liuhto (2002) Russian Gas and Oil Giants Conquer Markets in the West, *Journal of East-West Business*, 7:3, 31-72, DOI: [10.1300/J097v07n03_03](https://doi.org/10.1300/J097v07n03_03)

To link to this article: http://dx.doi.org/10.1300/J097v07n03_03

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Russian Gas and Oil Giants Conquer Markets in the West: Evidence on the Internationalization of Gazprom and LUKoil

Kari Liuhto

ABSTRACT. Russian firms are not integrated to the global business world solely via investments from the West to the East but also through investments from Russia to other countries. This article proves that some significant Russian corporations have already taken root in Western economies, including the US market. The first wave of the Russian companies in the West increases the pressure to analyze them as potential partners or competitors. This article uses a REM model to describe the foreign operations of the two biggest Russian corporations, Gazprom and LUKoil. The fast-expanding activities of Russian firms abroad signify that a new era in international business has begun on the eve of this millennium. *[Article copies available for a fee from The Haworth Document Delivery Service: 1-800-342-9678. E-mail address: <getinfo@haworthpressinc.com> Website: <<http://www.HaworthPress.com>> © 2001 by The Haworth Press, Inc. All rights reserved.]*

KEYWORDS. Foreign operations of Russian companies, the Russian oil and gas business, internationalization, Gazprom and LUKoil

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The author gratefully acknowledges the financial support of the Paulon Säätiö, and expresses his sincere gratitude to professors Urpo Kivikari, Tauno Tiisanen and two anonymous reviewers, for their comments, and to Seppo Remes, the corporate vice-president of Fortum, for providing this study with his ten-year-experience in the Russian oil and gas business.

RECENT ECONOMIC DEVELOPMENT IN RUSSIA

The dissolution of the Soviet Union in 1991 started the deep decline of the economic performance in the post-Soviet republics. During the past 10 years, the 15 former Soviet republics have lost from 6% to 69% of their real GDP, depending on the country in question. The Russian GDP has contracted by 43%. Besides the GDP fall, industrial output has dropped tremendously. Russian industrial production has decreased throughout the 1990's, except for the years 1997 and 1999. Both gas and oil production has fell less than industrial output as a whole (Bank of Finland, 2000; EBRD, 2000).

A lesser drop in gas and oil production was important for Russian industry, first because fuels and energy accounted for almost one-third of their entire industrial production. Should gas and oil production have declined more than it did, it would have meant an even deeper decline in their overall industrial production.

Second, Russian energy companies are the backbone of the Russian economy. The competitiveness of Russian companies would drastically worsen in the short-term, if they would be forced to pay world market prices for their energy consumption. In the long run, such an energy shock therapy might be necessary for developing sustainable competitiveness in Russia.

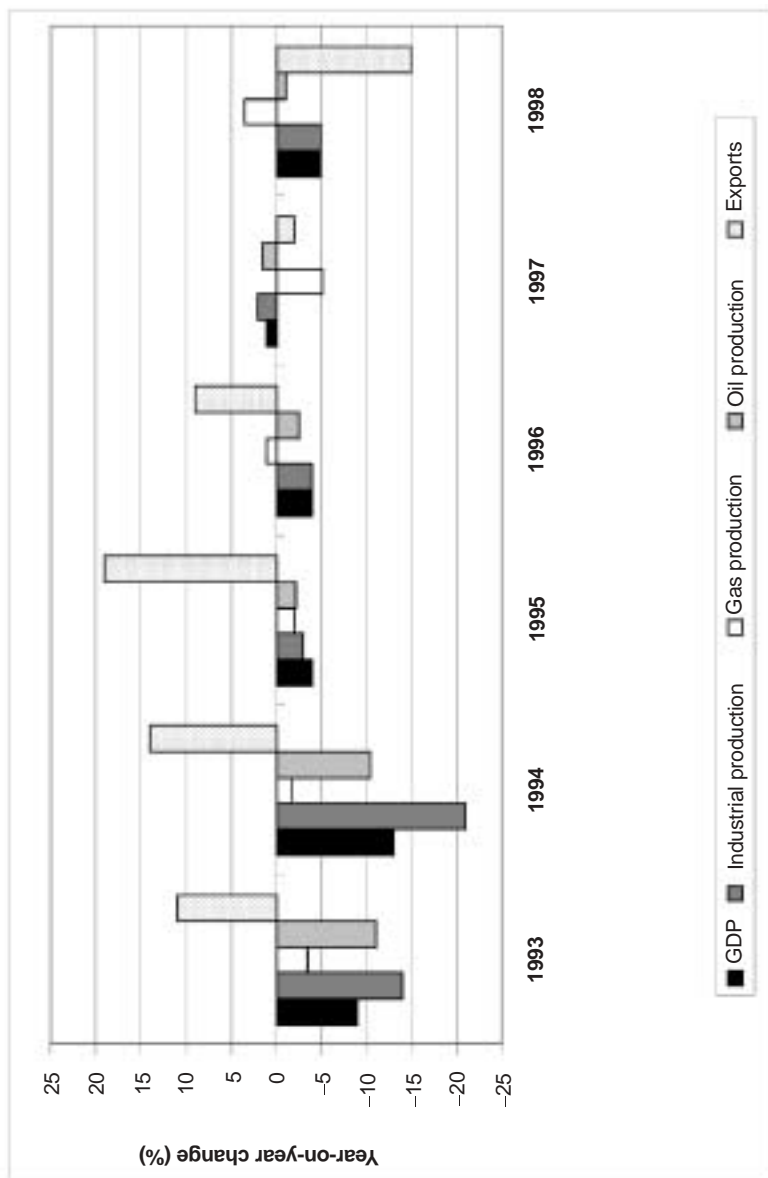
Third, the increase of oil prices to world market levels might create social turbulence inside Russia, since the energy firms subsidize many Russian regions and their organizations. Fourth, the energy companies are the most important source of federal tax revenue. Gazprom, the Russian gas monopolist, alone covers one-fourth of the Russian tax revenue. Fifth, the strategic importance of the energy sector becomes over-emphasized because energy goods dominate the Russian exports. Energy exports have formed approximately half of the total exports throughout the 1990's.

Despite the increase of their total exports and its energy-dominance, Russian gas and oil production has nonetheless diminished. The reason for this rather contradictory phenomenon was the fact that the Russian energy companies have simply sold a bigger share of their production abroad than what they managed to do during the Soviet era (see Table 1).¹

Although the internationalization of the Russian gas and oil sector intensified after the disintegration of the USSR, the Russian gas sector, still, is practically a monopoly of Gazprom. There are only two genuine gas producers independent of Gazprom: Yakutgazprom and Norilskgazprom, a gas supplier to the metal producer Norilsk Nickel. In addition to this gas trio, some conventional oil companies are producing natural gas.

The biggest gas producers among the oil firms are Surgutneftegaz with an annual production of 11 billion cubic meters (bcm), Rosneft with 5.5 bcm,

TABLE 1. The Development of the Russian Economy



LUKoil with 3.5 bcm and the Tyumen Oil Company with 2.5 bcm. However, their gas production is minimal when compared to Gazprom's 550 bcm.² In fact, this gas giant produces over 90% of Russia's natural gas, or one-fourth of the world's entire gas production.

Besides colossal production, Gazprom owns some 70% of Russia's gas reserves, which is one-third of the world reserves. Moreover, the corporation virtually controls the whole 150,000 km-gas pipeline network of Russia. To break Gazprom's monopoly, the Russian government ordered, in November 2000, the corporation to give other companies the right to use up to 15% of its pipeline capacity. However, it would be premature to hail the end of the firm's monopoly, since it has successfully fended off numerous attempts to break its hold on Russia's gas market in the past (see Appendix 1).

To sum up, Gazprom possesses significant economic power. Gazprom produces some 8% of the Russian GDP. Such economic status makes the group not only an extremely powerful economic actor but also a political *éminence grise* in Russia. Keeping Gazprom's gargantuan economic and political influence in mind, its current and future operations should not merely be evaluated from the perspective of a business organization.

If the Russian gas sector is overwhelmingly dominated by Gazprom, the country's oil business is made up of dozen Russian vertically integrated oil companies: LUKoil, Surgutneftegaz, Yukos, Tatneft, Sibneft, the Tyumen Oil Company (TNK), the Orenburg Oil Company (Onako), Slavneft, Komineft, Sidanko, the Eastern Oil Company (VNK), the Chechen State Oil Company, and Rosneft. Most of them can be found among the 50 biggest companies in Russia (see Appendix 2).

The five largest oil corporations produce approximately 60% of all Russian oil production. Besides the Russian oil majors, Transneft, the government-controlled company monopolizing the state oil pipelines in Russia, should be taken into consideration when analyzing the possibilities of Russian oil companies to internationalize.

The Russian oil business is not completely dominated by domestic companies, but some Western gas and oil corporations have already established their foothold in the Russian market, though many obstacles have slowed down their enthusiasm to enter the Wild East. Among the deterrents facing them have been political instability, inadequate legislation and the reluctance of Russian companies to accept Western competition. Even if some significant partnerships were built in 1997-1998, there were numerous rows over corporate governance and investor protection in the sector in 1998-1999, forcing many foreign investors to reconsider investing in Russia. Recently, however, developments achieved after Putin took over the presidency and the increase in energy prices have made the Russian oil sector more attractive (EIU, 2000a).

Although foreign companies have not rushed after Russian energy resources, some foreign energy firms have already explored for oil, acquired stakes in Russian corporations and established representative offices, gasoline filling stations and joint ventures in Russia.

As an example of oil exploration, Mitsui, Mitsubishi and RD Shell have produced oil under a production sharing agreement (PSA) in Sakhalin. Consequently, ExxonMobil, Texaco, SODECO, Itochu, and BP Amoco/Arco have signed or are negotiating PSAs concerning other blocks of the Sakhalin oil fields.³

Ruhrgas' minority ownership in Gazprom and BP Amoco/Arco's ownership in LUKoil, Sidanko and Rusia Petroleum are witness to the fact that foreign companies have entered the Russian market via investments to Russian companies. Besides owning shares in the Russian energy companies, some Western oil firms have established their representative office in Russia. For instance, Fortum's, the Finnish energy company's, representative office in Russia dates back to the Soviet era.

Moreover, BP Amoco/Arco, RD Shell and Fortum have opened gasoline filling stations in Russia. The joint venture between Conoco and LUKoil can be mentioned as an example of East-West joint venturing in Russia.

To sum up, the Russian gas and oil sector offers an extremely fruitful ground for analyzing the both directions of internationalization i.e., both the operations of the Western companies in the East and the activities of Eastern companies in the West. This article focuses on the latter theme, which has been almost completely neglected in the literature.

SOVIET CORPORATIONS AND THEIR SUCCESSORS ABROAD

Soviet Corporations Abroad

As a result of the ideological, political and economic barriers, the Soviet companies' operations abroad were rare. An ideological barrier was the fact that international operations were a reminder of the exploitation of less-advanced nations, which was not in line with socialist ideology. Politically, the Soviet enterprises' operations abroad were constrained by the Cold War between the East and the West. An economic obstacle was the difficulty of integrating the activities of the Soviet companies operating outside central planning, into the planned economy. Due to these barriers, the number of Soviet firms abroad remained modest (McMillan, 1987).

Although the number of Soviet companies outside the USSR was not huge, their operations abroad should be divided into two main categories—the Soviet companies in socialist countries and in non-socialist ones.

The Soviet companies in socialist countries: even if the cooperation between countries belonging to the Council for Mutual Economic Assistance (CMEA) was not so constrained by the barriers mentioned above, hidden resistance from small CMEA countries towards intensifying collaboration with the Soviet Union and various economic difficulties kept inter-enterprise cooperation rather insignificant.

By the mid-1980's, only a handful of CMEA joint enterprises with the participation of the USSR were established. Matejka (1988) names eight CMEA joint enterprises with Soviet participation: the Ulan-Bator Railway (activity–railway network, location–Mongolia, establishing year–1949), Wismut AG (uranium mining, GDR, 1954), Erdenet (copper mining, Mongolia, 1973), Mongolsovtsvetmet (gold mining, Mongolia, 1973), Petrobaltic (prospecting Baltic petroleum and gas, Poland, 1975), Interlichter (Danube-Maritime freight, Hungary, 1978), Robot (scientific cooperation, Czechoslovakia, 1985), and Bulgarian-Soviet enterprise (the manufacturing of electronic parts, Bulgaria, 1986).

Perestroika expanded foreign trade rights in the USSR and the joint venture legislation improved in Eastern Europe in the second half of the 1980's, and as a consequence, the number of the enterprises with Soviet participation within the CMEA multiplied. Already, by 1990, at least 175 Soviet-owned joint ventures were registered in the European CMEA countries: 68 in Poland, 50 in Hungary, 38 in Bulgaria, 21 in Yugoslavia and four in Czecho-Slovakia (Cheklina, 1991).

The Soviet companies in non-socialist countries: the operations of the Soviet companies were also rare in non-socialist countries. The USSR firms had around 30 subsidiaries in developing countries and 116 subsidiaries in the OECD countries at the end of 1983. Most of them, over 60%, operated in the current EU member states.⁴ Only five were registered in the USA: the Amtorg Trading Corp. in New York, Morflot America Shipping Inc. in Clark, the Marine Resources Co. in Seattle, Sovfracht Ltd in New York and Belarus Machinery Inc. in Milwaukee (Zaleski, 1986; McMillan, 1987).

The overwhelming majority of the Soviet subsidiaries in the West operated in the marketing of oil, metals, timber, chemicals, machinery and vehicles. In addition to this export promotion, the Soviet subsidiaries serviced the foreign trade activities of the USSR, as they operated in transportation, banking and the insurance business. Besides these foreign trade-related activities, Soviet organizations also operated in tourism and travelling (Hill, 1986).

Soviet parent companies usually possessed a majority ownership in their Western-based subsidiaries. The Soviet parent company had a majority stake in nine subsidiaries out of ten. Pursuing majority ownership was a natural investment strategy, since the Soviet corporations wanted to maintain direct con-

trol over their business activities rather than only act as a profit-seeking investor. As a whole, the internationalization strategies of the Soviet corporations did not significantly deviate between the Western countries concerned.

To summarize, the number of the Soviet corporations outside the Soviet Union was modest. Only 300-400 Soviet-owned firms were registered outside their country by the end of the Soviet era. Despite their insignificant number, it needs to be kept in mind that the foreign operations of the Soviet firms were not motivated by business logic alone, but also by the political goals of the USSR (Hamilton, 1986; Tiusanen, 1990; Sokolov, 1991).

Another observation worth noticing is the fact that Russian firms controlled most of the Soviet corporations abroad. Soviet corporations having their headquarters located in any other Soviet republic than Russia, established just a handful of them. This is one explanation, why Russian companies inherited the Soviet business units abroad, after the dissolution of the Soviet Union.

Russian Corporations Abroad

The official registers and data banks in Russia do not contain information about all those Russian-owned companies, which operate outside their country. Besides the absence of such registers and data banks, the Russian statistics on outward direct investment (ODI) are everything but complete and accurate. Therefore, it is impossible to offer an accurate description of either the amount or the destinations of the legitimate ODI from Russia.

In addition to the difficulties in describing the legitimate capital outflow, the evaluation of the illegitimate capital flight is even more vague. Despite the deficiencies involved in analyzing the outflow of Russian capital, the IMF offers a realistic estimate of the legitimate ODI and illegitimate capital flight from Russia (see Table 2).

A Canadian-Russian research gives a slightly bigger estimate on the capital flight than that indicated in the table above. This study indicates that during 1994-97 almost USD 70 billion escaped illegitimately from Russia (Institute

TABLE 2. Outward Direct Investment and Capital Flight from Russia (USD million)

	1993	1994	1995	1996	1997	1998	1999
Recorded ODI	0.7	0.1	0.4	0.8	2.6	1.0	2.1
Capital flight	n.a.	15.0	7.5	26.0	11.0	21.0	n.a.

Source: IMF (2000)

of Economics, 1999). The Fitch IBCA offers a much higher figure for the capital flight; USD 136 billion during 1993-98 (Kauppalehti, 1999).

Even if no precise figure can be offered, these estimations show that the capital outflow is manifold when compared to the foreign direct investment (FDI) inflow to Russia. During the whole of the 1990's, the cumulative FDI-inflow to Russia was only USD 20 billion (EIU, 2000b).

A huge gap between the capital outflow and the inflow implies that a great amount of the Russian capital still remains outside the country, despite the fact that a fraction of the illegitimately escaped Russian capital has already returned home. A clear indication of capital repatriation is the investments from Cyprus to Russia. Cyprus, with its practically non-existent Russian trade, is ranked the 3rd biggest investor, with a 21% share. Money laundering and tax evasion are usually the main driving forces behind the capital movements away from Russia and back again (Bradshaw, 2000).

Cyprus is by no means the only destination where illegitimate Russian capital has floated. Besides this Mediterranean state, Russian capital has also found its way to taxation havens. According to the Russian Ministry of Internal Affairs, Russians have registered some 60,000 companies in international taxation havens. Most probably, the majority of these companies are involved with the transfer of capital from Russia, and therefore, their operations cannot be regarded as genuine internationalization (Kuorsalo et al., 1999).

Even if some of the Russian capital has already returned home, Russian capital itself does not suffer from homesickness, i.e., Russian companies are also making investments from their Western fortresses towards other countries. To give two examples in the oil and gas business; LUKoil established a subsidiary in Lithuania via its Luxembourg unit and Gazprom acquired a stake in a Hungarian company through its Irish holding company, Milford Holdings.

Investing via an unknown foreign holding company may stem from the fact that a Russian company aims to hide its country of origin, since some ex-socialist states are reluctant to sell state companies of strategic importance to Russians, due to historic and psychological reasons. Bush describes the fears directed towards Russian companies when he writes the following (2000, 23-24): *"when Hungary opted for a market economy, it also said good riddance to Russian domination. Now the Russians are back though this time they're coming with money, not tanks. . . . And in the long run keeping out Russian capital looks a bit like trying to hold back the tide."*

Although no comprehensive statistics on the operations of Russian companies abroad are available, Väättänen and Liuhto's (2000) study indicates that Russian energy companies have been the most active in starting their operations abroad. In addition to the energy majors, smaller Russian companies in the software business and in finance have also established their subsidiaries outside Russia (see Table 3).

TABLE 3. Some Evidence of Russian Companies Abroad

Sector/Company	Markets	Operations
<u>Oil industry</u>		
LUKoil	Azerbaijan, Kazakhstan, Iraq and Egypt	Oil production
	Bulgaria, Romania, Ukraine, (Czech and Lithuania)	Oil refining
	Baltic countries, Czech, Kazakhstan, Moldova, Ukraine and the USA	Gas retailing
Yukos	Planning a pipeline to China	Oil exports
Rosneft	Azerbaijan, Iraq and Vietnam	Oil production
	Germany	Oil refining
Slavneft	Azerbaijan, Iran and Iraq	Oil production
TNK	Bidding for a refinery in Ukraine	Oil refining
<u>Gas industry</u>		
Gazprom	Exports to 25 foreign countries: Germany, Ukraine, Italy, France, Byelorussia, Turkey, Czech Republic, Hungary, Slovakia, Poland, Austria, Finland, Romania, Bulgaria, Moldavia, Lithuania, Greece, Croatia, Yugoslavia, Latvia, Slovenia, Estonia, Switzerland, Bosnia and Macedonia	Gas exports
	Planned production in Iran, Turkey and Asia	Production
<u>Transport equipment</u>		
GAZ	Marketing JV in the USA	Distribution
<u>Utilities sector</u>		
UES	Moldova	Production
	Finland	Sales
<u>Software</u>		
Galaktika	CIS countries, Europe and USA	Distribution
1C	CIS countries	Distribution
<u>Financial sector</u>		
Vneshtorgbank	Acquisition in Luxembourg	Finance
Alfa Bank	Securities license for a London based subsidiary	Brokerage

Source: Väättänen and Liuhto (2000)

Besides their UK operations, the Alfa Bank is very active in the Ukraine. It recently completed the takeover of Kievinvestbank, and will rename the financial institution, the Alfa Bank Ukraine. The company is planning an aggressive investment program in the Ukraine, and hopes to open 15-20 new branches by the end of 2001.

A significant Russian corporation, not mentioned in the table above, is Russky Aljumi, the world's second largest aluminum producer. This company covers one-tenth of the world primary aluminum production and has several production units abroad. For example, it has production units in Armenia and the Ukraine, where it owns three-quarters of the aluminum plant, Mykolayiv. Quite recently, it also purchased a refinery in Romania, and plans to acquire a production unit in the Czech Republic and Yugoslavia. In addition, Russky Aljumi plans to purchase a bauxite mine in Italy, Guinea and Venezuela.

Besides these globally-recognized corporations, a multitude of lesser-known Russian enterprises have established their foothold in the West. Many of these smaller companies have started their business in the only EU country neighboring Russia, namely Finland.

The representative of the Russian Chamber of Industry and Trade estimated that some 100 Russian firms operated in Finland at the end of the year 2000.⁵ This amount, in a country with five million inhabitants, implies that hundreds or even thousands of Russian-owned enterprises operate outside Russia (excluding those founded in taxation havens). Therefore, it is no exaggeration to argue that Russian firms are already in the West, and henceforth, more attention should be paid to their operations, since it reflects the new direction in East-West business.

OBJECTIVE, METHOD AND OUTLINE

The internationalization of post-Soviet companies is an extremely timely phenomenon. As the internationalization will most probably speed up, some facts may rapidly become outdated. Due to the time lapse between writing this article and its publication, it needs to be stressed that the final updating for this article was undertaken in January 2001.⁶

As the internationalization of the post-Soviet firms is a new research field, it is understandable that only a handful of academic studies have, so far, explicitly focused on the internationalization of Eastern enterprises. Filatotchev and Wright's (1999) study on the internationalization of Russian, Ukrainian and Belarus firms, Sôrg and Ivanova's (1999) research on the expansion of Estonian banks abroad, Heinrich's (2000) investigation on

Gazprom's foreign operations and Väättänen and Liuhto's (2000) report on the internationalization of Russian firms, can be mentioned as examples of these exploratory researches.⁷

Due to the generally descriptive nature of the work, theoretical discussion has received lesser weight in this article. Nevertheless, the author has designed a REM model for this study, which is based on the earlier literature about internationalization. With the help of this model, the author analyzes the case companies' internationalization.

The author has chosen a case study method since a lack of comprehensive list on Russian companies abroad prevents the conducting of quantitative research. Gazprom and LUKoil have been selected for the analysis, since earlier research evidence shows that their international operations are comparable to those of their most significant foreign competitors. Besides, these firms' colossal reserves of strategic natural resources underlines their importance as significant global actors, and hence, the selection of these companies seems well-founded (see Appendix 3).⁸

As the main objective of this article is to show that some Russian companies already have extensive international operations, this paper aims at describing the operations of the selected firms as accurately as possible. In this context, it must be noted that Russian enterprise managers are usually reluctant to reveal information concerning their foreign operations, because of competition, taxation and public opinion-related reasons. Due to this reluctance, written material forms the basis of the analysis, instead of management interviews.

In order to fill the possible gaps in the desk research, the author conducted an interview with an expert. The author interviewed a Finnish corporate vice-president, who has ten-years-experience in representing a foreign oil company in Russia.

As the author used a case method and chose the two biggest Russian corporations for the examination, it is risky to produce any generalization. Though these case descriptions do not create a solid scientific basis for generalization, the context of these descriptions may provide the chance to widen the research results beyond the primary observations. Despite the possible deficiencies of the data and the method, this article offers a new perspective on the internationalization in the context of the East-West business, as it deals with internationalization from the East towards the West.

In the following chapter, an overview on the internationalization theories is presented and the REM model is designed. Thereafter, the author describes the operations of Gazprom and LUKoil abroad and analyzes their internationalization via the REM model.

DESIGNING THE REM MODEL

Contractor and Kundu (1998) have discovered four main approaches relevant to the internationalization process: traditional market-entry literature, transaction-cost theory, the strategic theory of organizational capability and knowledge, and agency theory.

A historical view on the market-entry literature implies that in the 1960's, the main focus was on a comparison between two internationalization modes—exporting and FDI. In the 1970's internationalization literature identified licensing, franchising and subcontracting as other strategic options. In the 1980's the resurgence of mergers and acquisitions highlighted the choice between green-field ventures and acquisitions. In the 1990's booming Asian and post-socialist European economies renewed interest in the question of why some modes of entry offered lower costs than others, and of why certain circumstances seemed to favor certain modes over others (Buckley & Casson, 1998).

The principal focus of the transaction-action theory is on one transaction or negotiation at a time. The modal choice is that which minimizes the transaction costs, i.e., the company chooses the operational mode, which it perceives to be the most cost-effective (see Anderson & Gatignon, 1986).

The strategic theory of organizational capability and knowledge offers another useful perspective on many alliances as it involves the transfer of capability and knowledge between partners over a duration of time, rather than as one single transaction (see Winter, 1987; Bresman et al., 1999).

The agency theory separates ownership and control, as in many companies managers are not the primary owners of the organizations that they manage. The separation of ownership and control has led scholars to examine the mechanisms that owners have developed to ensure that employees act in accordance with the owner's plans. The agency theory becomes relevant to modal choice questions when dealing with international franchising and other contractual arrangements which separate an actor from an owner (see Shane, 1996).

In reviewing the internationalization literature, Dunning's OLI theory (1988) should also be mentioned, as it contributes significantly to the internationalization discussion. In the OLI theory, "O" stands for ownership, "L" for location and "I" for internationalization. Ownership is a principal method of maintaining control, location stands for finding the most appropriate foreign market and internationalization is linked with the advantages gained from foreign operations.

Even if the theories described above make indisputable contributions to the knowledge on the internationalization of a firm, some scholars have emphasized the need for a more eclectic view on internationalization. For example, Coviello and Martin (1999) state that internationalization is too broad a con-

cept to be examined by any single theoretical view. They conclude that by examining internationalization in an integrative manner, the limitations inherent in focusing on a single theoretical framework can be overcome, and a more realistic view of internationalization may be developed. An attempt to create a more holistic view for the purposes of this article is to approach internationalization through the REM model, which is a combination of the theoretical contributions mentioned above.

The R-factor: a reason for internationalization creates the foundation of the REM model, as it answers why a firm decides to internationalize in the first place. According to Ohmae (1990), some companies internationalize due to external motives, for instance, their rivals and customers' operations have become global. There is also evidence that internal factors, such as a goal to increase the firm's profitability, push enterprises to begin their internationalization (Gerlinier et al., 1989). Both external and internal motives determine, what is the balance between the pro- and anti-internationalization arguments, i.e., whether a company decides to begin internationalization or not.

The E-factor: the environment selection stands for the choice of business environment(s). As national borders are disappearing out of the way of various free trade areas or economic unions, the environment seems to be a more appropriate term than that of country or location (see Rugman & Verbeke, 1998).

There is a multitude of factors which influence environment selection. Dunning (1998) describes some variables influencing the environment selection decision and how the issues behind the decision-making have changed during the 1970's and the 1990's (see Table 4).

As the table above refers to, a choice of an environment may depend on host environment policy, which can either attract or discourage foreign companies.⁹ Also the home environment policy should be taken into consideration, as the governmental institutions in the home market may promote or restrict internationalization. Restrictive host and home policies usually reflect tensions between the micro-efficiency-driven behavior of a firm and the macro-efficiency or distribution objectives of governmental institutions (see Caves, 1982).

In the REM model, the home environment policy is not reflected in the environment selection but it influences whether a firm decides to begin its internationalization or not, i.e., the R-factor. Consequently, the host environment policy is highly relevant to the E-factor as it influences the environment selection.

The M-factor: the modal choice answers the question of how a firm implements its internationalization. Since neither a universally superior mode nor environment exists, the modal choice depends on the environment selection, and vice versa.¹⁰ Due to a close mutual dependence between the E- and M-factors, this relationship has been indicated in the REM model as a two-headed arrow.

TABLE 4. Some Variables Influencing Environment Selection in the 1970's and the 1990's

	In the 1970's	In the 1990's
(A) Resource Seeking	<ol style="list-style-type: none">1. Availability, price and quality of natural resources.2. Infrastructure to enable resources to be exploited, and products arising from them to be exported.3. Government restrictions on FDI and /or on capital and dividend remissions.4. Investment incentives, e.g., tax holidays.	<ol style="list-style-type: none">1. As in the 1970's, but local opportunities for upgrading equality of resources and the processing and transportation of their output is a more important locational incentive.2. Availability of local partners to jointly promote knowledge and/or capital-intensive resource exploitation.
(B) Market Seeking	<ol style="list-style-type: none">1. Mainly domestic, and occasionally (e.g., in Europe) adjacent regional markets.2. Real wage costs; material costs.3. Transport costs; tariff and non-tariff trade barriers.4. As A3 above, but also (where relevant) privileged access to import licenses.	<ol style="list-style-type: none">1. Mostly large and growing domestic markets, and adjacent regional markets (e.g., NAFTA, EU, etc.).2. Availability and price of skilled and professional labor.3. Presence and competitiveness of related firms, e.g., leading industrial suppliers.4. Quality of national and local infrastructure, and institutional competence.5. Less spatially related market distortions, but increased role of agglomerative spatial economies and local service support facilities.6. Macroeconomic and macro-organizational policies as pursued by host governments.7. Increased need for presence close to users in knowledge-intensive sectors.8. Growing importance of promotional activities by regional or local development agencies.
(C) Efficiency Seeking	<ol style="list-style-type: none">1. Mainly production cost related (e.g., labor, materials, machinery, etc.).2. Freedom to engage in trade in intermediate and final products.3. Presence of agglomerative economies, e.g., export processing zones.4. Investment incentives, e.g., tax breaks, accelerated depreciation, grants, subsidized land.	<ol style="list-style-type: none">1. As in the 1970's, but more emphasis placed on B2, 3, 4, 5 and 7 above, especially for knowledge-intensive and integrated MNE activities, e.g., R&D and some office functions.2. Increased role of governments in removing obstacles to restructuring economic activity, and facilitating the upgrading of human resources by appropriate educational and trading programs.3. Availability of specialized spatial clusters, e.g., science and industrial parks, service support systems etc.; and of specialized factor inputs. Opportunities for initiatives by investing firms; an entrepreneurial environment, and one which encourages competitiveness enhancing cooperation within and between firms.
(D) Strategic Asset Seeking	<ol style="list-style-type: none">1. Availability of knowledge-related assets and markets necessary to protect or enhance O specific advantages of investing firms—and at the right price.2. Institutional and other variables influencing ease or difficulty at which such assets can be acquired by foreign firms.	<ol style="list-style-type: none">1. As in the 1970's, but growing geographical dispersion of knowledge-based assets, and need of firms to harness such assets from foreign locations, makes this a more important motive for FDI.2. The price and availability of "synergistic" assets to foreign investors.3. Opportunities offered (often by particular sub-national spatial units) for exchange of localized tacit knowledge, ideas and interactive learning.4. Access to different cultures, institutions and systems; and different consumer demands and preferences.

Source: Dunning (1998)

The selection between the different modes is influenced by many issues, such as the control requirement, commitment, costs, the value creative potential and the complexity involved, experience, capabilities and resources possessed, partner-related risks and national/cultural preferences, the knowledge sharing policy, and most of all, the firm's overall strategy (e.g., Chi & McGuire, 1996; Erramilli, 1996; Hagedoorn & Narula, 1996; Holm, 1996; Tse et al., 1997; Contractor & Kundu, 1998). Buckley and Casson (1998) name various operation modes based on the operation type and the ownership of production and distribution (see Table 5).

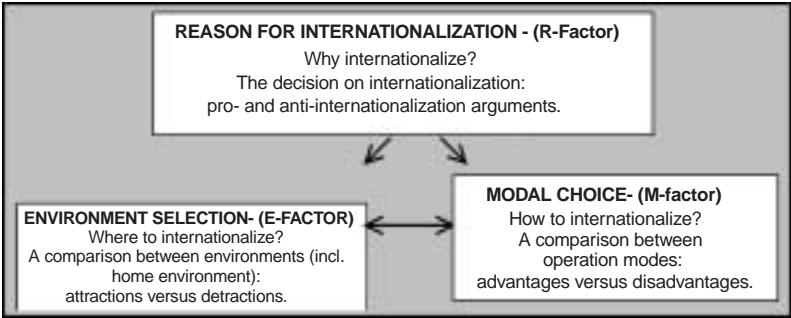
To conclude, the REM model is designed as a simplistic theoretical tool for the analysis of internationalization at the enterprise level. Even if the REM model had been created particularly for the purposes of this research, it might also provide other case studies with an adequate framework to investigate internationalization (see Table 6).

TABLE 5. Twelve Entry Modes and Their Variants

Type	Description	Variant
1. Normal FDI	Entrant owns foreign production and distribution facilities.	1.1. Both facilities are greenfield. 1.2. Both facilities are acquired. 1.3. Production is greenfield and distribution is acquired. 1.4. Distribution is greenfield and production is acquired.
2. FDI in production	Entrant owns foreign production but uses independent distribution facilities.	2.1. Production is greenfield. 2.2. Production is acquired.
3. Subcontracting	Entrant owns foreign distribution but uses independent production facilities.	3.1. Distribution is greenfield. 3.2. Distribution is acquired.
4. FDI in distribution	Entrant exports to own distribution facility.	4.1. Distribution is greenfield. 4.2. Distribution is acquired.
5. Exporting/franchising	Entrant exports to independent distribution facility.	
6. Licensing	Entrant transfers technology to independent integrated firm.	
7. Integrated JV	Entrant jointly owns an integrated set of production and distribution facilities.	
8. JV in production	Entrant jointly owns foreign production but uses an independent distribution facility.	
9. JV in distribution	Entrant jointly owns foreign distribution but subcontracts production to an independent facility.	
10. JV exporting	Entrant exports to a jointly owned distribution facility.	
11. FDI/JV combination	Entrant owns foreign production and jointly owns foreign distribution.	11.1. Production is greenfield. 11.2. Production is acquired.
12. JV/FDI combination	Entrant owns foreign distribution and jointly owns foreign production.	12.1. Production is greenfield. 12.2. Production is acquired.

Source: Buckley and Casson (1998)

TABLE 6. The REM Model



**THE OPERATIONS
OF TWO RUSSIAN ENERGY GIANTS ABROAD**

Gazprom Abroad

Gazprom has two faces—its export face and its domestic one. . . . On the domestic side, . . . the Russian government expects Gazprom to keep Russian homes and factories supplied with gas, whether consumers paid or not. . . . Abroad, Gazprom is Russia’s most significant player in international markets. (Gustafson, 1999, 54-55).

Exports

An adequate way to describe a reason why Gazprom is interested in exporting an increasing share of its production, is to quote from the insightful article written by Cullison and Bahree (1999, 10-13):¹¹

Roughly 40% of its [Gazprom’s] clients are Russian power stations, and the government won’t allow Gazprom to cut them off—not even for non-payment. . . . Three-quarters of Gazprom’s gas goes to nonpaying customers within Russia and the former Soviet Union. . . . In Russia, government price caps force Gazprom to sell its gas for about one-seventh of what it could fetch on the world market. . . . Retaining European clients—even if it means slimmer profit margins—is key for Gazprom: These exports provide the company’s only sure source of cash.¹²

The quotation stresses that sales abroad form Gazprom’s most reliable source of revenues, and therefore, it is not surprising that the group exports almost one-third of its production. The majority is delivered to non-CIS countries,

representing some three-quarters of the company's total exports. The share of the post-Soviet republics, especially the CIS, is declining while exports to the present EU are increasing (see Table 7).

Currently, Russia covers some 20-25% of the EU's gas consumption. The agreement on the intensification of energy cooperation between Russia and the EU, signed in October 2000, will most probably increase Russian gas exports to the EU.

Gazprom's export-production ratio grew just by one per cent in 1999 compared to the year earlier. Despite a modest rise, a wide price gap between the Russian and the world market and foreign customers' solvency motivates Gazprom to deliver even a bigger share of its gas production to solvent West-European countries. Juri Komarov, Gazprom's board member, stated in November 2000 that the company's exports to the West could reach 135 bcm in 2001 and even 200 bcm by 2010. However, raising gas exports to 200 bcm would require new pipelines from Russia to the West (see Appendix 4).

Building Strategic Alliances to Improve Distribution Abroad

The insufficient pipeline network constrains Gazprom from increasing its exports. Since the maintaining of the existing pipes and constructing new ones requires a massive investment and a long-term commitment from both the suppliers' and the buyers' side, Gazprom is building strategic alliances. Before a closer look on these alliances is provided, an overview regarding the existing pipelines can be enlightening.

The main pipes from Russia to the West are called Brotherhood, Progress and Union (capacity—1000 billion cubic feet each), Northern Lights (800 billion), Volga-Urals-Vyborg (100 billion) and Yamal (800 million). Through these pipes, Gazprom can export approximately 4700 billion cubic feet of gas, or some 130 bcm.¹³ Since Gazprom's total gas exports are already over 170 bcm, the need for constructing new pipelines is obvious. Currently, Gazprom is involved in developing at least the following westward pipes: Yamal-Europe, a connection bypassing the Ukraine, Blue Stream, and the Northern Gas route.

Yamal-Europe, known also as Yamal-1, would go across Belarus and Poland and link the Russian gas fields with the German gas network. The first leg of this pipe has already been completed. The German company, Wintershall, is for instance, involved in the Yamal-Europe's development. Since 1990, Wintershall and Gazprom have marketed Russian gas in Germany through a joint venture. Wintershall has a 65% stake in the venture, dubbed WinGas; Gazprom holds 35%.

TABLE 7. Development of Gazprom's Exports (EU member states are underlined and the EU's candidate countries are marked in *italics*)

Destination	Exports volume (bcm)	
	1998	1999
Former Soviet republics	52.4 (30%)	47.2 (27%)
CIS	48.1 (28%)	43.9 (25%)
Ukraine	30.5	29.6
Belarus	14.7	12.2
Moldova	2.9	2.1
Baltic States	4.3 (2%)	3.3 (2%)
<i>Lithuania</i>	2.2	1.8
<i>Latvia</i>	1.3	1.0
<i>Estonia</i>	0.8	0.5
Non-Former Soviet Republics	120.5 (70%)	126.8 (73%)
<u>Germany</u>	32.5	34.9
<u>Italy</u>	17.3	19.8
<u>France</u>	10.9	13.4
<i>Turkey</i>	6.7	8.9
<i>Czech Republic</i>	8.6	7.8
<i>Slovakia</i>	7.1	7.5
<i>Hungary</i>	7.3	7.4
<i>Poland</i>	6.9	6.1
<u>Austria</u>	5.7	5.4
<u>Finland</u>	4.2	4.2
<i>Romania</i>	4.7	3.2
<i>Bulgaria</i>	3.6	3.2
<u>Greece</u>	0.9	1.5
Croatia	1.2	1.2
Yugoslavia	1.9	1.1
<i>Slovenia</i>	0.5	0.6
Switzerland	0.4	0.4
Bosnia	0.2	0.2
Macedonia	0.02	0.04
Exports total	172.9 (100%)	174.0 (100%)
Production total	554	546
Exports/Production	31%	32%

Source: Gazprom (2000)

Another German gas giant also has a long tradition in collaborating with Gazprom. Ruhrgas currently owns some 5% of Gazprom, as it increased its share by one percentage point in the end of the year 2000. Currently, Ruhrgas is the only Western gas company to have a direct shareholding in Gazprom.¹⁴ Ruhrgas intends to increase its stake.

In October 2000, Gazprom signed an agreement with the French gas company, Gaz de France (GdF). The agreement confirms that GdF is going to study the feasibility of a gas pipeline section that will transport Russian gas from the Belarus-Polish border to Slovakia, and hence, bypass the Ukraine. Also Italian Snam, German Ruhrgas and Wintershall participate in the project.

The annual capacity of this pipeline would be around 60 bcm and the estimated cost of the construction, USD 2 billion.¹⁵ This pipeline, if constructed, would decrease Gazprom's dependency on exports via Ukrainian territory. As some 110-120 bcm of Russian gas transits the Ukraine, commissioning the bypass pipe may reduce the Ukraine transit to half of the current level. The Ukraine, which is heavily dependent on gas transit revenues, has resisted the bypass pipe project.

In addition to these allies, Gazprom is cooperating with RD Shell. In 1997, Gazprom and this Anglo-Dutch giant agreed to establish a jointly-held development company. Also the Italian company, ENI, is negotiating a deal to collaborate on the construction of a pipeline beneath the Black Sea, the Blue Stream pipeline. Via this pipeline Gazprom would gain direct access to the rapidly growing Turkish gas market.

According to preliminary negotiations, ENI would provide most of the engineering. In return, it would take a 50% stake in the finished pipe, if the technical challenges of laying gas pipelines two kilometers beneath the Black Sea can be overcome. Construction is slated to take place during 2000-2005, and by 2010, the Blue Stream is envisioned to distribute 16 bcm of gas to Turkey. Besides being involved in constructing this pipeline, ENI has announced that it is considering making a sizeable direct investment in Gazprom.

North Transgaz, a joint venture between Gazprom and the Finnish company, Fortum, has decided that a new gas pipeline—the Northern Gas route—would be built on the floor of the Baltic Sea. The new pipeline will reduce the length of the natural gas transport route from the North Russian gas fields to Northern Germany by 1000 kilometers, and will allow for the annual transportation of 22-35 bcm of gas.¹⁶

Despite the fact that these westward pipelines seem to be the most likely future alternatives for Gazprom, it should not be forgotten that it plans to create an overall gas supply system in Asia.

Gazprom has already signed a contract with Turkmenistan to provide the country annually with 50 bcm of gas. Correspondingly, Russia Petroleum has

signed an agreement with Chinese and South Korean companies to conduct a feasibility study for the development of the Kovykta gas field in Irkutsk, and to construct a pipeline to China and South Korea. This pipe would annually deliver some 20 bcm of gas to China and 10 bcm to South Korea. The gas reserves of the Kovykta field are estimated to be 1400 bcm. In addition, Gazprom is planning a production sharing agreement for the offshore exploration of gas in the Bay of Bengal with an Indian counterpart, GAIL.

Although Asian operations would reduce Russia's dependence on exports to the West, Gazprom has obvious difficulties in finding the financing for these gargantuan projects—even with the help of powerful strategic allies from Asia.

Equity Investments Abroad

In order to strengthen its position abroad, Gazprom has made equity investments. Gazprom owns equity stakes, for instance, in Finland, Germany, Greece, Hungary, Poland, and the Baltic States. Even if Gazprom's equity investments in the West are interesting, the company's ownership in the ex-CMEA states has raised more public attention, and hence, they are discussed in more detail in the following (see Table 8).

In the Baltic States, Gazprom is the second largest shareholder, after Ruhrgas, in the Estonian gas firm, with a 31% stake. In Latvia, Gazprom already acquired an 18% stake in Latvijas Gaze before the March 2000 auction, where the Latvian State sold an additional 28% share. As a results of the sale, Latvijas Gaze's ownership structure is the following: Ruhrgas 26%, Itera 21%, Gazprom 18%, Preussen Elektra 17%, the Latvian state 10% and others 8%. Gazprom is also eyeing the Lithuanian gas company, Lietuvos Dujos, as the

TABLE 8. Some of Gazprom's Equity Investments Outside Russia

Company	Country	Field of operation	Gazprom's share
Prometheus Gas	Greece	Construction	50%
Europol Gas	Poland	Gas distribution & transportation	49%
BorsodChem	Hungary	Petrochemicals	c. 25-50%
WinGas	Germany	Gas distribution & transportation	35%
Eesti Gaas	Estonia	Gas trade	31%
Gasum	Finland	Gas distribution & transportation	25%
TVK	Hungary	Petrochemicals	c. 25%
Latvijas Gaze	Latvia	Gas trade	c. 18%

Lithuanian government is expected to sell a 34-51% stake to a strategic investor in 2001. As the buyer is expected to diversify Lithuania's supply from Russia, it seems unlikely that Gazprom's possible offer would be accepted.¹⁷

Besides the Baltic States, Gazprom has made equity investments outside the former Soviet Union. In the fall of 2000, the group acquired a stake in two Hungarian petrochemical factories, BorsodChem and TVK. Gazprom's original attempt to obtain control over TVK failed, since the Hungarian gas and oil concern, MOL, managed to increase its stake in TVK to 32.9%, which allows it to make a buyout offer to all the other shareholders. Besides, MOL has four of the eight seats on TVK's board of directors, strengthening its position in the battle against Gazprom.

However, Gazprom may continue the battle over TVK's dominance via Oriana, the Ukrainian ethylene producer, which is TVK's significant supplier. As Oriana's privatization took place, just at the end of 2000, it is still unclear whether Gazprom will continue the battle over TVK via Oriana.¹⁸

These takeovers in Hungary are just examples that Russian companies may face political and public resistance. The reactions against Gazprom are not only due to the fact that the Russian firm was behind the takeover, but also because the foreign enterprise disregarding their country of origin made, the acquisition through a front firm. Takeovers made in such a hidden manner naturally raise the question as to whether or not there are also hidden goals behind the acquisition.

The acquisitions of the Russian corporations in Eastern Europe may prove that political means can be used to reach business goals, and vice versa. International business involving strategic commodities seems to follow not only the theories of internationalization but also those of international politics.

Summary of Gazprom's Internationalization

Gazprom's internationalization can be characterized by two concepts: their inherited internationalization and pipeline internationalization. Inherited internationalization is an appropriate concept since the Ministry of Gas Industry donated foreign customers, the majority of the Russian gas reserves and the pipelines inside Russia to Gazprom. It is perhaps not too much of an exaggeration to argue that Gazprom was an internationalized corporation even before it was founded in the late 1980's.

Gazprom's first steps abroad were taken within the CMEA. The former Soviet republics and the ex-CMEA countries represent, even at the moment, half of Gazprom's gas exports. Operations in Western Europe and Asia indicate, however, a new step in Gazprom's internationalization path.

Gazprom is following the pipes in its internationalization. Besides following the existing routes, the company is constructing, via strategic alliances, new connections. When the westward routes have been put into practice, it would allow Gazprom to decrease its transit through the Ukraine.

To avoid the disappearance of strategic gas transit, the Ukraine may offer Russia a stake in Ukrainian pipes in return for continuing gas transit. Moreover, Poland has supported the Ukraine in her attempts by being reluctant towards a bypass pipe via Polish territory, if the new route diverts gas that currently goes through the Ukraine.

Despite the resistance in the Ukraine and Poland, it seems self-evident that Yamal-Europe, the possible bypass of the Ukraine and the Blue Stream increase Russia's strategic negotiation power vis-a-vis the Ukraine. Consequently, this might have an impact on future relations between Russia and the Ukraine and even on the dialogue between the Ukraine and the West. Therefore, building new pipes not only influences the economic but also the political map of Europe.

In assessing Gazprom's foreign operations, the company's equity stakes abroad should not be forgotten. Although the company mainly owns minority stakes, it is not completely out of the question that Gazprom would not use the dependence of its foreign subsidiaries on Russian gas supply to acquire a majority ownership in the future.

This might have unpredictable implications on both the business and political life of these countries. Therefore, the top management of Gazprom is not only playing a global business game even though the management team would be solely interested in developing the company's business activities. As long as Gazprom represents the entire Russian gas industry, its activities have a political color, whether the corporation wants that or not.

In order to normalize the situation, it would be necessary to transform Gazprom from an "implicit governmental tool" to a genuine business organization by abolishing ownership constraints. By abolishing ownership constraints, foreign investors would most probably lay investments in these emerging gas companies.

Cullison and Bahree (1999, 11) aptly note that "*the question is whether they [Gazprom] are going to be a real company or a gas ministry with stock. They have to be concerned with building value, not preserving an empire.*"

LUKoil's Operations Abroad

Today LUKoil is a partner with the largest Western companies in some of the most prospective oil regions in the world. (Gustafson, 1999, 53).

Reserves and Production Abroad

Almost 30% of the company's oil reserves are located abroad. The major fields are in Iraq, the Azeri and Kazakh sectors of the Caspian Sea, and Egypt.

Some three-quarters of the company's proven foreign reserves lie in the Iraqi field, West Qurna. This oil field is believed to be one of the largest in the world. LUKoil's has almost a 70% interest in the project. The project has recently faced some difficulties, as Iraq stopped selling crude oil to LUKoil as punishment for their failure to develop the oil field. Due to the myriad obstacles in Iraq, production in the Azeri and Kazakh fields forms practically all of the company's foreign production.

In Azerbaijan, LUKoil made its first steps already in 1993, when it signed a framework agreement with the State Oil Company of the Azerbaijan Republic (SOCAR). With SOCAR, LUKoil created the Yalama project in 1997. However, production has not started in this field. LUKoil is also involved with a minor stake in the Shakh Deniz consortium and the Azerbaijan International Operating Company, which exploits the Azeri, Chirag and Guneshli fields.

In Kazakhstan, LUKoil takes part in developing the Tengiz, Kumkol and Karachaganak oil fields. The Tengiz field is operated by the Russian-US joint venture, LUKARCO, in which LUKoil's share is 54%. The Kumkol field is being developed by the Russian-Kazakh joint venture, Kumkol-LUKoil, where LUKoil's share is 50%. In 1997, LUKoil signed the PSA on the Karachaganak oil field. LUKoil's stake is 15%.¹⁹ In addition to the Caspian Sea region, LUKoil together with the Italian company, Agip, founded an equally-owned joint venture to explore and develop the Meleya fields in Egypt.

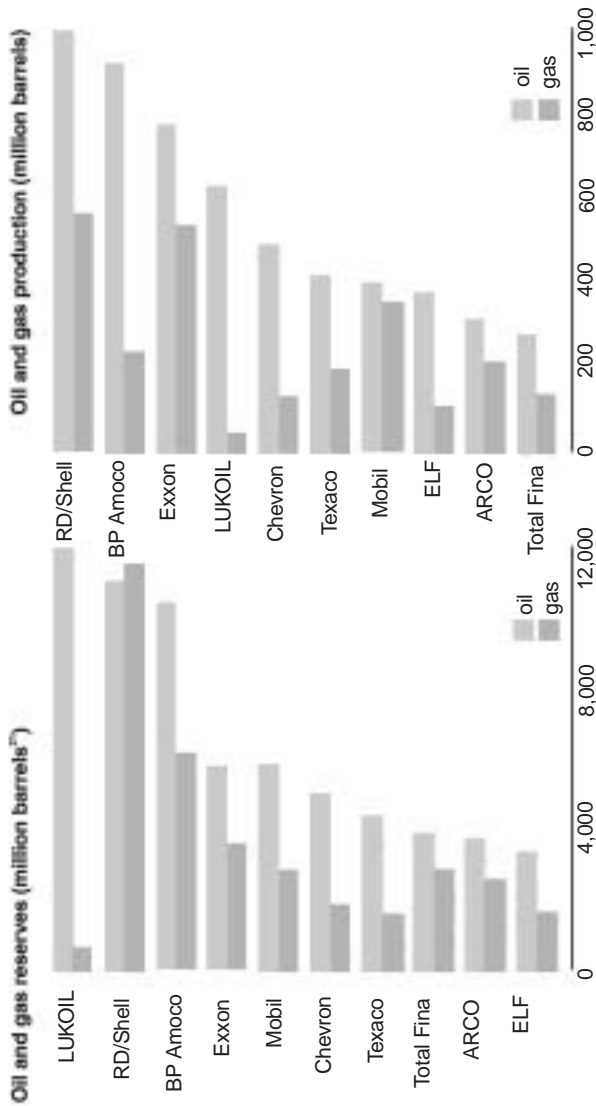
LUKoil has substantial oil reserves and is a considerable oil producer in international comparison. LUKoil is among five biggest oil companies in the world (see Table 9).

Only a small percentage of LUKoil's oil production occurs outside the Russian borders. Even if the production abroad is still relatively insignificant, it is growing rapidly. As an indication of its fast growth, it should be noted that the company did not have any production abroad in 1995. A year later production was 0.3 million tons (m tons). The production volume doubled in both 1997 and 1998, reaching 1.2 m tons in 1998. LUKoil's gas production is more international than that of its oil production; one-tenth of the gas production takes place abroad (see Table 10).

Refining Abroad

Approximately 30% of LUKoil's total refining took place abroad, where LUKoil has purchased three refineries. At the beginning of 1998, LUKoil ac-

TABLE 9. LUKoil in International Comparison in 1988²⁰



Source: LUKoil (2000)

TABLE 10. LUKoil's Production in 1998

	Oil production	Gas production
Russia	63.0 m tons (98%)	3.360 bcm (90%)
Abroad	1.2 m tons (2%)	0.388 bcm (10%)
Total	64.2 m tons (100%)	3.748 bcm (100%)

Source: LUKoil (2000)

quired a controlling stake in the Romanian refinery, Petrotel. This was the company's first purchase in refining outside Russia. Besides Petrotel, LUKoil practically controls the Odessa Refinery in the Ukraine. In 1999, LUKoil purchased the majority of the Neftochim Bourgas refinery in Bulgaria. The Bulgarian unit is LUKoil's most important foreign refinery with an annual capacity of nine million tons. The Bulgarian unit forms half of their total refining capacity abroad. Both the Romanian and the Ukrainian refinery cover one-quarter of the company's foreign refining capacity.

When analyzing LUKoil's plans for oil refining abroad, Mazeikiu Nafta, the Lithuanian refinery, should also be mentioned. LUKoil tried to acquire a stake in this company, but failed, as the shares were sold to the US firm, Williams International.²² Currently, Williams is having discussions with LUKoil about establishing a strategic alliance, and hence, securing Mazeikiu's steady supply of oil. In addition to the eyeing of the Lithuanian oil refinery, LUKoil is interested in obtaining a 70% stake in Paramo, the Czech refinery. In this context, it should also be noted that LUKoil has reversed its earlier plans to acquire the Novi Sad refinery, in Serbia.

Exports and Sales Abroad

Though the majority of the sales are currently directed at the domestic market, the importance of foreign markets is growing rapidly. From LUKoil's point of view, it is rational to expand sales to foreign markets, as the prices of oil products are considerably higher abroad.²³

LUKoil exported some 40% of its crude oil production—25 m tons—already in 1998. Crude exports are almost completely (95%) directed to non-CIS countries. LUKoil is promoting exports with its foreign units.

For instance, in the Baltic States, LUKoil is operating through LUKoil Baltija, which was established in Lithuania in 1992. LUKoil Baltija is the largest oil trading company in Lithuania. LUKoil Baltija's branch has been registered in Latvia. In Latvia, LUKoil has laid investment worth USD 15 million.²⁴ LUKoil-Moldova, established in 1995, is engaged in imports, transportation,

storage and the sale of oil products to Moldova and Romania. LUKoil also has a daughter firm in Bulgaria and a joint venture with INA Nafta Industria in Croatia. These units are clear signs of the expansion strategy in the former CMEA bloc.

LUKoil currently has some 1200 gasoline filling stations. Approximately 1000 of them are in Russia and the remaining 200 in the Baltic States, Kazakhstan, Moldova, the Ukraine and the Czech Republic. LUKoil plans to open about 500 new filling stations in the next two years. Most of them will be opened in Eastern Europe, probably in Bulgaria, Romania and possibly in Croatia.

In addition to operations in the aforementioned countries, LUKoil bought a controlling stake of Getty Petroleum Marketing (GPM) in November 2000. By purchasing GPM, LUKoil was the first Russian firm to acquire a publicly-traded US company. GPM has some 1300 gasoline stations in the USA. By acquiring a US enterprise, LUKoil aims at entering a lucrative business environment.

Distribution to Foreign Markets

LUKoil's oil deliveries to non-CIS countries were allocated between seaport shipments (56%) and pipeline deliveries (44%). The seaport shipments were divided as follows: Novorossiisk (26% of the total), Odessa (13%), Tuapse (8%) and Ventspils (9%).

Seaport shipments: LUKoil possesses a sea-going tanker fleet. Currently, LUKoil owns two shipping companies: LUKoil Arctic Tanker and LUKtrans-Shipping. Moreover, LUKoil obtained a controlling stake in the Murmansk Shipping Company.²⁵ In total, LUKoil's fleet numbers 66 vessels, and their total freight-carrying capacity amounts to 0.15 m tons. The company has become a major ship owner, controlling 13% of Russia's maritime tanker fleet.²⁶

Growing regional competition for transit freight has put Russian oil companies in the position of playing off the Baltic ports against one another. As a result of fierce intra-Baltic competition, the Russian oil majors have managed to push down transit fees to low levels, and they are in a powerful position to demand stakes in Baltic transport enterprises in exchange for oil supply guarantees.

Besides using the Baltic ports, LUKoil opened its own oil terminal in the Kaliningrad region in October 2000. In this context, it should also be noted that Latvia is expected to sell approximately a 40% share in the Ventspils Nafta oil terminal. LUKoil has expressed its interest in acquiring a strategic stake in the terminal. Ventspils Nafta's privatization is aimed at taking place at the beginning of 2001.

Pipeline deliveries: LUKoil supplied, via the Druzhba pipeline, the following countries: the Czech Republic (18% of total), Poland (8%), Lithuania (8%), Germany (7%), and Hungary, Finland and Slovakia (together 3%).

As deliveries via the state pipeline network are hindered by delivery restrictions and unstable prices, LUKoil is participating in at least three pipeline projects: the Baltic Pipeline System, the Caspian Pipeline Consortium and Varandey. The Baltic Pipeline aims at linking the Kirishi Refinery with Primorsk. The Caspian Pipeline Consortium, where LUKoil has a minor stake, will connect the Caspian basin with Novorossiisk on the Black Sea. LUKoil is also engaged with constructing a pipeline to the Varandey export terminal and connecting its fields in the Timan Pechora region with the Baltic Pipeline System. This pipeline will be the first significant export route not controlled by the monopoly pipeline operator, Transneft.

It seems that developing their own maritime fleet and pipeline network is strategically and economically rational, as they offer LUKoil a chance to bypass the state pipes, and hence, increase the transportation capacity and reduce the delivery payments collected by Transneft.

A Summary of LUKoil's Internationalization

LUKoil's operations are becoming increasingly international. In 1999, the firm's foreign operations generated approximately one-fourth of the company's total revenues.

LUKoil has purchased stakes in oil fields abroad, especially in the Caspian Sea region and Iraq. Besides participating in the development of oil fields abroad, the firm has acquired controlling shares in three refineries outside Russia—in Romania, the Ukraine and Bulgaria. Most probably, the company will carry on eyeing refineries and petrochemical factories abroad, most probably in the Czech Republic and Lithuania.

LUKoil's gasoline filling stations abroad indicate the company's interest in the ex-CMEA markets. Their recent expansion into the US-market shows that the internationalization of the company is not only directed towards the post-socialist markets but LUKoil has truly become an active player in the global oil business.

LUKoil's strategy for 2001-2010 confirms the above conclusion. The company's strategy indicates that it will focus on developing hydrocarbon reserves abroad, especially in Iraq and the Northern Caspian region. The strategy also indicates that the firm's refining acquisition in Eastern Europe will continue.

To sum up, in less than 10 years after the dissolution of the USSR, the first strategically-significant private post-Soviet corporation has emerged in the global business arena, as LUKoil is executing its aggressive expansion strat-

egy and conquering oil fields, refineries, and marketing companies in the West. Within ten years from now, LUKoil or another Russian oil major might merge with some international oil major to obtain a larger position in the global oil business.

REM Modeling Gazprom and LUKoil's Internationalization Strategy

Gazprom and LUKoil cannot be considered as twin brothers. Perhaps, the major difference between them is the fact that Gazprom supplies gas to Russian and even to some CIS customers though they cannot pay for the deliveries. By providing gas for free, Gazprom is more reminiscent of a policy-making ministry than a real business organization, which LUKoil indisputably is. Even if these case companies cannot be regarded as twin brothers, they have many common features. The similarities relevant to these companies' internationalization have been analyzed through the REM model designed for this research (see Table 11).

As a starting point, the reason (the R-factor) for internationalization seems obvious since the weight of the pro-internationalization arguments is much heavier than the anti-internationalization ones. The main driving forces for internationalization are a growing global demand, solvent foreign customers, an internationally-competitive product and a huge price gap between the Russian and the world markets. Taxation planning and logistical advantages add to the case companies' enthusiasm to move from direct exports towards operations abroad. Foreign ownership in the case companies has most probably encouraged the globalization of these corporations.

Although the studied firms have implemented a global expansion strategy, the first steps towards internationalization have concentrated on the post-socialist markets for several reasons. First, prior local experience and business networks give an advantage vis-a-vis their main international competitors. Second, Central and Eastern European countries are the logistically rational option as they are situated midway in the pipeline network, between the reserves in Western Siberia and consumption in the Western Europe. Third, undervalued privatization in Central Eastern Europe explains the special interest in these markets. Even if foreign operations have until now focused on the post-socialist states and countries nearby Russia, these companies are eyeing the lucrative West European and US markets.

It seems evident that in the following years, we will witness the aggressive globalization strategy of these companies, as they penetrate all the economically-significant markets around the globe. Therefore, it can be anticipated that the environment selection criteria (the E-factor) will most probably shift from

TABLE 11. Gazprom and LUKoil's Internationalization in the REM Model

R - REASON FOR INTERNATIONALIZATION: WHY INTERNATIONALIZE?	
Pro-internationalization arguments: <ul style="list-style-type: none"> * Internationally competitive product. * Growing demand abroad. * Enormous reserves and large production. * Substantially higher prices abroad. * Solvent foreign customers. * Heavy taxation in Russia. * Bureaucracy and corruption in Russia. * Foreign owner impact in these companies. * Inter-governmental agreements. 	Anti-internationalization arguments: <ul style="list-style-type: none"> * Reserves located far away from the attractive Western markets. * Pipeline bottlenecks. * State restrictions and tariffs (export quotas and high export duties). * Company-based weaknesses (financial constraints, relatively short experience in international business and the global business network is not completed yet). * Political resistance in Eastern Europe.
E- ENVIRONMENT SELECTION: WHERE TO INTERNATIONALIZE? <ul style="list-style-type: none"> * <u>Global strategy</u>: Post-Soviet republics and Eastern Europe act as a familiar foothold to the wider global arena: the EU, the USA, Asia and some countries with a special status. * Post-Soviet republics: Earlier experience, business contacts and undervalued privatization. * Eastern Europe: Logistically closer to growing European market and undervalued privatization. * The EU: High demand, high profit margins and solvent customers. * The USA: Extremely lucrative target market with high consumption and high competition. * Asia: Balancing the overdependence on Western markets. Potential for high growth. * Countries with a special status (Iraq, Libya, Serbia and Belarus): Operations by Western competitors non-existent in these environments. 	
M - MODAL CHOICE: HOW TO INTERNATIONALIZE? <ul style="list-style-type: none"> * From direct exports towards various operation modes abroad: Get rid of state restrictions and high export tariffs. Operations abroad create an opportunity for taxation planning and the minimization of logistical costs. * Foreign reserves: Due to high financial involvement and risks—foundation of joint ventures and strategic alliances. * Production abroad: Build new capacity closer to the growing markets—goal to maintain control, i.e., the goal to purchase controlling stakes in production units—acquisitions. * Marketing abroad: High profit margins—establishment of own sales units, i.e., a way to distribute own product—from complete ownership to franchising agreements. In addition, own trading companies abroad can be used to uncover shadow transfers of profits by undervaluing the exports of the parent company to own foreign trading units. * Distribution: Current pipeline capacity limits exports, and hence, new pipes are developed. Due to heavy financial involvement and a need for long-term commitment from both supplier's and buyers' side—creation of joint ventures and strategic alliances. * Many operation modes used simultaneously. 	

PECULARITIES CONCERNING THE INTERNATIONALIZATION OF CASE COMPANIES:

- * Due to enormous reserves and the production of strategic goods, the number of potential collaborators of a similar size is limited.
- * The Russian government aims at slowing down internationalization in order to secure her domestic energy supply. A similar policy can be observed also with other strategic raw materials.
- * A substantial price gap between the Russian and the world markets.
- * Due to resistance in the ex-socialist countries, the special need for operations via front firms.
- * Extraordinary heavy investment required for building a pipeline network—long-term commitment at governmental level needed from both seller's and buyers' side—inter-governmental agreements.
- * The global business game is so riddled with the domino game of international politics that the international operations cannot just be regarded merely as the internationalization of a firm but the perspective of international politics should be taken into consideration.

the familiarity of the environment towards the integration of regional environments into their global strategy, with the aim of creating synergy.

The M-factor has developed during the past few years, since these companies do not just use direct exports but also more complex modes of internationalization. Despite the rapid adaptation of modern internationalization modes, it seems that control over foreign business activities dominates their entry strategy. These firms have, however, been satisfied with a minority position in those operations, which include a high risk (e.g., oil exploration), a heavy investment or a long-term commitment (e.g., pipeline construction).

The internationalization of these companies is rather understandable when analyzed through the REM model. However, certain peculiarities must be remembered when the internationalization of the case companies is dealt with.

The considerable price difference paid for the raw material between the Russian and the world market is one fundamental peculiarity in the case companies' move towards internationalization. Due to this peculiarity, the findings of this study should be applied to post-socialist companies, which face a similar situation, i.e., a wide price difference, a strategic commodity, and a growing demand worldwide.

Another peculiarity worth mentioning is the political aspect involved in their internationalization. An example of the political aspect to their internationalization is the restrictive home environment policy, which is reflected in the case companies' internationalization. Using various restrictions, the Russian government aims at securing the supply of the strategic goods in the home market, at a subsidized price level.

Although the Russian government's goal is to guarantee the domestic energy supply, the restrictive home policy may speed up the internationalization of the energy companies since they move production abroad to avoid export quotas and duties. The only sustainable policy measure would be allowing the energy prices to climb up to the world market level, even if it would increase inflation and reduce the competitiveness of Russian industry in the short-term. A long good-bye to the Soviet energy policy does not help in creating the international competitiveness of Russian firms in the long run, as these indirect state subsidies erode any real effectiveness.

Secondly, some of the government's actions actually promote the case companies' internationalization. For instance, the agreement between Russia and the EU on the intensification of energy collaboration gives a more reliable foundation for mutual long-term commitment than inter-firm agreements. These inter-governmental agreements are especially required in planning the long-term trade relations between Russia and the EU and pipeline projects, which involve heavy investment.

Thirdly, the Russian government's interest in the case companies' activities may create pressures for restrictive policy measures in the host environment, since the host governments may fear that Russia exerts political influence via these corporations. The historical dominance of the USSR during the communist era is probably the main reason for high resistance in the ex-CMEA countries. Consequently, Western governments have just followed the expansion of the Russian corporations without any exceptional reaction on their part.

Hopefully, the future expansion of Russian companies into foreign markets will not be influenced by political aims, as was the case during the Cold War. Without the political content of the Russian firms' expansion abroad, the internationalization from the East towards the West complements the internationalization from the West towards the East, and contributes to the peaceful integration of post-socialist economies into the world economy.

CONCLUSION

The number of Soviet corporations outside the USSR was modest. Only some 300-400 Soviet firms operated abroad on the eve of the disintegration of the Soviet Union. The dissolution of the USSR accelerated the operations of Eastern companies in the West. The biggest Russian companies have been especially active in expanding their activities outside their home environment. This article deals with the internationalization of the two biggest Russian companies, namely Gazprom and LUKoil. This article uses *the REM model* (the Reason for internationalization–Environment selection–Modal choice) to describe the operations of these energy companies abroad.

The reason for internationalization: a growing global demand, solvent foreign customers, an internationally competitive product, a huge price gap between the Russian and the world markets, taxation planning and the foreign owner's influence within these corporations are the main pro-internationalization arguments, which clearly outweigh the anti-internationalization factors, and hence, gives these companies a clear motive for internationalization.

Environment selection: earlier experience, logistical advantages and undervalued privatization explain why post-socialist economies have been selected as the principal environment. Even if foreign operations have focused on the post-socialist states, the studied companies are eyeing the lucrative West European and US markets, where they have already a foothold. In this context, it should also be noted that the majority of post-socialist countries will become EU members in the coming decades, and hence, the former communist states may open a familiar backdoor to the EU's internal market.

Modal choice: these corporations do not use only direct exports but also more complex modes of internationalization. Despite the rapid adaptation of modern internationalization modes, it seems that maintaining control dominates the internationalization strategy of these companies. The studied firms have, however, been satisfied with a minority position in those operations which include a high risk, a massive investment or a long-term commitment from both supplier's and customer's side.

The internationalization of these companies seems extremely understandable when analyzed through the REM model. However, certain peculiarities need to be emphasized where the internationalization of the case companies is concerned. Perhaps, the Russian government's influence in these firms' internationalization is one special aspect, which should be taken into consideration.

The Russian government both encourages and discourages internationalization. The inter-governmental agreements, for instance, promote internationalization as they give a relatively solid guarantee for mutual long-term commitment. On the other hand, Russia's export quotas and tariffs aim at slowing down internationalization.

The Russian government's special interest in the case companies may also raise a negative attitude towards these companies in the host environment. To exemplify, political and public opinion in some former socialist countries has been against these Russian companies, as these post-communist states fear that Russia aims at gaining political influence via these companies. We will see relatively soon whether the expansion of Russian energy companies abroad stresses the need to integrate theories of international business with those of international politics.

In closing, theories regarding internationalization generally aid in understanding the increasing expansion of Russian firms abroad, though the peculiarities of their internationalization stresses the need to make some modifications. Scholars may find the REM model designed for this study useful, in analyzing the internationalization of other post-socialist companies.

NOTES

1. The year 2000 was an exceptional year. Then, the value of the Russian energy exports rose substantially, even if the export volume practically remained unchanged. For example, the volume of crude oil exports rose just by 1%, while the price jumped by 129% during the first six months of the year 2000. The respective growth figures for natural gas were 5% and 52% (PlanEcon Report, 2000).

2. Also ITERA, a company registered in the USA, is becoming an important actor in the Russian gas business. It is Russia's third-largest gas trader at the moment.

3. An Indian Oil and Natural Gas Company is expected to buy Rosneft's 40% share in the Sakhalin-1 project. The sale is scheduled to take place in February-March, 2001. Foreign experts doubt whether the deal will be accomplished. Also, the Hungarian gas and oil company, MOL, plans to start oil production in Russia. MOL has signed an agreement with Yukos for the joint exploitation of the Zapadno-Malobalyk oil field, located in West Siberia.

4. According to McMillan (1987), nine Soviet-owned enterprises were established in Finland, for instance, Suomen Petrooli (oil trading), Teboil (gasoline filling stations), Konela (sales of Soviet automobiles), Fexima (the production of refrigerators), and the Saimaa Lines (transportation). A closer description of the Soviet corporations in various Western countries can be found in Hamilton's (1986) and McMillan's (1987) book.

5. According to Finnish sources, the number of the companies with Russian capital in Finland is many times higher than what was indicated by the Russian expert.

6. As an example of the unpredictable changes possible in the Russian energy sector; Gazprom's management has been accused of moving considerable parts of Gazprom's assets to ITERA. Most probably, Gazprom's inner circle owns ITERA.

7. Although the following research studies do not explicitly focus on internationalization, they offer valuable insights into Gazprom and LUKoil's operations: Kryukov and Moe (1996), Seifulmukov and Lane (1997), and Kryukov and Moe (1998).

8. According to EBRD (2000, 92), *"the globalization of Russian companies is confined to several large oil and gas companies, in particular LUKoil and Gazprom. LUKoil is the biggest outward investor in the region [in the entire former socialist bloc], with USD 2.3 billion in direct investments abroad. . . . LUKoil also had a large lead in terms of employment and sales abroad."*

9. According to Globerman and Shapiro (1999, 526), *"the government policies that matter most for investors generally are those that promise to change economy-wide demand and cost conditions significantly such as one would anticipate from a comprehensive trade liberalization agreement with a country's largest trading partners."*

10. An argument indicating a superior operation mode in the Chinese market has been offered by Pan et al. (1999, 81) who state that *"equity joint ventures have a higher profitability than either wholly owned operations or contractual joint ventures."* Even if this would be true in China, it does not mean that equity joint ventures would be a superior mode in other environments. In fact, many scholars have indicated the complexities involved in managing equally-owned joint ventures in other business environments.

11. The predecessor of Gazprom started its internationalization as early as 1966, when the USSR exported gas to Poland.

12. The price for 1000 cubic meters of natural gas inside Russia is USD 10, whereas in the West, some USD 80.

13. Some 35.3 cubic feet equal to 1 cubic meter.

14. However, several foreign gas companies, such as ENI and Gaz de France, have expressed their interest in buying a stake in Gazprom.

15. Foreign experts have doubted the capacity of the bypass pipeline since it lacks the network from the gas fields.

16. In January 2001, the Russian president Putin and the Finnish premier Lipponen met and reached a principal agreement on building a gas pipeline from the natural gas

fields located in the Barents Sea via the Finnish territorial waters to Central Europe. According to preliminary plans, the project would be finished by the year 2007.

17. In addition to the equity investments referred to in the table, Gazprom has considerable shareholdings in Central Asia and in several ex-Soviet republics.

In terms of turnover, Eesti Gaas was 17th, Latvijas Gaze 6th, and Lietuvos Dujos the 4th largest company in its country in 1999.

18. Also LUKoil has made overtures to the Ukrainian government to acquire Oriana. At the end of November 2000, it seems that LUKoil might be ahead of Gazprom in the competition over Oriana. In this context, it should not be forgotten that LUKoil and Oriana have founded a joint venture, LUKor.

19. In addition to Azerbaijan and Kazakhstan, LUKoil is looking into the possibilities of participation in projects in Turkmenistan's shelf of the Caspian Sea.

20. The table provides the 1988 data, and therefore, it does not take into account notable oil mergers, such as ExxonMobil and BP Amoco/ARCO. It should also be noticed that the table is based on the data provided by LUKoil. Independent Western observers suggest that LUKoil's oil reserves are the fourth biggest, after ExxonMobil, RD/Shell and BP Amoco/ARCO in 1999.

21. One barrel is equal to 159 liters, or correspondingly, 0.136 tons.

22. The Lithuanian government says that it will ask experts of English law to review the 1999 deal selling a 33% stake and operational control of Mazeikiu Nafta to Williams. The Lithuanian constitutional court recently struck down parts of the law that allowed Williams to buy the stake.

23. In the autumn of 2000, Andrei Illarionov, the advisor of the Russian president, stated that oil prices in Russia are 35-70% of the world market prices depending on the product in question.

24. LUKoil Baltija R was the 29th largest company in terms of the net turnover in Latvia and LUKoil Eesti, 135th in Estonia in 1999.

25. LUKoil also aimed to buy the Latvian Shipping Company, which was under privatization. However, LUKoil's bid did not meet the requirements set by the Latvian Privatization Agency. As no other buyer appeared, the shipping company's privatization was postponed. The Latvian Shipping Company is planned to be privatized during the spring of 2001.

26. LUKoil has a large fleet of railway rolling stock. One of its subsidiaries, LUKoil-Trans, is second only to the Ministry of Railways in the volume of transporting petroleum products.

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SUBMITTED: April 2000

FIRST REVISION: August 2000

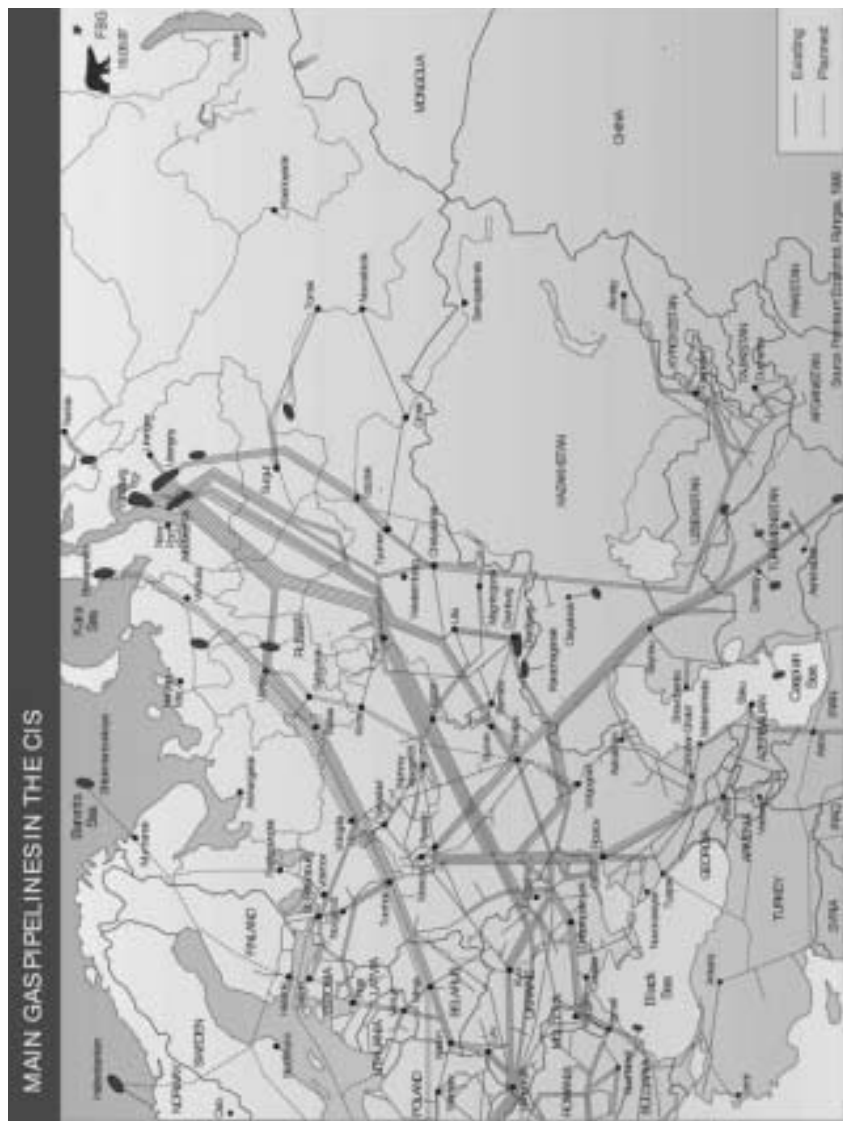
SECOND REVISION: January 2001

ACCEPTED: April 2001

APPENDIX 1. Major Oil and Gas Pipelines from Russia Towards the West



Source: The Finnish Ministry of Trade and Industry (1999)



Source: The Finnish Ministry of Trade and Industry (1999)

APPENDIX 2. The Turnover of 50 Biggest Russian Companies

	Name	Region	Turnover (million USD)		
			1999	1998	1997
1.	Gazprom	Moscow	12388	17408	23800
2.	LUKoil	Moscow	10859	8299	10507
3.	RAO EES	Moscow	9846	16531	24988
4.	Surgutneftegaz	Tjumen	3272	2619	4262
5.	Norilsk nickel	Moscow	2705	2552	3092
6.	Sberbank	Moscow	2202	25068	4160
7.	Svjazinvest	Moscow	2200	4167	639
8.	Yukos	Tjumen	2106	2467	4641
9.	AvtoVAZ	Samara	1943	2668	4114
10.	Tatneft	Tatarstan	1805	1721	2901
11.	Sibneft	Omsk	1644	1783	2994
12.	TNK	Tjumen	1534	2923	2166
13.	Severstal	Vologda	1497	1724	2449
14.	Aeroflot	Moscow	1131	1317	1409
15.	GAZ	Nizny Novgorod	983	1479	2214
16.	Mosenergo	Moscow	914	2198	3793
17.	Rostelkom	Moscow	586	908	1378
18.	Nizhnevartovskneftegaz	Tjumen	563	n.a.	n.a.
19.	Orenburgneft	Orenburg	544	440	876
20.	Slavneft	Moscow	514	495	2378
21.	Sverdlovenargo	Sverdlovsk	476	919	1318
22.	Nizhnekamskneftehim	Tatarstan	450	575	912
23.	Nizhnetarilsky MK	Sverdlovsk	419	444	1047
24.	Bashirenergo	Bashkortostan	369	728	1233
25.	MTS	Moscow	358	365	218
26.	KamAZ	Tatarstan	355	134	672
27.	Slavneft-Merionneftegaz	Tjumen	350	678	1054
28.	Metshel	Tsheljabinsk	332	413	832
29.	Irkutskenergo	Irkutsk	331	575	849
30.	Tshernogorneft	Tjumen	320	277	446
31.	Angarskaya NHK	Irkutsk	320	207	583
32.	Lenenergo	St. Petersburg	291	630	1049
33.	Uralkaly	Perm	290	316	344
34.	Permenergo	Perm	285	674	1024
35.	Tsheljabenergo	Tsheljabinsk	283	614	1061
36.	Kuzbassenergo	Kemerovo	279	576	931
37.	Nojabrskneftegaz	Tjumen	277	870	1773
38.	NOSTA	Orenburg	269	n.a.	n.a.
39.	Komineft	Komi	261	119	237

	Name	Region	Turnover (million USD)		
			1999	1998	1997
40.	KomiTEK ²⁷	Komi	261	451	479
41.	Krasnojarskenergo	Krasnojarsk	257	568	732
42.	Samaraenergo	Samara	256	581	901
43.	Lurneftegaz	Tjumen	252	498	753
44.	Sahalinmorneftegaz	Saratovsk	246	277	531
45.	Vimpelkom	Moscow	226	374	294
46.	Silvinit	Perm	224	229	211
47.	Nizhnovenergo	Nizhny Novgorod	207	470	708
48.	DVMP	Primorsky krai	207	263	349
49.	Nizhnkamshina	Tatarstan	195	333	698
50.	Energya	Moscow region	190	130	357

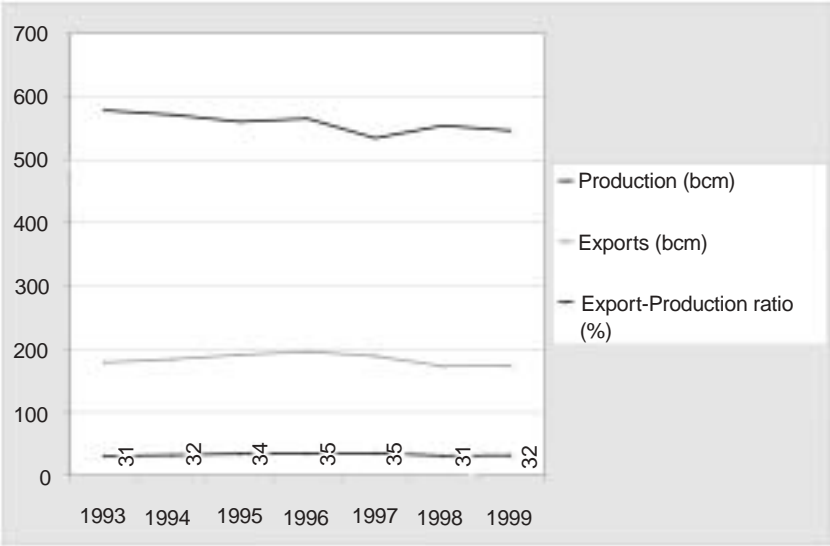
Source: Kommersant dengi (2000)

APPENDIX 3. Company Background Data in 1998²⁸

	Gazprom	LUKoil
Established	1989	1992
Ownership		
Russian state	38%	27%
Russian companies & individuals	57%	40%
Foreign companies & individuals	4% (maximum limit 20%)	34%
Personnel		
Employees	362 000	94 000
Reserves		
Gas reserves (bcm)	32 200	227
Share of Russian reserves	66%	0,5%
	(32% of the world reserves)	
Oil reserves (m tons)	N.A.	2 072
Share of Russian reserves	N.A.	31%
Production		
Gas production (bcm)	554	4
Share of Russian production	94%	0,7%
	(23% of the world production)	
Oil production (m tons)	N.A.	64
Share of Russian production	N.A.	21%

Compiled from various sources

APPENDIX 4. The Development of Gazprom’s Production and Exports



For reference see Heinrich (2000)

APPENDIX 5. The Location of Russia’s Energy Reserves (% of total)

Region	Oil	Gas	Solid fuels
North of the European Part of Russia	7,0	1,3	4,1
The Northern Caucasus	0,9	0,7	3,3
The Volga region	6,2	5,8	0,0
The Ural mountains	8,9	2,8	1,0
Western Siberia	73,4	79,9	46,5
Eastern Siberia	1,6	2,0	33,4
The Far East	1,0	2,2	9,8
The Continental Shelf	0,8	5,3	0,0

Source: Dudarev & Zverev (1999)