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Investment Attractiveness of the Russian Energy Sector MNCs: Assessment and Challenges

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ABSTRACT

Being the most important economic sectors, the energy sector provides significant profits for the Russian economy and is largely dependent on the functioning of several multinational corporations such as Rosneft, Gazprom and Lukoil. Investments in these companies have always been important drivers for the Russian economy. New conditions of the global economy create serious challenges for the sector; therefore, the investment attractiveness of the sector is changing. The authors propose a new approach to the analysis of investment attractiveness, based on the conjugation of technical financial analysis, reflecting the internal factors that affect the companies' performance, and the SWOT analysis of the industry combined with the Doing Business Rankings that give a full picture of the external factors of investment attractiveness. This methodology makes it possible to identify the main specific characteristics of Russian MNCs and develop an investment strategy in the Russian energy sector in the current difficult times. Another result is a strategy for the development of the Russian energy sector in order to attract additional investment. The novelty of the article includes the implied methodology of investment attractiveness and evidence of the high investment attractiveness of the Russian energy sector even in unstable conditions, especially in the COVID economic shock.

Keywords: Energy Sector, MNC, Financial Analysis, Economic Conjuncture, Investment Attractiveness, Russia

JEL Classifications: P28, Q48

1. INTRODUCTION

Today, the global economic situation remains unstable, and the future of many traditional sectors is unclear. In these conditions, it is necessary to identify the main sectors and the most attractive companies that operate in these sectors in order to stabilize the national economy through stimulating these companies, including financial measures to be taken.

Anguelov (2012) stated that the most attractive companies for investment in the globalized world are multinational companies

(MNCs), which today are the main economic force in the corporate sector. The energy sector has also been a stable and sustainable sector for a long period of time, especially in developing countries, where it forms the basis of economic development (Luo et al., 2019; Giuliani and Macchi, 2014). In Russia, more than 45% of government revenues come from the production and export of oil and gas (Atradius, 2019); this brings together two areas interesting for investment – MNCs and the energy market.

The article discusses the energy sector as oil and gas upstream, midstream and downstream, excluding the production and

distribution of electricity, since in Russia it is mainly completely controlled by the state and operate without reference to the situation in the economy and have no interest in terms of investment attractiveness.

The article presents a wide analysis of the factors contributing to the energy sector investment attractiveness by assessing the basic indicators of the financial stability of Russian MNCs – Rosneft, Gazprom and Lukoil, selected for their dominant position in the Russian energy sector (Lavrov and Aleksanyan, 2017). The analysis of their financial situation is supplemented by an analysis of the Russian energy market with further unification of the results obtained.

2. LITERATURE REVIEW

The study of Russian MNCs and their position in the global economy began at the time of Russia’s entry into global markets. McCarthy et al. (2009) described the situation in the global MNC markets and the position of the Russian MNCs on them; however, their research lacks an analytical part due to the immaturity of Russian MNCs at that time.

More recent researches, such as (Savchina et al., 2017), pointed to the important role of the economic conjuncture in assessing the position of Russian MNCs. This approach has its pros and cons; the main problem is that the internal factors of the investment attractiveness of companies are not in the focus. Conversely, Andreff (2015) focused mainly on internal factors of competitiveness and analyzed the strategic aspects of the development of MNCs. Both of the presented approaches allow to conclude that Russian MNCs are the main drivers of the Russian economy and that their position is vital for Russia.

Abramova and Garanina (2016) studied the current trends in the strategies of Russian MNCs in the field of attracting investments and showed that Russian MNCs in the studied areas have high potential for development, especially in partnership with Chinese MNCs, but in their study there are no proposals for Russian MNCs and their investment strategies. In another study, Abramova and Garanina (2018) presented a broad analysis of the economic conjuncture and made an interesting conclusion about the shock resistance of Russian MNCs in the times of crisis.

3. METHODOLOGY

In this study, the methodology consists of two parts: (1) The assessment of the Russian MNCs financial stability, (2) the analysis of the economic conjuncture in the Russian energy sector at the present stage.

The first part includes technical financial analysis based on the calculation of six main coefficients that characterize the investment attractiveness of a company’s shares and bonds (TD/EQ ratio and P/E ratio), and the company’s financial efficiency for investments purposes (ROE and ROI) and potential financial stability and ability to act in a crisis situation and bankruptcy (FS and CLR

indicators), necessary to assess potential risks for investors in the current conditions of global instability and post-COVID economy. These indicators in the article are calculated as follows:

$$\frac{TD}{EQ} = \frac{LRD + SRD}{TA} \quad (1)$$

where LRD – long-run liabilities, SRD – short-run liabilities, TA – total value of assets.

$$\frac{P}{E} \text{ ratio} = \frac{SP}{EPOS}; EPOS = \frac{EBITDA - Div}{SQ} \quad (2)$$

where SP – share price, EPOS – earnings per ordinary share, Div – dividends per preferred shares, SQ – total quantity of ordinary shares.

$$ROE = \frac{EBITDA}{TA} * 100\% \quad (3)$$

$$ROI = \frac{EBITDA}{TA + LRD} * 100\% \quad (4)$$

$$FS = \frac{TA + LRD}{TL} \quad (5)$$

where FS – financial stability ratio, TL – total liabilities.

$$CLR = \frac{CA}{CL} \quad (6)$$

where CLR – current liquidity ratio, CA – current assets, CL – current liabilities.

The new conditions, especially the issue of the “too big to fail” companies (this is just the case of the Russian energy sector MNCs for the Russian economy), require the creation of a mechanism, which could encompass both internal and external threats to companies. The authors put forward the idea of combining existing methodologies to assess the economic conjuncture in the Russian energy sector and to identify the main challenges and opportunities. To do this, the authors refer to the SWOT analysis, which is the basis for the introducing two characteristics of the industry:

- 1) Viability – consists of the strengths and weaknesses of the industry. It reflects the current stage in the industry development and the position of the Russian energy industry in the global energy market. It is calculated as the Qs/Qw, where Qs is the quantity of strengths, and Qw is the quantity of weaknesses. In case the value is more than 1, the industry has a high development potential and is crisis-resistant. In the opposite case, the industry is weaker than the average energy industry in the world and has significant problems even the short term;
- 2) Field of possibilities – consists of opportunities and threats. It shows potential wiggle room and the space for decision making in the industry. It is calculated as Qo/Qt, where Qo is the quantity of opportunities, and Qt is the quantity of threats. If the value is more than 1, the industry has a high development potential and is crisis-resistant. If the value is low, the actions taken in order to overcome the current problems in the industry will have little or no effect.

Based on the SWOT analysis and its derivatives, as well as the Doing Business dynamic analysis, the authors introduce a modified delta of the change in Russia’s business environment.

The next step is the comparative analysis of the economic conjuncture and MNCs financial results in Russia.

4. RESULTS

4.1. Analysis of the Russian MNCs Financial Attractiveness

The current situation in the global oil and gas markets is very unstable. Since the prices for hydrocarbons tend to fluctuate in the long term with a moderately rising trend, the revenues of the energy sector companies remain low (Haider, 2020) (Figure 1).

The other side of the situation on the global oil market is the OPEC deal failure. The deal brought the oil prices up (Pierru et al., 2018), while after its collapse, the prices plundered by more than 10% (BBC, 2020).

The Russian energy sector also experiences significant shocks. Under the influence of the sanctions imposed against Russian companies, the national sector suffers significant shocks due to the lack of investment and financial resources. In such a situation, it is obvious that the financial behavior of companies should become less stable, therefore, this should be reflected in the indicators presented in Table 1.

Table 1: Results of the financial analysis of the Russian energy MNCs

Company	Rosneft		Lukoil		Gazprom	
Year	2019	2018	2019	2018	2019	2018
TD/EQ	0.60	0.64	0.37	0.29	0.13	0.12
P/E ratio	6.61	7.08	5.89	4.88	7.59	3.81
ROE	6.22	4.93	13.34	13.49	4.09	5.93
ROI	4.47	3.46	11.82	11.93	4.09	5.93
FS	1.39	1.42	1.13	1.13	1.01	1.01
CLR	0.87	1.05	1.29	1.62	1.64	1.96

Source: Created by the authors, based on (Gazprom, 2020; Rosneft, 2020; Lukoil, 2020)

The dynamic of financial indicators is shown in Figures 2 and 3. The overall dynamics in Figure 2 for the companies is as follows: Rosneft – overall positive, with current liquidity problems, Gazprom – positive, with no worrying trends, Lukoil – moderately positive, with significant indebtedness problems.

In this regard, it is noteworthy that only Rosneft, affiliated with BP, has significant liquidity problems. Other companies seem to have found ways to avoid sanctions and acquire capital and liquidity in the short run. A significant factor contributing to the emergence of such a situation is the “turn to the East,” which allows to attract capital from Chinese companies (Skalamera Groce, 2020; Torkunov et al., 2020).

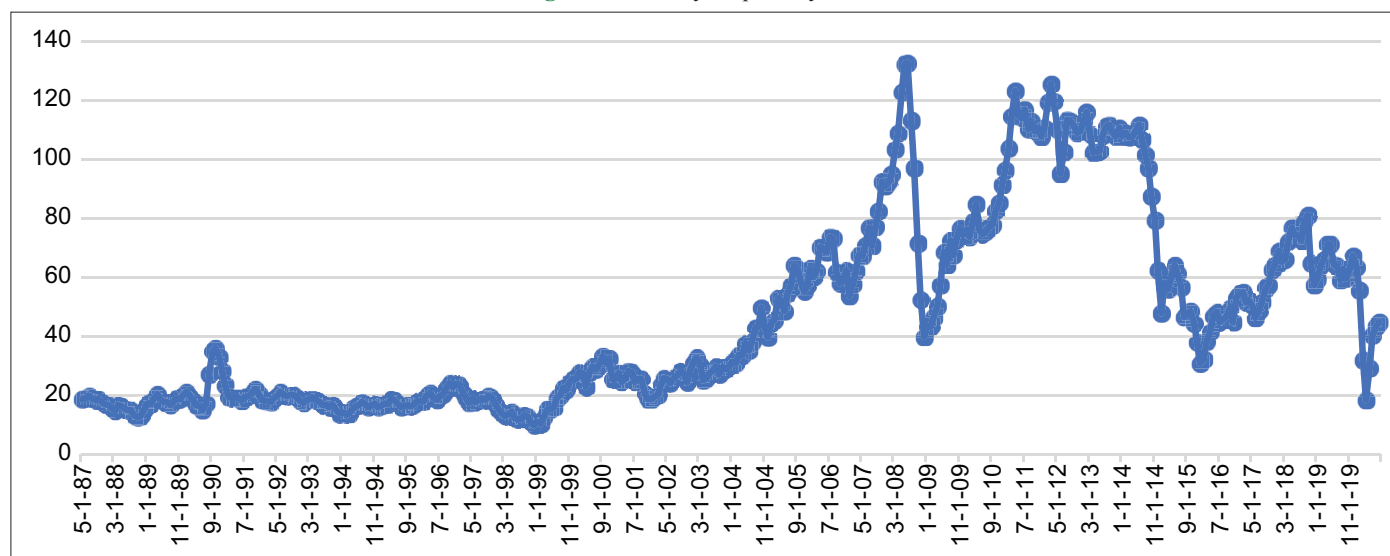
In this regard, it is noteworthy that the current economic and financial situation in the Russian energy sector demonstrates a decrease in the investment attractiveness of Russian MNCs. The overall situation in the Russian economy also remains unstable.

4.2. The Situation in the Russian Economy and Energy Sector. SWOT Analysis

Trends in the development of the tax system, especially those related to changes in the taxation of the oil and gas sector, the so-called “tax maneuver” and the unclear situation with gasoline prices presses down the expectations of the hydrocarbon sector. Such conditions lead to the survival of the major players, which have high reserves, leaving MNCs out of the sector.

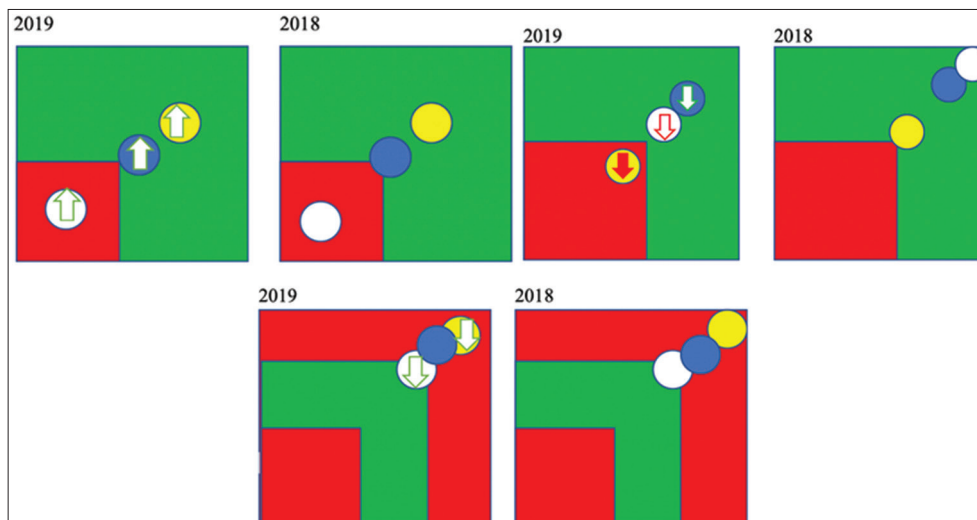
Another important factor contributing to negative trends in the hydrocarbon sector is the continuation of sanctions against the Russian economy. Companies have adapted to the new normalcy of the Russian economy – the high pressure of the economic conjuncture, but the future of gas contracts with Europe and expectations for growth in oil exports to Asia are dubious (Baboshkin, 2020; Yilmaz and Daksuyeva, 2019). On the one hand, the pivot to the East by the Russian economy is a significant opportunity for national exports. On the other hand, the downturn

Figure 1: Monthly oil price dynamics



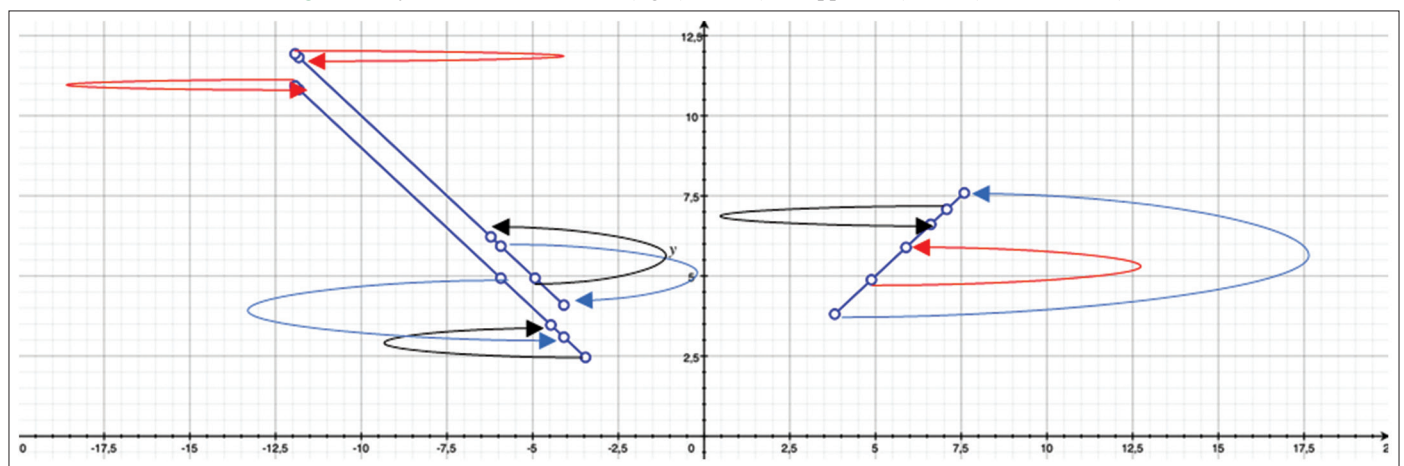
Source: (FRED Economic Data, 2020).

Figure 2: TD/EQ (upper left), CLR (upper right), FS (down)



Source: Created by the authors

Figure 3: Dynamic of the P/E ratio (right), ROE (left, upper line), ROI (left, lower line)



Source: Created by the authors

in economic growth in China, a key partner of Russian oil and gas companies, leads to the conclusion that the market is shrinking, and the infrastructure for export has not been built, and the prospects for trade with China carry risks of high competition from Chinese MNCs and Asian energy carry companies in general. Further, the sanctions resulted in insufficient inflow of new technologies and investments in the Russian energy sector, hence, several projects involving technologies in this sector were closed or suspended.

The third factor contributing to instability in the Russian energy sector is the global and rapid transition to clean energy sources (Csomós, 2015; Gielen et al., 2019). This closes the monopoly opportunities for Russian energy exports in Europe, leaving the Commonwealth of Independent States (CIS) market as the major export market to the west of Russia’s borders. Taking into account possible competition from new players such as the United States with its exports of shale gas to Europe, including potential exports to Poland (Richman and Ayyilmaz, 2019) and exports from Iran (Brown, 2020), the future of Russian MNCs in the European market and the CIS market is not cloudless.

High volatility in global markets, suppressed by the COVID-2019 pandemics, poses another threat to the Russian energy market. The onset of the second wave of the disease in Russia determines another important factor – the stagnation of the national economy.

The failure of the OPEC deal has dubious consequences for the Russian economy. On the one hand, the quantitative limits were exceeded, but prices did not rise as planned (O’Dell, 2020). The results for the Russian economy may be calculated as follows: 11 million barrels/day before the deal and 8.5 million barrels/day after (Yagova and Gorodyankin, 2020). The fall in prices for Urals US\$ 61.75 in January, 29.55 in May and 42.20 in October. Urals is the most exported blend of Russian oil (Six, 2015). The net losses of the Russian economy from the OPEC + deal amounted to US\$ 428 million/day in May and about US\$ 280 million/day in October. The calculations are based on the assumption of a stable oil price over the period at best and the completion of the OPEC + deal:

$$L=Q_1 * P_1 - Q_2 * P_1 \tag{7}$$

where L is losses, Q_1 is the initial quantity of extraction (11 million barrels/day), P_1 is a stable price at the beginning of the year, Q_2 is the OPEC+ deal quantity (8.5 million barrels/day), P_t is the price in the calculated period.

On the other hand, the Russian energy sector has long been the main sector in the formation of the state budget and the development of the Russian economy. Over those successful years, the MNCs in the sector managed to form a significant reserve of financial resources (Filippov, 2010); hence, the current capital expenses of the companies in the sector may remain low in the absence of significant projects.

The costs of hydrocarbon extraction in Russia at the upstream stage are relatively low compared to the costs in South America and new exporters of shale oil (Balafas and Fakiolas, 2020). In this regard, Russian companies have competitive advantages.

Due to significant natural reserves and high volumes of extraction, Russian MNCs have a developed infrastructure for transporting extracted resources; owing to the long-term contracts on gas exports to Europe in the first decade of the 21st century (Kutcherov et al., 2020), the export infrastructure in the EU is well developed. The construction of the Nordstream-2 will enhance these possibilities (Sziklai et al., 2019). In addition, because of the long-term cooperation between MNCs and the public sector and the large number of affiliated people in the government structure, the lobby of the energy MNCs in the Russian government is very strong.

The Asian vector of external trade remains of high significance for Russia, specifically in the context of the overall accelerated development of the Asian region (Basri and Hill, 2020; Teginina and Khalova, 2020). This leads to the possibility of oil and gas demand in the region, especially in case of the introduction of the new pipelines to China. The Asian vector encompasses exports to Central Asia, the development of which is stimulated by the Chinese Belt and Road Initiative. This initiative gives opportunities for the dissemination of technologies, investments and the formation of trade relations between Asian countries. In this regard, the export of Russian oil and gas to the region can stimulate the initiative and, at the same time, create new markets for the expansion of Russian hydrocarbons in Asia.

COVID-2019 may bring a one-time bonus for the world economy – the initial supply shock. While most economic agents operated on a lower scale during the pandemic and their demand for raw materials tended to deteriorate (Zhu et al., 2020), defeating the virus will lead to a recovery in demand, which, compared to the price during the pandemic, will be significantly higher, which will lead to short-term increases in raw materials prices.

To form a unified approach to assessing the investment attractiveness of the Russian energy MNCs, the authors conduct a SWOT analysis of Russia’s energy sector as a whole, presented in Table 2.

The SWOT analysis presented in Table 2 suggests that the Russian economy has the potential for future growth, which is weakly

connected with COVID-2019, despite opposing opinions (World Bank, 2020b). Most of the factors presented are structural rather than short-term.

It is necessary to point out the main differences in the analysis in 2018-2020. Most of the factors remain the same. However, in 2018 (as to Strength), capital expenses were high due to the duration of projects in the Arctic region, so they were not among the strengths, the OPEC + deal brought strong results in terms of oil price growth, so this is a strength; the threats of COVID-2019 and Chinese economy were not relevant. In 2019, the main difference from 2020 was the absence of COVID-2019 in Threat and the failure of the OPEC deal in Weakness.

The authors have considered the internal and external factors, which form the investment attractiveness of the Russian energy industry. According to the proposed methodology, the authors refer to the assessment of the investment climate and business environment in Russia (Figure 4).

The lack of small and medium-sized enterprises (SMEs) in the energy sector in Russia and the lack of their emergence in the sector clearly indicates the inadequacy of the WEF methodology for business climate assessment. The normal course is that SMEs should emerge quickly if the business climate in a country improves annually. In this regard, the authors propose to use the methodology, expanding the WEF ratings.

The above SWOT analysis of the industry demonstrates the factors of high importance to the industry. Based on these factors, their appearance and disappearance, the industry may be characterized by two major characteristics – viability and the field of possibilities. The value of these characteristics is presented in Table 3.

Table 2: SWOT analysis of the Russian energy market in 2020

Strength	Opportunity
- Cost of hydrocarbons’ extraction	- Export to Asia
- Low capital expenses	- Export diversification by regions and countries
- Developed export infrastructure to the EU	- Long-term export contracts
- Significant volumes of extraction	- The Belt and Road Initiative development
- Significant reserves	- The initial supply shock
- Strong lobby of the sector in the government	
Weakness	Threat
- Lack of new technologies	- Tax reform
- Low quantity of the SMEs in the sector	- Sanctions
- OPEC deal failure	- Green energy transition
	- Competition from new players
	- COVID-2019
	- Chinese economy downturn

Table 3: Characteristics of the Russian energy industry by the proposed characteristics (the authors’ calculations)

Year	2018	2019	2020
Viability	6/2	6/2	6/3
Field of possibilities	5/4	5/5	5/6

Therefore, these coefficients should be applied to the delta coefficient of the Doing Business rating changes in the country’s position to determine the key dynamics of the investment climate and business opportunities in the Russian energy sector (Table 4).

From the analysis in Table 4, the authors have obtained several important results:

- 1) The field of possibilities for the Russian energy sector is very narrow, moreover, it is becoming even narrower due to the negative influence of the economic conjuncture on Russia’s economy. The initial shock of the oil prices fall in 2018 (Petroleum Economist, 2018; Fattouh and Economou, 2018) passed (corrected delta ratio increases to 3 from 2.402), as the MNCs adapted the new policy, cutting down the upstream and midstream costs, abandoned ambitious Arctic shale projects, etc., however, the country’s economy is still facing the consequences of the shock in 2020 (corrected delta ratio falls from 3 to 2.4, which is almost the same as before the price shock);
- 2) The potential of the energy industry in Russia both financial and physical is high; due to the lack of markets for selling Russian energy, the potential is not fully used;
- 3) The overall negative shift in oil price forced the Russian energy MNCs to become more efficient and develop new approaches to economic and financial operations;
- 4) The Russian energy sector is separated from the Russian economy as a whole, since it does not follow the general dynamics of the economic conjuncture of the Russian economy (this is proved by the noncorrelation between the market conjuncture indicators and the corporate sector development);

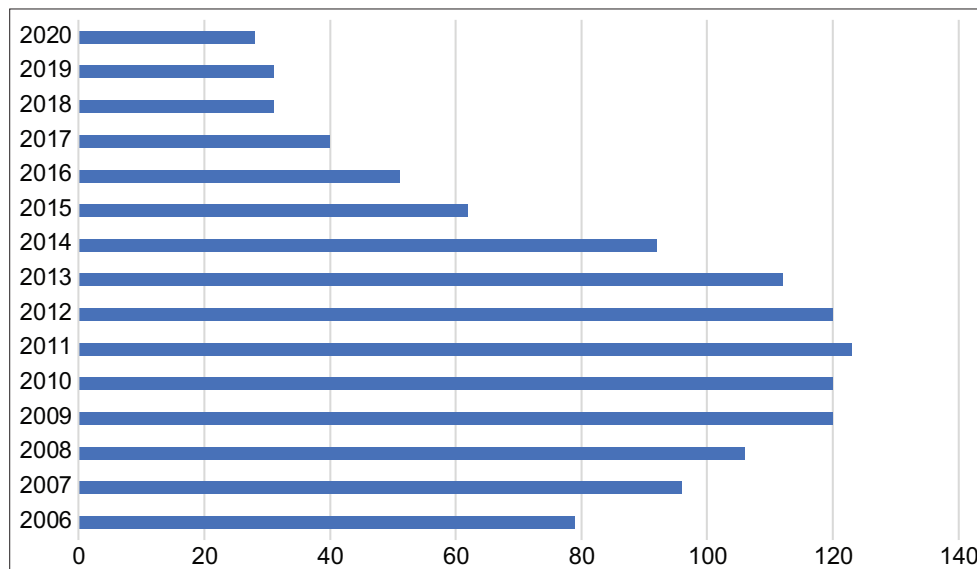
- 5) The Russian MNCs in the energy sector are not alike, their financial performance proves to be different, and their dynamics are also different;
- 6) Lukoil looks extremely conservative in its dividend policy; the investment attractiveness of the company, according to ROE and ROI as the key indicators of the company’s financial performance should be high, but due to low P/E ratio, the company is attractive for conservative investors in the long run. Rosneft is a balanced choice for an investor, it has a positive dynamic of the financial efficiency and a moderate P/E ratio. Gazprom is losing its former status as the best Russian company, with the loss of financial efficiency and the jump in P/E ratio, it should become a good choice for more risky investments – investor is likely to lose nothing, but risks not receiving dividends in future periods;
- 7) The general characteristic of the Russian energy MNCs remains the same: they are attractive for investments; however, they need to adapt to the new situation on the global market, and their risks are growing in the short run.

The results obtained provide a solid basis for developing an investment strategy and a strategy for the development of the investment attractiveness of Russian MNCs.

5. DISCUSSION

The main characteristics of the investment strategy of Russian MNCs today look like the classic Markowitz theory portfolio (Markowitz, 1952) with three companies representing different

Figure 4: “Doing Business” rating of Russia



Source: Created by the authors, based on (World Bank, 2020a) and other Doing Business reports up to 2006

Table 4: Comparative dynamics of the economic conjuncture and financial indicators of the Russian energy MNCs

Market conjuncture				Corporate sector		
	2017-2018	2018-2019	2019-2020		2017-2018	2018-2019
Delta coefficient	0.225	0	0.129	Rosneft	2	1
Corrected delta	0.675/0.281	3/1	0.258/0.1075	Lukoil	2	3
Oil price shift (based on Figure 1)	Pos.	Neg.	Neg.	Gazprom	2	2.5

levels of risk. The share of investment in one chosen company depends on the investor's attitude to risk, however, the following recommendations may be useful in the current situation:

- 1) Investments in the Russian energy sector should be weighed by investment in the green energy sector and investment in the US energy companies. This measure follows from the need to reduce the risks of oil price shifts and the risks of a narrow field of possibilities for the Russian energy sector in general;
- 2) The future expectations of the investment returns should not be as high as in the past. The Russian energy sector is going through a transition period aimed at reducing costs of operation and capital expenses;
- 3) Today, foreign direct investment and foreign portfolio investments in the Russian energy sector MNCs are hampered by the sanctions, therefore, the lack of foreign investment is compensated by the national sector, consequently, the volatility of the Russian currency and the lack of national investors are transferred to the companies' performance in general. In this regard, the risks of investments in the Russian energy sector and MNCs are higher than those calculated and expected at the beginning of 2020;
- 4) The COVID-2019 shock has not yet fully taken effect, so the Russian energy MNCs will perform worse in 2021. This leads to the conclusion that investments in the Russian energy sector should be delayed until about mid-2021.

The described strategy of investments in the Russian energy sector creates significant difficulties for its development. Given the fact that the Russian energy sector is the key contributor to the development of the country's economy, this situation cannot satisfy the country's authorities. The authors propose to introduce the number of measures, which can contribute to the development of the national energy sector and MNCs:

- 1) The investment attractiveness of the energy sector will greatly benefit from the transparency of the tax reform. It is aimed at the unification of taxes, but for now it contributes mainly to the growth of budget revenues. In this regard, the introduction of a wider range of subsidies for MNCs in the energy sector, for instance, the midstream subsidies aimed at stimulating the development of the oil and gas products sector, could help increase the competitiveness of Russian MNCs in the global market and expand the field of possibilities for their conquest of new markets, including Asian markets;
- 2) The conjugation of the energy sector and other sectors of the economy will be beneficial both for the energy sector and for the development of the stagnating Russian economy as a whole (Baranov, 2020). This conjugation may be fulfilled through a higher presence of SMEs in the energy sector, which, in turn, will lead to a higher involvement owing to counteractions with banks and other SMEs in the studied sector of the economy. Thus, the economy would form a multiplier of oil and gas revenues and be able to automatically redistribute extra profits of the sector;
- 3) The creation of a single system of tenders for the MNCs in the energy sector. It should be created on the basis of the existing system of public procurement (Zakupki.gov.ru, 2020). This will help to improve the financial results of companies due to higher competition from their suppliers;

- 4) The development of the system of financial monitoring of the studied MNCs, since they are the "too big to fail" institutions for the Russian economy, so their risks should be minimized;
- 5) The activation of public-private partnerships in the energy sector (National PPP Center, 2020) will lead to an increase in hydrocarbon exports, allowing to reduce export prices and conquer new markets. In addition, the proposed measure will lead to an increase in the number of SMEs in the industry, which will increase the viability of the industry;
- 6) The development of existing methods of investor protection (based on RFDI [the Russian Fund for Direct Investment] and VEB [Vnesheconombank Development Corporation]) at the state level will reduce investor risks and attract newcomers to the Russian energy market;
- 7) Partnerships with Chinese MNCs (Yishan, 2000; Paszak, 2020) in the energy sector will significantly increase the field of possibilities for the industry in general and MNCs in particular.

The proposed measures are more general in nature, however, their implementation in the state economy is vital for the future development of the energy sector. In case they are implemented, the Russian energy sector, and first of all MNCs, will significantly benefit. In addition, these measures can stimulate the Russian economy.

6. CONCLUSION

The authors have assessed the possibilities of investment in Russian energy MNCs, in particular, in Rosneft, Gazprom and Lukoil. All of these companies face significant difficulties at the current stage of development and require additional financial resources. This does not mean that they are threatened by a crisis in the energy sector, but their development and income in the future are at risk.

The main challenges identified by the authors are volatile oil prices, high risks of the post-COVID economy, the emergence of green energy, the formation of barriers by the sanctions against Russia, and restraints on new markets, such as the Chinese economy downturn, the nontransparency in tax reform, etc. These challenges become even more serious due to the failure of the OPEC deal and the lack of technologies in the Russian energy sector.

However, the sector provides significant bonuses for the Russian economy; it is supported by the Russian government, successfully reduces operating costs, and has the opportunity to conquer the Central Asian markets through participation in the Belt and Road Initiative. These factors, given the relatively good financial performance of Russian energy MNCs, contribute to a positive vision for the future of the energy sector.

Such contradictory trends lead to the need to assess the overall situation in the Russian energy sector. The authors have developed a methodology that allowed to conclude of the high potential of the Russian energy sector and the high attractiveness of Russian MNCs for investors, especially in the long term, but at the same time indicated the need for reforms in the sector as a whole.

The proposed reforms include conjugating the energy sector and the rest of the economy, developing public-private partnerships, stimulating small and medium-sized enterprises in the sector, and developing investor protection mechanisms and partnership with foreign, primarily with Chinese, energy institutions.

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