

LUKOIL

Background

Russia was, and still is one of the most important energy producer states in the world, however in parallel possesses the peculiarity to be the only country that had to change radically its political environment. The transition from communism to democratic and market based values was bitter and kept many surprises for everyone. The communist economic model had to be renovated or radically changed, something that had a striking effect on Russia's most important sector, the energy complex.

All of today's Russian energy giants started life as divisions of the Soviet Ministry of Oil. Each held responsibility for developing a compact geographic region, while they relied on other state ministries for their inputs (exploration, construction, equipment, supplies) and provided crude oil to yet another ministry to be refined and distributed to consumers and other clients. Not only the system was cumbersome, but it was highly centralized and relied on decisions that most of the times destroyed in some extent the production capacity.

However, as the USSR fragmented and production numbers declined dangerously, Moscow started to allow some slack for economic experimentation. That was the environment that permitted few people to become billionaires, while it highlighted the path to the future. Less control from the central government meant radical proposals, and one of them permitted the creation of what would become Lukoil. The managements of three West Siberian producing associations (Langepasneftegaz, Uranyneftegaz and Kogalymneftegaz) asked to secede from the oil ministry and form a joint stock company.

Lukoil was established in November 1991 as a state owned oil and gas concern, while each of the producing associations gave an initial letter to form the company name. At the time, the new company reflected the ambition of the Soviet Ministry of Oil and Gas, led by Vagit Alekperov¹, to create a vertically integrated energy major modeled on Italy's ENI. Alekperov became head of the company at its formation, and had the ambition to create an oil major that was integrated from exploration and production, through refining and marketing. Kremlin's tolerance permitted actually the creation of the first Russian major, designed according to

¹ See Appendix A for a profile.

western models. It was a bold, revolutionary idea in the closing days of the Soviet state.

The next step that shaped the face of Lukoil and the Russian energy complex was the privatization and the integration in parallel of companies that had to face a new reality. Units gained independence and integrated into new entities, while after the loans for shares scheme the industry shrunk and passed to the control of the few. As a result from the 36 original Soviet-era producers, 20 remained in the hands of the state and 13 listed as private companies.² Lukoil once again led with an innovation, after the loans for shares, was the largest energy major that was relatively free from state interventionism. The government kept a 7, 6% of the stock, the management of the company approximately 30%. Lukoil was the only Russian energy major company with a free float exceeding 50% of the total amount of the shares issued.

Lukoil's Past---Development and Strategy

Lukoil started to expand considerably becoming the biggest energy major in Russia having to face only the competition from Yukos. In the 1990's, Lukoil reached a pre-eminent position in the Russian oil sector. Its strategy consisted firstly on its background. As the first privatized energy major it had the luck to possess a management team with deeper roots in the Soviet past. That permitted the company to possess areas already in full production, technical equipment and a transportation network capable to cover most of the market. Most importantly, Lukoil run by men with know-how, who knew what and when to do the right thing for the company. Experienced managers and hardened engineers became a valuable asset in the wild first years of the market based energy complex in Russia.

However, this had also its downside as it made Lukoil a conservative company. While Yukos or TNK-BP expanded by using western ways (management-production-exploration), Alekperov continued to do things in the old fashioned way. As a result company oil output has grown, but only through producing asset acquisition, rather than better management of its own fields.

Most importantly the Soviet roots made Lukoil a company that as Alekperov said, 'knows to act on its limits.'³ Knowing limits made Lukoil's board solidly, but not

² The most important were- Lukoil, Yukos, Surgutneftegaz, Slavneft, Sidanco, Komineft, Eastern Oil, Onako, Tatneft and Bashneft.

³ Mass, Peter. August, 1, 2004. The Triumph of the Quiet Tycoon, *New York Times Magazine*, p. 29

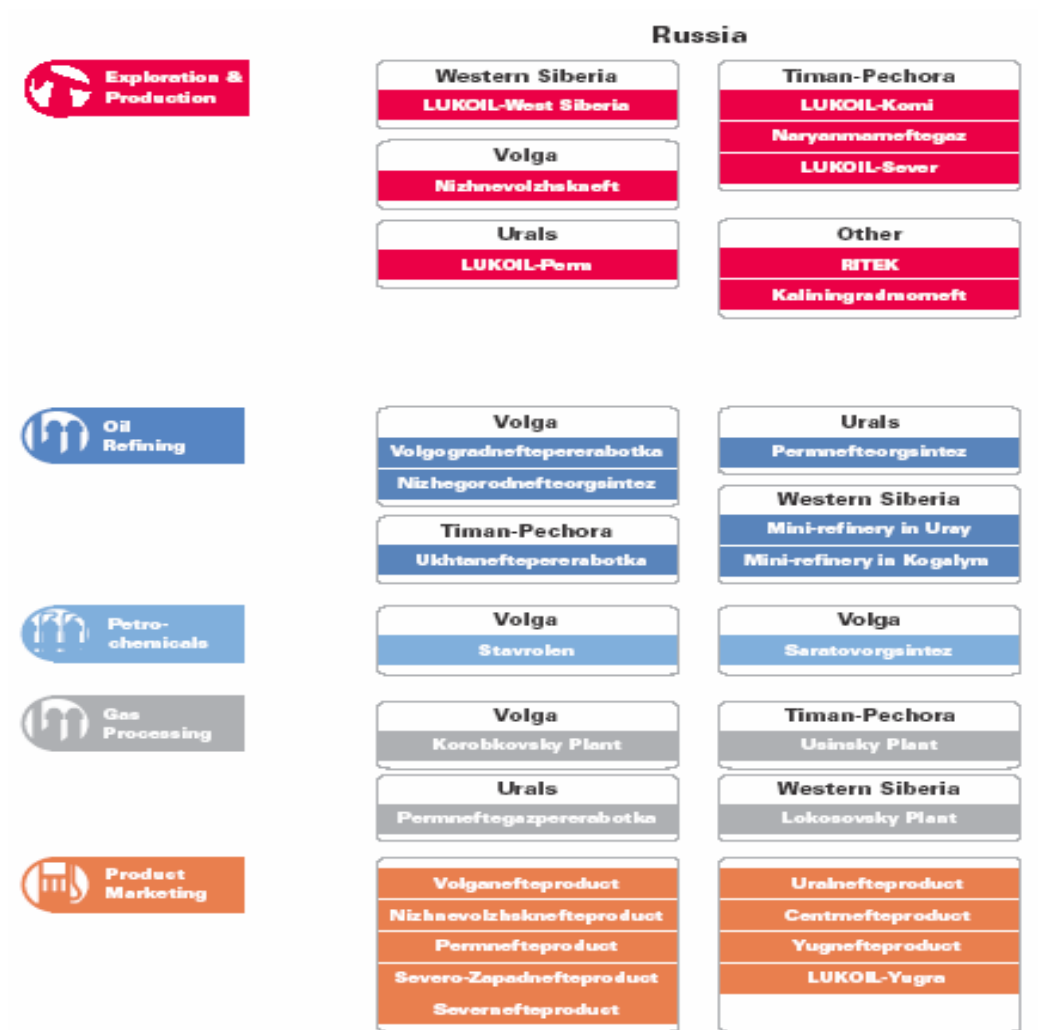
completely Russian. Knowing limits has slowed, but not stopped, company layoffs, lowering the adverse social and political impacts of privatization. It has made the company proudly assertive about being one of Russia's largest taxpayers and very circumspect in lobbying for release from obligations to the state. This *quiet* approach permitted Lukoil to utilize its strengths and battle its weaknesses becoming the most important Russian oil major and one of the largest in the world as we are going to see later. As a result its corporate strategy is based on the ethos described above. Soviet know-how, conservatism, and knowing limits blended with competition from other majors helped Lukoil create its strategy. A strategy based upon four major aspects.

Right from its creation, Lukoil took advantage of the upheaval in the domestic energy sector acquiring a large number of smaller companies and producing entities. Acquisitions are Lukoil's forte and the first cornerstone of its strategy. As we already said the company based on three large production units. Langepasneftegaz and Kogalymneftegaz were senior producers in the Middle Ob region, while Urayneftegaz covered the small discoveries made in the fifties and sixties on West Siberia's western margin. Nevertheless the first two units are hugely important for Lukoil. In 1992 these units made 72% of the company production while in 2003 their potential fell to 53%.

The Langepas unit operates a dozen fields located along the right bank of the Ob river between Samotlor and Fedorovskoye, while the Kogalym unit works on second-generation super giant fields like Povkhovskoye, Vatyeganskoye and South Yagunskoye, while it holds one of the most promising of the third generation finds, Tevlin-Russinskoye.

Lukoil proceeded in acquiring companies in Volga-Ural basin and Timan-Pechora basin, while it took advantage of every chance of expanding its resource and production base. A series of privatizations and acquisitions in Western Siberia, and European Russia⁴ enabled the company to widen its lead over the domestic competitors in terms of both production and reserves. It was acquisitions that gave Lukoil its production growth but also created an organizational chaos. By January 2003, 47 separate entities under the Lukoil umbrella held licences to explore and produce oil and gas in Russia, creating a behemoth that had to be faced somehow. The table below shows the Lukoil structure in 2005, after an ambitious scheme to streamline the company.

⁴ Most importantly the privatization by Lukoil of nine major production units in 1995 and the acquisition of KomiTEK in 1999.



The second major element of Lukoil’s strategy is expanding its interests and business internationally. It’s also a form of acquiring assets and companies not only in the periphery but in areas that were considered a taboo for any Russian major in the past. At the start, expansion to the post Soviet space was natural. States like Azerbaijan and Kazakhstan craved for western involvement in the first years after the collapse but did not estimate specific advantages that the Russians enjoyed.⁵ Alekperov’s close ties with Kremlin, in particular with Victor Chernomyrdin, also meant that the company received state support in its activity in Russia’s ex- periphery (Caspian).

⁵ The property of the energy transport network, presence of the Russian Army, contacts in all these new Joint Ventures were just some of the advantages of the Russians against westerners.

As a result Lukoil's policy was aggressive and rude while it blended quite well with the political agenda of Kremlin at the time. Building on this support, Lukoil acquired a 10% stake in the Azeri-Chirag-Guneshli project (sold to INPEX in 2002), a 5% stake in Shah-Deniz and stakes in several smaller projects in Azerbaijan. Other major acquisitions included a 5% stake in Karagachanak, a 5% stake in Tengizchevroil and a 12, 5% in CPC (Caspian Pipeline consortium).⁶ Both Azerbaijan and Kazakhstan tried to avoid any Russian involvement since at the time, Russian energy majors served as Trojan horses of Russian foreign policy agenda, rather as any other corporation worldwide.⁷ The first years of Lukoil's expansion were important because they highlight not only political preferences inside the company⁸ but also Russian energy strategy as a whole. In parallel, Alekperov managed to build a solid base not only domestically but also in the periphery.

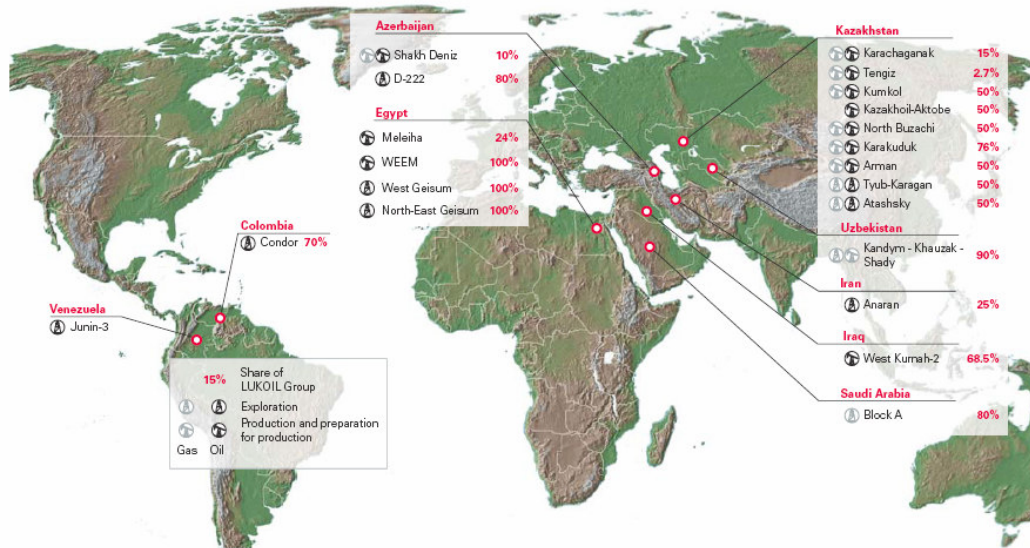
The third move was relative expansion abroad, in areas and states that were considered taboo for Russian companies. In addition to Ukraine, Lukoil proceeded in acquiring assets in Egypt. In 1995 signed an agreement to participate in Meleiha project. The Meleiha fields discovered in the 1970's and contain 120 production wells, while in 2005 proven reserves reached 11 million barrels. In parallel the company holds the exclusive rights in west and North-east Geisum fields. Contracts signed in 2003 and the duration of the agreement stands for the next 30 years.

⁶ This latter acquisition reflected the unique status of the company, demonstrating that it could pursue projects that were opposed by major Russian government players.

⁷ Political Coercion through participation in Energy Joint Ventures was a strategy on behalf of the Kremlin in the 90's. For more discussion: Freedman, Lawrence (2003), 2nd ed. Strategic Coercion, Concepts and Cases. Chapter 8.

⁸ Chernomyrdin, Yeltsin and Alekperov had great relations with each other, and that explains Lukoil's boom in winning contracts almost everywhere in the 90's.

International projects of LUKOIL Group



The company expanded considerably in Iran, Iraq and Saudi Arabia being the only Russian major with a presence in the Mecca of Oil, the Middle East. Although the projects are of small importance, they highlight the ethic and strategy that characterizes Lukoil. The Saudi Arabia agreement is about the Ghawar field, and Lukoil is an operator (80%) for exploration and production alongside Saudi Aramco (20%). The project in Iran is a minor one. The agreement's duration is 3 years (2003-2006), and Lukoil will provide exploration services. In Iraq, the agreement is significantly more important. The company holds 68, 5% of the project for producing oil and gas from the West Qumah field, a part of the giant Rumaylah field near Basra. The duration of the agreement is for 23 years (signed in 1997), with estimates of around 6bln barrels of high quality crude.

In addition, Lukoil expanded in the Balkans where it bought refineries in Romania, Bulgaria, and in 2001, downstream assets in Serbia. Activity can be founded in America. In Venezuela and Colombia we can locate Russian corporate penetration in two fields, Anzoategui and the Condor block. In 2000, the company acquired Getty petroleum gas stations on the US East coast, and in 2004, Getty Petroleum Marketing Inc., a wholly owned subsidiary of Lukoil, announced its acquisition of 779 Mobil-branded gasoline stations in New Jersey and Pennsylvania from Conoco Phillips. According to the terms of this transaction, Getty Petroleum Marketing Inc. has acquired 308 Mobil branded fee and lease properties plus contracts to supply an additional 471 Mobil branded locations. Collectively, these sites generate over 1.1

billion gallons of gasoline sales annually and will more than double the amount of Getty's current light product sales in the United States.

These moves tell a lot about Lukoil's corporate tactics. The dominance of the domestic market was the first set piece for establishing real power where it counts, in the home front. With the help of the Kremlin it gained access to the post Soviet space in the first years of its creation. Its presence in Azerbaijan and Kazakhstan is hugely significant both economically and politically, since it can restrain through its participation the local governments. Moves to Middle East, Colombia and Venezuela are not important for the company in absolute terms of sales but prove that global presence is the long term target.

As we already foretold the two major producing units of the company in the federation are slowly depleting. Langepasneftgaz and Kogalymneftgaz company production in 2003 fell to 53%. Turning to other areas is vital for the longevity of the company but also important for maintaining its position as the No.1 Russian oil major. Therefore, finding and concentrating efforts to new fields is the third corporate strategy of Lukoil. Up to now, attempts concentrate on two major areas, the Russian Caspian sea and the Timan Pechora region.

Fields of the Northern Caspian



In the Russian Caspian Sea, Lukoil won licences in the mid-nineties. Drilling with their own jack-up rig since 1999, the company has already made six major commercial discoveries in this area. Khvalynskoye, Yu. Korchagin, 170km, Rakushechnoye, Sarmatskoye and V.Filanovsky have the capacity to deliver up to 4 bln barrels of crude while the whole region carries a serious geological potential-(14bln barrels) and it's located in a convenient position to both export and domestic

markets. It must be noted that first these discoveries pale before the Kashagan discovery in the Kazakh sector of the Caspian, and second all initial test showed that these fields are disappointingly gassy.⁹ Lukoil's decision to explore this area was corporately courageous because Lukoil is the only Russian company in the post-Soviet Russian oil industry to open a new major exploration frontier. In parallel shows the need for new findings that will safeguard its place in the global market.

Obtaining a dominant position in the Timan-Pechora basin was the second, and more important, part of the company's medium to long term plan to raise oil production. Although Lukoil now dominates the basin, its original plans were twice as large, but had to be reined in due to a drop in profits in 2001 and 2002.

Largest fields of LUKOIL Group in the Komi Republic



Lukoil became active in the region in 1999 with the acquisition of KomiTEK. In 2001 the company bought Bitran, Baitek-Silur, AmKomi, Kharyaganefit and Arkhangelskgeoldogycha production units. Timan-Pechora represents 23, 8% of Group reserves and 13, 8% of production, and in the future it is expected to be the basis of the company's oil production. However, many experts described the move to Komi Republic as Lukoil's biggest gamble.

Oil quantities are huge but not in the levels of the Urals or West-Siberia. The wells are surrounded with thousand of tonnes of wax, the soil is extremely rocky while the climate is very harsh. 'With the exception of the Yamburg gas field in northern West Siberia, nowhere in Russia is a substantial volume of oil or gas produced from a worse place to work.'¹⁰ The proximity to the arctic ocean makes the climate extremely cold but also presents the second major advantage to Lukoil which

⁹ That means that they contain high quantities of gas that make extremely difficult the proper exploration of the fields. In addition the wells that contain gas in large percentage are unstable, in their potential. That means that despite test data they can deplete quicker than expected.

¹⁰ Grace, D, John. (2005), Russian Oil Supply. Performance and Prospects. (Oxford: Oxford University Press), p. 114

is access to the ocean. The basin is clearly favoured, though tanker entrance is restricted severely during the winter. The ability to evade the morass of the Transneft pipeline system when exporting crude is a major plus for Lukoil.

Last but not least the fourth element of Lukoil's corporate strategy is streamlining the company as a whole. Put it simply, the company seeks to improve corporate profitability. Lukoil and Surgutneftegaz were the oil companies controlled by their management which consisted primarily of the Soviet oil industry generals. Lukoil demonstrated greater continuity in management than other Russian majors and managed in a short time to decentralize and expand its asset base.¹¹ However, its procedures regarding oil production and exploration among other remained attached to Soviet times. The corporate ethos that we mentioned above was actually good but it caused Lukoil some problems in relation to domestic competition.

The YUKOS-Sibneft model brought a fundamental change in the profile of the Russian oil industry. These changes have been notable at Lukoil, Russia's biggest company in terms of reserves. Lukoil was the first company that became private but because of a high degree of managerial continuity, the company's managerial culture remained predominantly Soviet. Since 2002 however, the company moved to replicate at least in part the strategies employed by YUKOS and Sibneft. Lukoil's change revealed in 2003, and included, plans to cut costs by 20% primarily through reducing lifting costs, shutting down marginal wells and selling off non-core assets. Also the company planned to reduce its personnel from 140,000 in 2002 to 85,000 in 2010, and to shut down 5,000 low production wells which accounted 24% of its well stock but only 3% of production. These moves introduced in order to get rid of the stiff running of the company and streamline its operations in order to become more efficient. The company did shut down 1,130 low-oil/ high water wells in 2002. A good start, but far less than the goal of 5,000 loudly proposed at the beginning of that year.

Before we continue we must refer to the company's relation with the political factions inside the federation, and more specifically at the centre. Lukoil's corporate strategy is being based to the four pillars we analysed above but without political help it could not achieve much. So it's vital to refer to the political changes in relation to the company.

¹¹ During the privatization of the Oil industry the crown jewels of the Russian oil complex separated by three groups- YUKOS, Sibneft and TNK bought by financial groups. Lukoil and Surgutneftegaz remained in the control of Oil generals, and Tatneft, Bashneft remained under the control of their regional elites. Rosneft and Gazprom remained state owned.

Politically, Lukoil and its president were almost untouchable during the Yeltsin era. Lukoil's conflicts with oligarchic groups, such as the confrontation with Vladimir Potanin over the *izvestia* newspaper in 1997, and the dispute with YUKOS over licences in the North Caspian in 1997-98 tended to settle in favour of the Oil giant.

Lukoil's status declined during the transition from Yeltsin to Putin in 1999-2000. Alekperov failed to anticipate Putin's rise to power and made several political mistakes. He supported the Fatherland-All Russia political movement of Moscow's mayor, Yuri Luzhkov and former Prime Minister Yevgeni Primakov which competed with the Pro-Putin Unity party. Alekperov also allegedly failed to carry out the first political assignment of the Putin administration-silencing Boris Berezovsky's TV6 channel, in which Lukoil had a stake.

The reprisal from Kremlin was severe and swift. A wave of negative media on the surface and the withdrawal of government support behind the scenes led to a series of costly incidents. In June 2000, Transneft temporarily suspended Lukoil's exports on a highly controversial court order. In July 2001, the Tax police opened an unprecedented investigation against Alekperov for alleged tax evasion. Additionally, Lukoil lost the competition over the Mazeikiu Nafta refinery in Lithuania to YUKOS. On the whole, Lukoil missed out many opportunities that had been presented by the favourable economic and commodity price environment since 2001. As its oligarch-owned rivals such as YUKOS and Sibneft exploited the corporate governance agenda, presenting their companies as clean and transparent, Lukoil did not completely break away from the image of a 'black box'. As a result, portions of the company's revenues and capital expenditure are still difficult to account for.

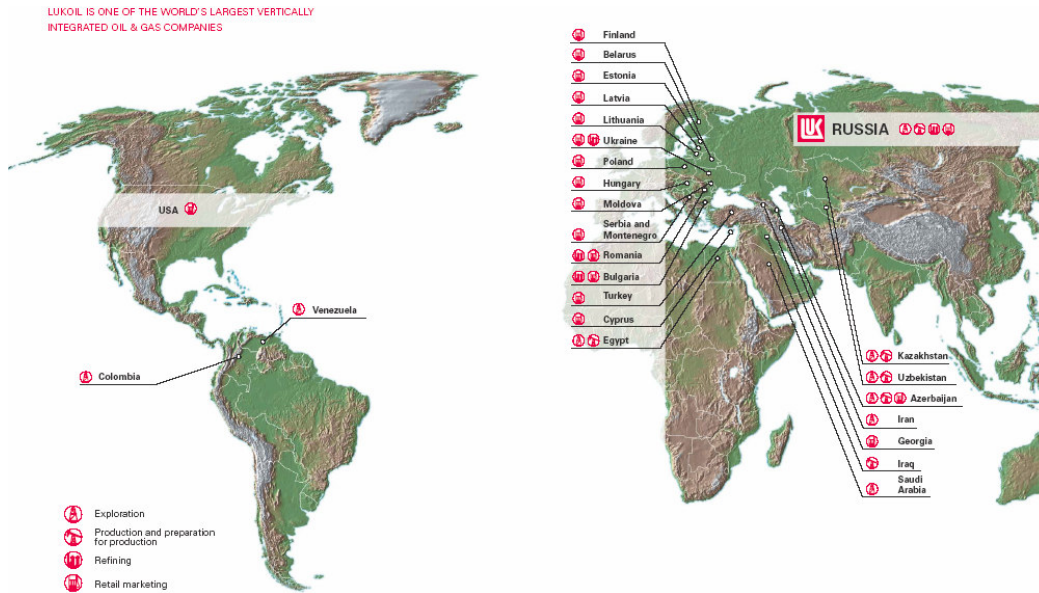
Despite the negative tide that characterized Lukoil's relations with Kremlin, things improved a lot. The recovery of its political stance achieved at the end of Putin's first term in office but at a price. For instance, Lukoil abandoned its earlier hopes for a deregulated gas market, agreeing a long term contract deal to supply its Yamal gas to Gazprom. In 2003-2004 responded quickly to the governments demands for higher tax payments. It was the only Russian major that agreed to compensate the government paying over 100million US\$ to the state budget. In early 2004, in a show of political loyalty, Lukoil also pledged not to use any tax minimizing schemes whether legal or not.

Clearly Lukoil right from the start based its corporate strategy on expansion and acquisition both domestically, in the periphery and globally. Having an agenda almost identical with Kremlin's, improved the company's standing in such extent that Lukoil expand domestically and in the post Soviet space, in a large extent. Its Soviet base and the relative cumbersome managerial stance helped the company but also created situations of corporate loss especially from YUKOS.

With its old production units in decline and its structure in flux, the company started to streamline itself by expanding to other continents, making bold moves while in parallel attempting to streamline the interior situation by closing wells and firing personnel in order to become more profitable. Despite all these ups and downs, Lukoil seems to expand and grow, while it retook the No.1 position in Russia from 2004. Lukoil is today one of the largest oil majors in the world, and that we are going to examine below.

The Present--- Lukoil in 2006

Lukoil today is one of the world's leading vertically integrated oil companies, and certainly Russia's leading oil major. Main activities of the company are exploration and production of oil and gas, production of petroleum products and petrochemicals and marketing of these outputs. The company possesses 1, 3% of the world's total oil reserves and 2, 2% of the worlds total oil production, while its share of gas reserves and production are relatively smaller. 0, 4% of world gas reserves and 0, 3% of world gas production respectively.



Lukoil had 16,114 bln barrels of proved oil reserves at the end of 2005, while in the last 5 years the reserves of Lukoil group have grown by 24, 4%. Oil production of the group was 90, 16mln tons (664 mln barrels) and its production increased by 24, 6% in the last 5 years. The company is the largest private oil and gas company in the world by proven reserves of oil and the 2nd largest in the world by proven hydrocarbon reserves. Lukoil, is clearly first while second comes Exxon-Mobil with 10,5 bln barrels and third comes BP, with 9,6 bln barrels by the end of 2005. In addition, for proven hydrocarbon reserves, Exxon-Mobil hold 1st place with 21, 6 bln boe, Lukoil second with 20, 3 and BP third with 17, 6. Chevron, Shell and Total followed in the next places.

Countries where LUKOIL has oil reserves



Lukoil as an integrated company refines oil as well. It has refineries in 4 countries, Russia, Ukraine, Romania and Bulgaria. The overall capacity of the group at the end of 2005 was 58, 5 mln tons of crude per year (429 bln barrels per year) or 1, 4% of global capacities. The group refined 47, 55 mln tons of crude in 2005, representing 1, 3% of total world refining

Oil refineries of LUKOIL Group



After production and refining comes transportation of oil to the world market, and despite the chronic problem of all Russian energy deliveries (access through sea lanes) Lukoil is relatively well organized in that sector as well. Subsidiaries of the group delivered about 43 mln tons of oil to the international market in 2005, representing 2, 3% of total oil deliveries.

In the Russian market the company enjoys the first place undoubtedly. Despite fierce competition by Yukos, Lukoil today is the biggest Russian oil major and in parallel the biggest Russian business group with annual turnover in excess of 50bln\$. Most of the company's activity is focused in 4 federal districts of the federation, while the company's assets include 4 refineries, 2 mini-refineries, as well as 4 processing plants and 2 petrochemicals plants. Lukoil sells its petroleum products in 59 regions of the federation. The company is vital for the country as it holds 21% of Russian oil reserves and 18, 4% of Russian oil production. In parallel 15, 5% of Russian refining capacity and 18% of the country's throuputs derive from the group. As well as being the leader among other majors, Lukoil holds 19% of Russian oil exports and 17, 2% of Russian petroleum exports.

Due to its managerial style and its unique position of being the first energy company that became vertically integrated from Soviet times, Lukoil is healthy financially and as a matter of fact its share value increases steadily.

LUKOIL share price, \$



Lukoil's shares are among the most liquid and attractive instruments on the Russian stock market today and are also traded extensively on foreign markets (the LSE, and several German exchanges). Company market capitalization has grown by nearly 5 times in the last 5 years, which is one of the best results among international oil and gas companies. Lukoil is thus achieving one of its strategic goals, which is to increase shareholder value and ensure full access to market for investment capital.

The timeline of the company's ownership scheme is important for the full understanding of its internal workings in some extent of course. Thus, in 1993 the Russian government holds almost 91% of its shares while the rest distributes to employees. A year later the state share fall to 72%, and in 1995 to 55%, that year also ARCO became an important strategic partner with a 6, 3% stake. The privatization program that changed radically the face of the country was a landmark for Lukoil as well. The company privatized in a large extent with the federal government possessing only 33% of share capital. The capital share declined up to 7, 6% of the total equity stake up to 2004.

That year was monumental for Lukoil a company which enjoyed the largest free flowing of equity stakes all the other Russian majors. The summer of 2004 the Russian government decided to sell its last 7, 6%. The auction starting price of 29, 83\$ per share would raise 1, 93\$ billion, a nice revenue opportunity for the state treasury. On September 29, 2004, ConocoPhillips bought the share for slightly more than then original minimum price, paying 1, 98\$ billion. Immediately another 2, 4% of Lukoil stock bought by the company. The agreement also permits ConocoPhillips to obtain up to 20% of Lukoil's stock in the near future at a cost that will likely be over 5\$ billion.

So in financial terms Lukoil is healthy, it runs in a western way and it does nothing to do with the government. Government interventionism in terms of owning shares gradually declined until Lukoil became fully private as we saw. Lukoil today leads not only Russia's oil complex but its one of the largest and most important oil majors in the world. Lukoil was the first oil major that became integrated vertically, the first to become private, and the largest Russian company of any kind that has a truly global character.

The Future--- Lukoil's Plans

Attempting any form of prediction for Lukoil is a relative risk. The energy industry in Russia and in global terms is a highly volatile environment in which a lot can happen. In addition the domestic economic and political climate can change for or against Lukoil if something happens and then every scenario is open¹². In its website, the company itself refers to the language it uses by clearing out that forward looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward looking statements will not be achieved.

It is a fundamental reality that the world of business and especially oil and gas is one of the most volatile globally. We must mention that the parameters that actually can determine the future course of the Lukoil group are the price of oil, and the inflation, interest and exchange fluctuations that more than often happen worldwide. As we examined, Lukoil works in many different regions of the federation, the periphery and the world. Risk lies in the effects of competition in the areas that operations are conducted, and in parallel in the effects in laws, regulations taxation or accounting standards. Last but not least the effects of, changes in, Russian government policy are a parameter vital for the longevity of the group.

The goals of the group are, as we already examined, quite ambitious. At first Alekperov and the shareholders want to preserve a leading position in the domestic market for the company. Lukoil has a lot of advantages such as a vast network of vertically integrated production units in upstream and downstream operations. Its relations with the government are good; its reputation solid, its importance for the

¹² The example of the Yukos affair illustrates just that.

Russian energy complex is safeguarded. In order to remain No.1, Lukoil must safeguard its production, invest more, acquire know how, form JV's. On a nutshell it must be aware in order to keep its primacy intact.

Secondly, Lukoil's plan is to further expand. At the time the company performs operations in the ex Soviet space, the Balkans, South America, North Africa, and the continental US. It has built a reputation of stability among other companies and it performs quite well. However, further expansion is more than welcomed, cause in that way Lukoil will become truly a global energy major, as is the aspiration of its president. The ability to win big contracts against Exxon-Mobil or Shell is something that it will take time, but it is a long term goal. Expansion also serves another goal, which is to stop relying so much on the domestic resource base.

Thirdly, it must safe keep its relations with the state. The Yukos affair proved that the government cannot accept corporate/political ambition. Kremlin wants and needs oil majors that provide capital to the state treasury among other benefits, but also companies that comply with state guidelines. Political aspirations and a general strategy that does not comply with state policy in general will be met with swift reprisal from various state mechanisms. Here we met with a Russian paradox. The general commercial ethic worldwide disapproves any state interventionism practices in the code of conduct of any company.

However, in Russia the state craves for foreign investment and participation of foreign capital, but in parallel is extremely careful of not give to much control away. The energy crown jewels must be kept in Russian control. This strategy derives from the past since all these oil companies belonged to the state, but also from the present; by dealing with the commercial reality that prevails in the world of energy markets. The Yukos example is quite illuminant in the minds of Russian shareholders. They must keep intact business in a global way, but in parallel safeguard in some extent energy policy.

At that point Lukoil is No.1, but it might face difficulties in two fundamental areas. The first is the maintenance of production levels, a very important element of corporate strategy. With adequate production there is not refining, not expansion. If production declines Lukoil might loose its primary position. In terms of producing oil things are tricky. As we already showed, out of the three major production units of the company, the one is steadily decline (Langepasneftegaz), and the other (Urayneftegaz) was considered quite small one. Only Kogalymneftegaz is considered

enough for covering sufficiently the future production of the group Lukoil. However, no oil major can rely in one production area and consider itself one of the largest majors in the world.

From the new projects Lukoil also risks a lot. The Russian Caspian sea expansion did not produced what expected, while the Timan-Pechora region might be the biggest gamble the company took. It's a rich resource based area, near the artic ocean but the weather and geological difficulties might endanger future profitability. If these two expansion moves do not produce what is expected, then Lukoil will be in a very precarious position in the domestic and in the global market. International expansion and projects are vital for the company as well. However, none of these can be considered as projects of major importance for the company. Lukoil's presence is safeguarded nominally not in essence. What the company needs is participation in international projects with huge production potential and from what we know only the periphery and the Egypt participations are good enough.

Lukoil was the first oil major that created in the Russian market for many years, the first that expanded considerably, the one with an overwhelming presence in the Caspian region. It is the best known Russian oil major, one of the most important worldwide since it possesses a huge resource base. Politically is doing well with Kremlin at the moment, it has a solid equity base, a good managerial style, and the cooperation with ConocoPhillips is very important and profitable. Lukoil was and still is No.1, and despite some difficulties that might appear in the future it will remain one of the most, maybe the most important –after Gazprom- energy major in Russia.

APPENDIX A.

Profile---- Vagit Alekperov

Born in 1950, Vagit Alekperov graduated in 1974 from the Azerbaijan institute of Oil and Chemistry. During his studies he also worked as drilling operator in Kaspmoneft, a Caspian regional production company. After graduation, he continued his work there, and by 1979 he had advanced from engineer to deputy head of a production unit. Alekperov moved to Western Siberia in 1979 and worked at Surgutneftegaz between 1979 and 1985. In 1985 he became the first deputy general director of Bashneft. In 1987 he became general director of the newly created production company Kogalymneftegaz.

In 1990, Alekperov's career took a giant leap forward when he became deputy minister of the Oil and Gas industry of the USSR (he was the youngest deputy minister in the history of the ministry). At that time, Alekperov lobbied for the establishment of vertically integrated state owned energy companies, which would bring together the wide range of organizations in the energy sector that were at that time reporting to different Soviet bureaucratic institutions.

As a deputy minister, of the ministry was directly engaged with the creation of the first vertically integrated state owned company, Langepas- Uray- Kogalymneft, which was established in late 1991 as a subsidiary of the Ministry of Fuel and Energy. In April 1993, Lukoil was created with Alekperov as its president. It is worth-noting that on the one hand Alekperov's adaptation to the current circumstances and especially Putin's dominance over Russian political life and on the other the Kremlin's recognition i) that Lukoil is a much-needed partner (particularly after Yukos' dissolution) and ii) that it is a great beneficiary in the state's budget –paying its taxes and the imposed penalties- has resulted in finding a diachronic *modus vivendi* between the two sides. Alekperov is one of the few in Russia who has the opportunity to meet and discuss with Putin on a regular basis.

Sources.

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- Various PDF documents from www.Lukoil.com
- All Maps and charts from Lukoil site.

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