

State-Owned Oil Enterprise Case Studies: Gazprom

I. Historical prerequisite to monopolistic development

The history of the creation of Gazprom and key milestones in the development of the company

By 2018, Gazprom reached the status of a transnational energy corporation and the world leader in terms of reserves and production of natural gas (16.7% and 12.1% of the world level, respectively). In 2017, Gazprom ranked first¹ in the S&P Global Platts “Top 250 Global Energy Companies” rating² and 49th in the Fortune Global 500 rating³.

Today, the corporation has the world's largest gas pipeline system (total length - 172.1 thousand km) and is a key exporter of natural gas to European countries (the company accounts for 34.2% of the total supply of gas from countries in the European non-CIS countries)⁴. In Russia, this company represents 68% of natural gas production and 11% of oil production.

The platform for the modern Gazprom was the Ministry of Gas Industry formed in 1965, that was transformed in August 1990 into the state gas producing concern Gazprom (since February 17, 1993 it became RJSC "Gazprom"⁵, from July 17, 2015 - PJSC "Gazprom"). Until the collapse of the USSR, the ministry oversaw all the issues of gas pipeline construction, field development, as well as gas production and distribution in the territories of the Soviet republics. The political crisis of 1991 led to the fact that the post-Soviet republics, along with independence, obtained the rights to all fields and gas pipelines located in their territories. As a result, at the time of the market transformations, the future Gazprom lost 30% of gas pipelines and 25% of compressor stations.

In the early 1990s, when developing a plan of reforms for the oil and gas industry, there was considered the issue of creating a number of independent companies on the grounds of Gazprom, as it was done in the oil industry, where several independent companies were created.

In 1992, full-scale market reforms were launched across the country and the privatization of state property was announced. The privatization plan of Gazprom assumed that within three years from the establishment of RJSC “Gazprom”, the share of the Russian Federation should be at least 40%. Up to 15% of the shares were to be sold to employees and the administration of the

¹ Note: in the preliminary ranking of S&P Global Platts for 2018, Gazprom shifted from 1st place to 17th.

² Top 250 Global Energy Company Rankings. – <https://top250.platts.com/Top250Rankings/2017/Region/Industry>.

³ Fortune Global 500 – <http://fortune.com/global500/gazprom/>.

⁴ Annual report of PJSC "Gazprom" for 2017. – http://www.gazprom.ru/f/posts/85/227737/gazprom_annual_report_2017_rus.pdf.

⁵ See: Decree of the President of the Russian Federation of November 5, 1992 No. 1333 “On the Transformation of the State Gas Concern Gazprom into the Russian Joint-Stock Company "Gazprom" and Resolution of the Council of Ministers - Government of the Russian Federation of February 17, 1993 No. 138“ on the Establishment of the Russian Joint-Stock society "Gazprom".

company by closed subscription and at least 20% of the shares were to be sold through privatization checks⁶. While drafting a privatization plan, 2 enterprises (Yakutgazprom and Norilskgazprom) were withdrawn from RJSC and should have been privatized separately in the first place⁷. However, this plan has not been fully implemented.

In May 1992, the former head of the monopoly went to work in the government, becoming the prime minister of the country since December 1993. From this point on, all attempts aimed at dividing the company have been terminated. During this period, the economic influence of Gazprom as the backbone Russian oil and gas company only started to grow. At the same time, from February 1, 1993, the domestic gas price was increased 3.6 times. Together with the monopoly right to export any gas from Russia, the corporation received significant tax breaks and preferences⁸. For example, the concern had the right to keep 45% of the currency earnings for itself and not to pay duties on export operations. In addition, Gazprom received the right to create a special fund at the expense of deductions from the cost of production and profits remaining at the disposal of the company's enterprises. This fund was removed from the tax system.

The administrative command control regime was fully preserved by the monopolist, which was beneficial both for the country's leadership and for Gazprom itself. The government with the help of the company solved the emerging socio-economic and political problems in the country. For example, thanks to Gazprom's foreign currency earnings, the ruble exchange rate was maintained, and with the help of the company's funds, pension arrears were redeemed. It was during this period that the Board of Directors was formed to manage the company, consisting almost entirely of government officials and having significant credentials⁹. Despite the various subsequent historical events, this authority has not lost its significance.

The arrival of the former head of the company to lead the country has also led to a change in the initial privatization plan¹⁰:

- 5.2% of the shares of RJSC "Gazprom" were to be sold at a check auction in the Yamalo-Nenets Autonomous Okrug to representatives of small indigenous

⁶ See: Decree of the President of the Russian Federation of November 5, 1992 No. 1333 "On the transformation of the State Gas Concern "Gazprom" into the Russian Joint-Stock Company "Gazprom".

⁷ See: Donin A.N., Nikolaev A.N. Features of the privatization of the Russian gas industry in the first half of the 1990s // Bulletin of Saratov State University. 2016. p. 83.

⁸ Note: since 2014, Gazprom has only a monopoly on the export of pipeline gas.

⁹ Decree of the President of the Russian Federation of January 26, 1993 No. 58-or "On the Board of Directors of the Russian Joint-Stock Company "Gazprom" and the placement of its shares among citizens of the Russian Federation".

¹⁰ Decree of the President of the Russian Federation of January 26, 1993 No. 58-or "On the Board of Directors of the Russian Joint-Stock Company "Gazprom" and the placement of its shares among citizens of the Russian Federation".

minorities of the North and employees of state-financed organizations providing development of gas condensate fields;

- 28.7% of the shares were transferred to the population of other regions where gas producing and gas transportation enterprises of RJSC "Gazprom" are located - in proportion to the value of fixed assets of the facility in the relevant territory;
- 1.1% of "Gazprom" stocks were to be sold for vouchers to "Rosgasification" Joint-Stock Company;
- 10% was reserved for the sale of Gazprom to foreign investors.

In general, this privatization plan was different from the generally accepted approach, since not all citizens of the country could participate in the privatization of the company's property (in fact, 62 of 89 regions).

The whole privatization process took place under the complete control of the company. Foreign citizens, according to the charter of the company, could not own more than 9% of the shares (on average, there were 1,600 shares per voucher in the country). In the course of the incorporation, 1030 thousand Russian citizens invested 8.3 million of their vouchers into RJSC. Successful production activities of the group contributed to the fact that many, both companies and private individuals, sought Gazprom's securities. However, foreign investors did not attract the company's securities due to their low liquidity and high risks in the procedure for the sale of shares. Certain relief for foreign capital occurred only in 1999.

It is important to note that in 1994 Gazprom and the government signed a trust agreement in accordance with which 35 out of 40% of state-owned shares, as required in the trust agreement passed into the trust management of Gazprom itself¹¹. Under the terms of the agreement, 30% of the shares could have been bought back by the company itself in 1997 on the nominal ownership of the first issue (about \$ 12 million). At the same time in 1997, the capitalization of Gazprom amounted to already 29.3 billion dollars. However, this plan was not destined to come true¹².

The next milestone in the development of the company was 1998 - the period of the Asian financial crisis, the fall in oil prices to the level of 9.1 dollars per barrel, the onset of default in Russia and the subsequent devaluation of the ruble. During this period, Gazprom for the first time in several years showed a loss. The new government of the country demanded to terminate the trust agreement of 1994 and pay all tax arrears. Gazprom, despite the crisis in the country, managed to pay off the resulting debt to the state.

¹¹ The contract of trust № 2 of 17.02.1994.

¹² See, for example: Decree of the President of the Russian Federation of May 12, 1997 No. 478 "On Measures to Ensure State Governance of the Federal Shares of the Russian Joint-Stock Company "Gazprom", fixed in federal ownership".

Since the 2000s, disagreements between the government and the management of the company no longer arose, the company was under the complete control of the state. For the company, this was a period of active development, primarily as a result of rising prices for gas and oil, as well as a low base asset value. In 2004, the state received a controlling stake, the share of ownership in the company's structure was 50.01%.

In 2005, the company made the first deliveries of liquefied natural gas to the United States, and also liberalized shares¹³. In general, over the 2000s, Gazprom became the largest exporter of gas on the European market. Until 2014, the corporation had a monopoly on the export of any gas from Russia.

During the economic growth of the 2000s, Gazprom's capitalization reached a record \$ 364.8 billion (May 2008), which was the third largest indicator in the world (second only to China Mobile and General Electric). According to the company's management, the cost of Gazprom in 5-7 years should have reached \$ 1 trillion. However, already in 2008, the capitalization of Gazprom collapsed sharply, and in subsequent years, it only continued to decline. At the end of 2017, Gazprom's capitalization amounted to \$ 53.5 billion, having decreased by another 11% compared to the 2016 level. Despite this, the company ranks 2nd in Russia in terms of capitalization, second only to Sberbank of Russia (\$ 84.3 billion). In terms of capitalization, today Gazprom ranks 200th in the world, behind the largest Apple corporation 16 times, and, for example, Starbucks coffee companies 1.4 times. In terms of assets, Gazprom is ranked 99th in the world.

The company's current value is clearly inconsistent with the role and scale of the company's activities as a transnational energy corporation and a world leader in terms of reserves and production of natural gas¹⁴.

Other important milestones in the history of Gazprom were the following events:

On December 20, 2013, the company began oil production at the Prirazlomnoye field in the Pechora Sea. This is the first project in the history of Russia to develop the resources of the Arctic shelf.

In May 2014, Gazprom and the Chinese corporation CNPC signed a major contract for the supply of gas to China. The contract price was 400 billion dollars. The agreement is for 30 years. To fulfill the terms of the agreement, a gas pipe is now being laid within the framework of the "Power of Siberia" project. The cost of laying a gas pipe and developing the Chayandinskoye field will exceed 1.5 trillion rubles.

On May 7, 2017, construction began on the offshore section of the "Turkish Stream" gas pipeline, a new non-transit route for Russian gas supplies to Turkey, as well as to the European market.

¹³ Federal Law of March 31, 1999 No. 69-FA "On Gas Supply in the Russian Federation".

In 2018, the implementation of the "Nord Stream - 2" project began, allowing almost directly to deliver 55 billion m³ of gas to Germany per year.

On March 13, 2018, Gazprom set an absolute daily record for gas supplies to non-CIS countries - 713.4 million m³ of gas.

The main mandate and tasks of Gazprom

The company sees its mission in a reliable, efficient and balanced supply of consumers with natural gas, other types of energy resources and their products. The strategic goal of the activity is to establish Gazprom as a leader among global energy companies through the diversification of sales markets, ensuring reliable supplies, increasing business efficiency, and using scientific and technological potential¹⁵.

In its activities, Gazprom is guided by the Long-Term Development Program, which is updated annually¹⁶. In December 2017, the Long-term Gas Business Development Program for the period 2018–2027 was approved¹⁷. The program was supplemented by a section on the development of production activities abroad. The company's strategic development targets were approved by a resolution of the Gazprom Management Board back in June 2006 and reflect current lines of business.

The objectives of Gazprom's activities were defined in the Decree of the President of Russia back in 1992, which was not formally canceled¹⁸:

1. Reliable gas supply to consumers of the Russian Federation, as well as gas supplies outside Russia under interstate and intergovernmental agreements.
2. Conducting a unified scientific, technical and investment policy for the reconstruction and development of the Unified Gas Supply System.
3. Construction and financing of gas pipelines - high pressure outlets for gasification of the village.
4. Control over the functioning of the Unified Gas Supply System of the country.
5. Access of any producer to the gas transmission system of the country is proportional to the volume of gas produced by him in the territory of the Russian Federation, in compliance with a single price regulation mechanism.

¹⁵ Gazprom's official web-site – <http://www.gazprom.ru/about/>.

¹⁶ Note: not publicly available.

¹⁷ The Long-Term Development Program was approved by the decision of the Board of Directors on December 19, 2017 No. 3059 (minutes of the meeting of the Board of Directors of December 19, 2017 No. 1176).

¹⁸ See: Decree of the President of the Russian Federation of November 5, 1992 No. 1333 "On the transformation of the State Gas Concern Gazprom into the Russian Joint-Stock Company Gazprom.

Now the definition of the company's tasks is directly involved in its management body - the Board of Directors. In determining the tasks, directives of the Government of Russia are taken into account, which are conveyed to members of the Board of Directors through representatives of the state that are members of this governing body.

Gazprom's tasks should be linked to:

- a) forecasts of the socio-economic development of the country ¹⁹;
- b) Russia's energy strategy ²⁰;
- c) a general scheme for the development of the gas industry ²¹;
- d) the main provisions of the federal target programs in relation to the gas industry²², directives and other instructions of the Government of the Russian Federation, as well as other documents regulating the development of the branches of the fuel and energy complex (FEC).

As part of the development of the gas business in Gazprom, 5 main blocks of tasks have been identified²³:

1. Exploration and production.
2. Development of gas transmission capacities.
3. Underground gas storage.
4. Development of gas processing, gas condensate and gas chemistry.
5. Development of production and trade of LNG.

Institutional position in the state system

In institutional terms, Gazprom is an independent commercial corporation with a state share of more than 50%. The controlling stake (50.232%) belongs to the Russian Federation. The state owns shares directly through the Federal Agency for State Property Management (38.37%) and indirectly through the companies at 100% owned by the Federal Agency for State Property Management (OJSC Rosneftgaz (10.97%), JSC Rosgazifikatsiya (0.89%)). The remaining shares for 25.2% in the form of American depositary receipts belong to The Bank of New York Mellon (issuing bank), and 24.57% to other registered persons. It should be noted that in addition

¹⁹ See: Forecast of the long-term socio-economic development of the Russian Federation for the period up to 2030 (developed by the Ministry of Economic Development of Russia).

²⁰ See: Decree of the Government of the Russian Federation of November 13, 2009 No. 1715-p "On the energy strategy of Russia for the period up to 2030".

²¹ The general scheme for the gas industry development for the period up to 2030 (approved by Order of the Ministry of Energy of Russia of June 6, 2011 No. 213).

²² See: Decree of the Government of the Russian Federation of April 15, 2014 No. 321 "On approval of the state program of the Russian Federation "Energy Efficiency and Energy Development".

²³ For details, see the Annual Report of PJSC Gazprom for 2017. -http://www.gazprom.ru/f/posts/85/227737/gazprom_annual_report_2017_rus.pdf.

to Gazprom's shares, Rosneftgaz also holds a controlling stake in Rosneft (50% + 1 share)²⁴) and 27.63% in the "Inter RAO" company²⁵. Thus, to date, Rosneftgaz has a portfolio worth more than \$ 40 billion.

The Rosneftgaz company was created in 2004 to buy back Gazprom shares from its subsidiaries. In 2005, the task was completed. In 2006, the company was used to conduct a Rosneft IPO. From a certain point in time, Rosneftgaz has ceased to be a public company and the company is not obliged to disclose financial statements. At the same time, Rosneftgaz has its own investment program, about which very little is known. In particular, such investment projects were the Zvezda shipyard in the Far East and power plants in the Kaliningrad region, which are not formally projects of Rosneft, Gazprom or Inter RAO.

From the standpoint of transparency in the activities of oil and gas companies, the problem is that Rosneftgaz, receiving dividend income from owning shares, can directly transfer money to the budget, and can hold it for some time in its accounts or send it directly to various investment projects. However, the mechanism for accepting funding for these investment projects is not known. At certain points in time, these "budget" funds may be returned to finance investment programs of oil and gas companies or used to solve other tasks of the government (for example, financing scientific and educational projects, building power plants, projects in the field of aviation, etc.). In fact, an intermediary is created between the state-owned company and the state budget with an unclear set of functions for society. The company employs no more than 10 people, while taken together in Gazprom, Rosneft and Inter RAO more than 700 thousand people.

In addition, Rosneftgaz can be used as an intermediary in the sale of property of companies. In particular, in 2016, the proceeds from the sale of a 19.5% stake in Rosneft initially entered the accounts of Rosneftgaz, and only then into the federal budget²⁶.

In general, Rosneftgaz in Russia today is a historically established phenomenon, to assess the effectiveness of which, based on the available data, is not possible. In any case, regardless of its effectiveness, such a mechanism does not increase the transparency of the activities of oil and gas companies.

Other shareholders of Gazprom are different registered entities (24.57% of shares). In its reporting, the company does not disclose accurate data regarding other large shareholders. At the same time, among the owners, we can highlight the German natural gas distributor E.ON Ruhrgas AG, the hedge fund company Deutsche UFG, NAFTA-MOSCOW, NAFTA-EAST, etc.

²⁴ Rosneft share capital structure – https://www.rosneft.ru/Investors/structure/share_capital/.

²⁵ Inter RAO share capital structure – <http://www.interrao.ru/investors/securities-information/shareholder-structure/>.

²⁶ Press release of Rosneftgaz JSC – https://www.rosneft.ru/upload/site1/document_file/Rosneftgaz_press_release_3.pdf.

The exact number of owners, as well as their final beneficiaries, is difficult to determine like any large company. According to official reports, their number is at least 1,700²⁷.

Gazprom, as the largest gas monopoly, is subject to regulation by various government bodies. The main regulatory state body in the field of gas is the Ministry of Energy of Russia²⁸. This authority has such important powers in the field of gas as:

- a) development and implementation of state policy in the field of gas supply;
- b) development and implementation of a federal gasification program in the Russian Federation;
- c) approval of annual and quarterly balance sheets for the main types of fuel, oil products and liquefied petroleum gases;
- d) determination of gas accounting rules.

However, with regard to Gazprom, the role of the federal ministry is not so significant. First, the government carries out the coordination and adoption of the documents developed by the Ministry. Secondly, the development of documents in the field of gas occurs in close cooperation with Gazprom. Thirdly, the federal minister is a member of the Board of Directors of Gazprom and some decisions can be made already at the company level.

In this regard, Gazprom, as the largest monopoly with enormous significance for the development of the country, is essentially a quasi-Russian gas ministry of energy. Being a quasi ministry, Gazprom can partially regulate itself personally. Gazprom had a particularly high influence in terms of gas price regulation during the existence of the Federal Tariff Service (it was directly subordinate to the Russian Government) and was abolished on July 21, 2015. In general, the issue of pricing at monopoly tariffs is very controversial and also applies to other monopolies.

In 2015, the authority on setting the tariffs for natural monopolies passed to the Federal Antimonopoly Service, which should be assessed positively. This body is designed to monitor compliance with legislation in the field of regulated prices and tariffs. To implement its powers in the field of tariffs, a collegial body of 12 people was created in the Federal Antimonopoly Service, which are representatives of various ministries. Decisions are made by voting without the veto power by any administrative agency. The purpose of these changes is the adoption of economically sound tariffs²⁹. As in the past, the setting of gas tariffs took place according to the “belts” (in 2018, 60 of them were determined). A significant role in determining tariffs was received by the Ministry of Economic Development of Russia (they have 2 votes). In fact, for the

²⁷ List of affiliated persons of Gazprom as of June 30, 2018 – <http://www.gazprom.ru/f/posts/24/126753/gazprom-afflist-2018-06-30-ru.pdf>.

²⁸ Official website of the Ministry of Energy of Russia – <https://minenergo.gov.ru>.

²⁹ FAS Order of May 11, 2018 No. 609/18 “On approval of wholesale prices for gas produced by PJSC Gazprom and its affiliates, intended for subsequent sale to the population”.

coordination of tariffs, the consent of the Ministry of Economic Development of Russia and the Federal Antimonopoly Service is sufficient (they have 5 votes), thanks to ensuring an absolute majority in voting.

Despite the measures taken by the state, gas prices in Russia continue to grow. According to the Forecast of Russia's social and economic development for the current year and for the period from 2019 to 2020 from the Ministry of Economic Development of Russia, the wholesale gas price for all consumers from July 1, 2018 increases by 3.4%, from July 1, 2019 - by 3, 1%, from July 1, 2020 - by 3.0%. The strategic price target for gas since 2007 has been designated as “achieving equal profitability of gas supplies to external and domestic markets and taking into account the cost of alternative types of fuel”³⁰. However, this goal is quite controversial.

In 2017, Gazprom operationalized more than half of the gas sold on the domestic market - 229.9 billion m³ of gas. Net revenue amounted to the sale of gas (without VAT) in the domestic market reached 875.7 billion rubles. Total gas consumption in Russia reached 468 billion m³ of gas and, on average, has remained almost unchanged for several years. Despite this, the level of gasification in the Russian regions is only 68.1%. In terms of gasification rates, Russia lags behind, for example, from Azerbaijan, Belarus, Armenia and Ukraine. One of the explanations is geographic and economic, associated with a large territory and the economic inexpediency of building gas transportation infrastructure in separated regions.

On the one hand, at present, Gazprom receives revenues from the sale of 1 m³ of gas in Russia 2.4 times lower than when selling gas for export. This may indicate that domestic gas prices have the potential for substantial growth. On the other hand, considering the issue of the availability of natural gas (the ability to buy gas for an average monthly income), we will see that having a relatively low price for gas within the country, Russia is not a leader in its availability to the local population (inferior to Kazakhstan and Luxembourg)³¹.

Today, equalizing the profitability of gas in the domestic and foreign markets will lead to its inaccessibility to the local population. This is primarily due to a significant disproportion in the living standard of the population in different countries.

It should be noted that the largest consumer of gas in Russia is not the population (11% of gas consumed), but the power industry (37%)³². As a result, any increase in gas prices automatically leads to an increase in electricity prices, and, ultimately, leads to a decrease in the competitiveness of the production of goods and services. In terms of electricity availability,

³⁰ Decree of the Government of the Russian Federation of December 29, 2000 No. 1021 “On State Regulation of Gas Prices, Tariffs for Transportation Services and Charges for Technological Connection of Gas-Using Equipment to Gas Distribution Networks in the Russian Federation”.

³¹ Ranking of countries on the availability of natural gas for the population in 2018 – <http://www.riarating.ru/countries/20180619/630096994.html>.

³² Note: petroleum industry (9%), household sector (8%), metallurgy (6%), other spheres (29%).

Russia today holds 11th place among European countries³³, while taking into account the significant potential in hydropower. As a result, without increasing the efficiency of the electricity sector and raising the living standard of citizens, it is premature to talk about a rise in domestic gas prices. So far, the presence of the largest gas producer in the country does not yet create appreciable competitive advantages for economic development.

Organizational structure

Today, Gazprom is a widely diversified international company with a commercial presence in more than 20 countries around the world. The company participates in the capital of 148 Russian and foreign companies, of which 36 are registered abroad. Gazprom represents 100% capital in 80 companies, more than 50% in 29, less than 50% in 39 companies. In addition to the gas industry, the company is deeply integrated in oil production, electric power, petrochemistry and gas chemistry.

In the organizational plan of Gazprom's activities, 21 business lines can be distinguished, directly or indirectly related to the objectives of the corporation (*see fig. 1*).

³³ Availability of electricity for the population of European countries - rating 2018 – <http://riarating.ru/infografika/20180626/630098087.html>.

Gazprom			
Hydrocarbon production	19	Gas sales to Russian consumers	7
Hydrocarbon transportation	22	Service companies	12
Hydrocarbon processing	8	Gas sales to consumers abroad	9
Gas-fired cooker production	2	Financial assets	5
Banking services	2	LNG sales	1
Transportation services	3	Natural gas storage	1
Design, financing, construction and operation of South Stream gas pipeline section	6	R&D, sci-tech and project activities, educational services	18
Power generation assets	4	Pre-development of Unified Gas Supply System facilities	4
Investment assets	11	Purchasing and marketing of natural gas from Yuzhno-Russkoye field	2
Overhaul, upgrade, retrofitting and re-equipment of Unified Gas Supply	4	Other	27
Hydrocarbon exploration	2		

Figure 1 - Grouping of Gazprom companies by activity

Among the areas that include more than 10 companies, we can distinguish (in descending order):

- a) transportation of hydrocarbons (22);
- b) hydrocarbon production (19);
- c) research, scientific and technical, design activities, educational services (18);
- d) service companies (12);
- e) investment assets (11).

Currently, the company employs 469.6 thousand people (including the number of people working in subsidiaries). The number of Gazprom personnel in comparison with the total number of employees in the Russian Federation is 0.6%. In terms of the number of personnel, Gazprom is second only to Russian Railways (737 thousand people) in Russia, which specializes in rail transportation.

II. Accountability - to the state and society

Role and Mandate

Gazprom is the largest energy corporation in the world, ranking first in a number of areas³⁴. In Russia, it is the largest taxpayer (5% of all tax revenues of the budget system). Gazprom paid taxes to the budget for 1 497.2 billion rubles. The company annually makes significant investments in the construction of new gas pipelines, primarily those oriented to foreign countries. Because of its development history, the company received not only a monopoly on all gas pipelines and gas exports, but also the right to develop new fields with virtually no competition. Gazprom achieved these results, using its political influence and knowledge, allowing to achieve the necessary priorities for the company. **Today, Gazprom is not** only the largest taxpayer in Russia, but also a whole foreign policy mechanism, given its enormous impact on entire countries and its dependence on Russian oil and gas resources.

Due to the significant role of the company in economic and political terms, the government is trying to find a compromise between the goals and objectives of the state and the company. On the one hand, the state is interested in paying significant dividends (50% of IFRS net income)³⁵. The Ministry of Finance of Russia expects to receive from the monopoly 215 billion rubles in 2019, 216.2 billion - in 2020 and 226.3 billion in 2021. In 2017, Gazprom paid in the form of dividends 26% of net profit. On the other hand, Gazprom, for any reason, implements large investment projects that allow it to achieve political goals as well, which requires large expenses from the company.

An attempt to find an optimal point for development is taking place against the background of geopolitical risks and the absence of significant volumes of increase in natural gas production. In this regard, it is difficult to separate the economic and political role of the company, which may be in internal contradiction. For these reasons, a mechanism for resolving conflicts of

³⁴ Note: natural gas reserves; natural gas production; the length of the gas transmission system; gas export volume; the volume of gas processing installed capacity and the production of electricity in thermal generation; thermal energy production.

³⁵ On Dmitry Medvedev's instructions on the payment of dividends in joint stock companies which shares are in federal ownership – <http://government.ru/orders/selection/401/27460/>.

interest has not been created yet. The court also does not always allow to resolve possible conflicts³⁶.

Today, the state is trying to achieve more favorable tax revenues by regulating tax rates. For this, for example, in 2018, a higher ratio for the mineral extraction tax (Severance taxes) was introduced. The increased rate was valid from September 1 to December 31, 2018. It is worth to note that the severance taxes is often used in relation to a monopoly as a mechanism for regulating its activities.

The opposite situation is the provision of tax incentives for investment projects. In particular, with respect to the activities of Gazprom, for example, the following benefits have been established:

- a) until 2035, the zero property tax rate on the gas pipeline "Power of Siberia", as well as associated gas production and storage facilities. In this case, the benefits will affect only the owner of the Unified Gas Supply System of the Russian Federation, that is, Gazprom. Thus, pipelines — the diversions of other independent gas producers, if their gas does get into "Power of Siberia", continue to be taxed.
- b) the gas monopoly will receive zero severance tax during the first 15 years for fields that will become the resource base of the "Power of Siberia" and are located in the Irkutsk Region and Yakutia.

Thanks only to the tax incentives on property tax, the company can save up to 1 billion dollars at the first stage of work.

As a result, the role of Gazprom is not only as a major player in the energy market, but also as a company that allows to achieve political goals. Taking into account the importance of the company in all processes, its authority is difficult to underestimate. However, the presence of such power does not mean that it can fully use it.

It should be recognized that the top managers of the corporation are actually accountable to the state, while this connection is quite strong, which is generally characteristic of systemically important companies with a high share of state participation. Unfortunately, the presence of close political ties does not always make it possible to make strategic decisions that are effective for a company, as in terms of investments in capital construction projects, the choice of markets and dividend payments.

Corporate Governance

Several changes that can be divided into several stages have taken place throughout recent years in regards to corporate governance in Gazprom to improve efficiency.

³⁶ See, for example: the decision of the Moscow Arbitration Court on the case between Gazprom and the Federal Tax Service of Russia. – http://kad.arbitr.ru/PdfDocument/106af077-f808-4e6b-b3e2-29192adc89b5/A40-36890-2017_20170803_Reshenija_i_postanovlenija.pdf.

The first stage started at the beginning of the 2000s, in a period of increasing the role of the state in the company's activities. At the first stage (presumably ended in 2003), the main requirements for corporate governance were identified, rules for managing and improving budget planning were developed. In general, the high quality of budget planning was due to the growing market and favorable political environment, which made it possible to make a number of qualitative changes in the company.

At the *second stage* (starting from 2004), the goal was to increase the efficiency of Gazprom as a vertically integrated company. During this period, the task was to optimize the business management structure in various subsidiaries to ensure the transparency of financial flows. It is worth noting that in a few years this task was only partially solved. An indirect and simple way to verify this approval is the period of public placement of financial statements. As a rule, the placement of the annual financial statements of Gazprom is carried out in April following the reporting year. If you look at other major companies (for example, ExxonMobil), you can see that they are posting reports already in February. Indirectly, this situation may indicate that the process of data consolidation and subsequent approvals in the company are still quite difficult than in other similar corporations.

At the *third stage* of the reform of corporate governance, non-core assets were to be separated from a number of subsidiaries and transferred to specially created companies in accordance with certain business segments. As a result, each subsidiary structure should specialize in performing a narrow circle of core functions. In terms of areas, this reform was carried out, but it did not have a significant impact on the transparency and capitalization of the company.

In corporate terms, the key governing body of Gazprom is the Board of Directors, which includes 11 people. The corporate governance structure of a corporation is shown in fig. 2.



Figure 2 - The corporate governance structure of PJSC Gazprom

In accordance with p. 3.6 of the Regulation on the Board of Directors of Gazprom, the general meeting of shareholders for the period until the next annual meeting of shareholders

elects members of the Board of Directors³⁷. In theory, the meaning of this norm implies periodic rotations of members of the Board of Directors. In practice, the average tenure in this position is 7.3 years. Independent directors are almost unchanged which undermines the credibility of this institution of participation in the management of the company. The reasons may be different. One of them is the absence of other authoritative candidates and the need to ensure the stability of the work of the governing body. However, independent directors are employees of state enterprises³⁸. Of the 11 members of the Board of Directors, 3 people are top federal officials, and one of them is the Minister of Agriculture of Russia, whose activities are in no way related to Gazprom's core business.

As a result, an obvious conflict of interest arises between the state and a commercial organization. On the one hand, internal corporate procedures share the role of company managers and independent directors, as well as government officials (they do not receive remuneration from the company). On the other hand, obvious political interference with the company's operations reduces the effectiveness of its oversight. The Federal Antimonopoly Service is the only authority exercising effective oversight of the company's activities, but it is able to conduct supervision only within its authority, primarily in terms of setting tariffs and developing proposals for creating conditions for developing a competitive market.

It should be noted that the practice of including state officials in the Board of Directors of state-owned companies does not comply with international principles of building effective management. In this regard, in 2011 the President of Russia initiated a reform, in accordance with which civil servants were to leave the Boards of Directors of state-owned companies. At that moment, he instructed to remove core deputy prime ministers and ministers from the boards of directors of state-owned companies operating in a competitive environment, as well as to introduce a special regime for handling corruption complaints and to give more rights to minority shareholders. In practice, this measure has not been implemented. Therefore, the existing conflict of interests between the government and business continues to exist.

The powers of the Board of Directors include approval of the company's budget (financial plan) for the next three years. Scenario conditions, on the basis of which Gazprom's budget is calculated for the medium term, including the forecast of oil prices, exchange rates, consumer price indices, are formed by the financial and economic unit of the Government of the Russian Federation. As a rule, these estimates are conservative for the federal budget, which also distorts the forecast financial and economic plans of Gazprom. In practice, such an approach leads to the fact that the Board of Directors accepts initially understated key performance indicators, which are then revised during the year.

³⁷ Note: The first composition of the Gazprom Board of Directors was formed on the basis of the Order of the President of the Russian Federation in 1993.

³⁸ Resolution of the Board of Directors dated June 20, 2018 No. 3132 "On the recognition of certain candidates for members of the Board of Directors of PJSC Gazprom as independent candidates for members of the Board of Directors" – <http://www.gazprom.ru/f/posts/81/835405/decision-board-of-directors-2018-07-12.pdf>.

In accordance with the legislation and local regulatory acts of Gazprom, the Board of Directors is accountable to the General Meeting of Shareholders (the highest governing body) as well as the Chairman of the Management Board (reports directly).

The company lacks an independent advisory council for controlling and monitoring, for example, in the form of the Supervisory Board. The Board of Directors itself, also due to the inclusion of independent directors and government officials, carries out the actual part of the control functions. Certain forms of control are carried out by the audit commission and the external auditor, but only in terms of the company's finances, and not control over the effectiveness of the achievement of target indicators.

The Russian Ministry of Energy could play a more prominent role in controlling and monitoring the company's activities. This state authority, as responsible for the implementation of state policy in the field of gas supply, could verify the communication of program documents adopted at the federal level and the long-term development program of Gazprom. In general, the need to audit the implementation of a long-term development program is defined in Directive of the Government of the Russian Federation of July 17, 2014 No. 4955p-P13. However, the implementation of the long-term development program of the Ministry of Energy of Russia does not audit the implementation, since has no authority for this. In addition, the permanent acting supreme body of external state control (audit) in the Russian Federation - the Accounts Chamber of Russia, does not carry out this audit. In 2016, the audit company FBK LLC (this company conducted an audit of Gazprom's financial statements in 2016-2017) carried out the audit of the long-term development program³⁹.

Despite the various problems and features of the functioning of Gazprom, the company is one of the most attractive employers. In 2017, the company took the 1st place in Universum "The most attractive employers in Russia, according to students for 2017" in the specialty "Engineering / natural sciences". The average staff turnover throughout the corporation is 4.7%. The company has a system of continuous corporate professional education of personnel. Education is mainly carried out in its own educational institutions. 342,9 thousand employees passed the program of professional development in one year alone. Gazprom can also provide charitable assistance to state universities. Annually the amount of such assistance is about 304 million rubles (according to 2011 data).

It should be noted that, despite the scale of the company's activities, it is quite closed for most of the society. In recent years, no significant cases of corruption or control errors have been reported to the public.

³⁹ Note: the technical task for the audit of the implementation of the long-term development program was approved by the decision of Gazprom's Board of Directors on March 1, 2017 No. 2908.

As the main tasks for corporate governance in 2018, Gazprom outlined the following⁴⁰:

- a) further improving the mechanism for ensuring the rights of shareholders;
- b) improvement of internal regulations and procedures, including those related to the preparation of non-financial reporting;
- c) further development of corporate ethics;
- d) continuation of active interaction with shareholders and investors.

Now, in practice, minority shareholders can hardly have any influence on the majority shareholder. There were various court proceedings on this issue, also within the framework of the Constitutional Court of Russia. Gazprom, in case of loss of rare litigation, prefers to pay fines than to change its attitude to small shareholders.

Transparency

Gazprom as a diversified company seeks to play a key role on the world stage. At the same time, given the scale of the company's activities and the range of its tasks, it is not interested in ensuring a high degree of transparency of its activities beyond the requirements established by law and financial reporting standards. Despite this Gazprom, like the central government itself, discloses detailed enough information about budgets and related processes in accordance with accepted standards. In 2017 Russia ranked quite high in 15th place in the world according to the "Open Budget Index-2017" rating with a score of 72 points⁴¹. The limiting factor here is the level of public participation in the budget process (a total of 13 points out of 100). It should be agreed that this value also reflects the approximate level of communication between the society and the state company. In terms of public participation of citizens in the activities of the company, the question arises of the adoption and implementation of its long-term development strategy. Unfortunately, there is no public access to a single strategy for Gazprom's activities in the form of a single document justifying quantitative indicators. On the official website of the corporation, you can find only some of its elements⁴². It can be learned about the selected results of achieving strategic goals by company only from annual reports⁴³.

In accordance with the Natural Resource Governance Institute study on assessing the level of transparency of state enterprises, Gazprom ranked 30 out of 74 in 2017, which according to the accepted gradation, is a weak result⁴⁴. According to the Resource Governance Index (RGI),

⁴⁰ Gazprom's financial and economic policy (press conference of 06/28/2018) – https://www.gazpromvideo.ru/fileadmin/press/2018/0628/presentation_28062018_ru.pdf.

⁴¹ Open Budget Index Rankings – <https://www.internationalbudget.org/open-budget-survey/open-budget-index-rankings/>.

⁴² Gazprom's strategy – <http://www.gazprom.ru/about/strategy/>.

⁴³ See, for example, PJSC Gazprom Annual Report 2017 – http://www.gazprom.com/f/posts/60/709300/gazprom_annual_report_2017_eng.pdf.

⁴⁴ Natural Resource Governance Institute – <https://resourcegovernance.org/>.

reflecting the level of efficiency of natural resource management in the country as a whole, Russia ranked 50th (45 points) out of 89, giving way to Sierra Leone, Tunisia and Papua New Guinea⁴⁵.

The RGI is used to evaluate the political and practical measures used by governments to manage the oil and gas and mining industries. The index can be used to identify problems of managing the mining industry at the global level and search for their optimal solutions, including through multi-stakeholder dialogue and public participation.

This index includes 3 basic components (cost realization, income management, creation of favorable conditions), which in turn are divided into 14 subcomponents, consisting of 89 assessments and 149 questions (see *Table 1*).

Table 1 - Russian Resource Management Index in 2017

	Score	Rank
Value realization	47	55th/89
Licensing	31	53rd/89
Taxation	47	74th/89
Local impact	53	38th/89
State-owned enterprises	56	30th/74
Revenue management	40	47th/89
National budgeting	40	33rd/89
Subnational resource revenue sharing	Not covered	
Sovereign wealth funds	40	20th/34
Enabling environment	47	45th/89
Voice and accountability	35	59th/89
Government effectiveness	66	31th/89
Regulatory quality	50	47th/89
Rule of law	46	50th/89
Control of corruption	34	60th/89
Political stability and absence of violence	21	70th/89
Open data	77	15th/89
Composite	45	50th/89

Source: *NRGI*.

⁴⁵ 2017 Resource Governance Index – <https://resourcegovernance.org/sites/default/files/documents/2017-resource-governance-index.pdf>.

A detailed analysis of the RGI index showed that Russia has 0 as an evaluation value for 44 issues. On the one hand, this indicates that there are significant problems in the effectiveness of natural resource management in the country (“45” is a threshold value between a group of countries with a “weak "and" bad "). On the other hand, the current situation offers opportunities for improving the efficiency and transparency of the activities of oil and gas companies, given the best foreign practices.

This assessment methodology, like any other methodology, is not without flaws. At the same time, it allows assessing changes in various aspects of the effectiveness of natural resource management from year to year, which is important in assessing the effectiveness of decisions made.

Today, Gazprom’s transparency is ensured through two mechanisms.

First, being a public company it is required to undergo a mandatory external audit and to post financial and accounting reports on the official website in accordance with Russian and international standards.

Secondly, being a monopoly, the company is subject to the requirements of Federal Law No. 147-FZ of August 17, 1995 “On Natural Monopolies”, incl. in terms of ensuring a certain transparency of activities. However, this law, like any other regulatory act, has its drawbacks and prospects for improvement. For this reason, in 2015, the Ministry of Economic Development of Russia drafted a bill allowing it to oblige all natural monopolies to disclose the costs of investment projects⁴⁶. The draft law established the procedure for approving, coordinating and exercising control over the implementation of investment programs of natural monopolies. The federal ministry wanted to oblige the gas monopolist to allocate regulated activities in the investment program, which would limit the growth of the final gas price. However, according to the company, the adoption of such a bill could lead to risks of causing damage to the economic interests of the company and its shareholders. Moreover, the necessary transparency is ensured by the public placement of the audited financial statements. While the bill is not adopted, discussions are underway.

Gazprom must comply with the requirement for an external audit. In accordance with paragraph 1 of Article 5 of the Federal Law of 30 December, 2008 No. 307-ФЗ “On Auditing”, all joint-stock and publicly traded companies are subject to mandatory external audit. The external auditor is selected on terms of tender. The Audit Committee of the Gazprom Board of Directors carries out the approval of the tender documentation, the review of the results of the evaluation and the comparison by the tender committee of the applications of the tender participants, as well as the preparation for the Board of Directors of recommendations on the candidacy of the company’s auditor. At least 3 people are elected to this committee from the

⁴⁶ Bill No. 50224-7 “On Amendments to the Federal Law “On Natural Monopolies” and Article 29 of the Federal Law “On Electric Power Industry”. – [http://www.asozd2.duma.gov.ru/main.nsf/\(Spravka\)?OpenAgent&RN=50224-7](http://www.asozd2.duma.gov.ru/main.nsf/(Spravka)?OpenAgent&RN=50224-7).

Board of Directors. The General Meeting of Shareholders approves the candidacy of an auditor. The external auditor conducts an audit of 3 types of reporting:

- a) accounting (financial) statements of the Gazprom's head office, prepared in accordance with Russian legislation (is of interest to fiscal authorities);
- b) consolidated accounting (financial) statements of the entire Gazprom Group, prepared in accordance with Russian legislation;
- c) the consolidated financial statements of the Gazprom Group prepared in accordance with International Financial Reporting Standards (is of interest to investors).

Despite the presence of competitive procedures in the selection of external auditors, the international auditing company PricewaterhouseCoopers (PwC) was the permanent auditor of Gazprom from 1995 to 2014 (the value of contracts ranged from \$ 6.7 to \$ 8.6 million). From 2015, the Russian company FBK began to conduct an audit under contracts denominated in rubles. The unofficial reason for changing the auditor is Western sanctions.

It should be noted that the legislative authorities also do not have sufficient opportunity to exercise direct control over the activities of state-owned companies. The form of control by the legislative authority did not arise because of the adoption of the Federal Law of May 7, 2013 No. 77-FZ “On Parliamentary Control”. In accordance with this law, in case of any questions, it is necessary to contact the government with a request. However, to send a request, it is necessary to gain an absolute majority of the votes of the deputies. For example, in 2017, 100 deputies took the initiative to find out the reasons for the increase in bonuses to the management of Rosneft and Gazprom for 2016 and I quarter of 2017, but one party with an absolute majority did not support the initiative.

The state should have full information on the pricing of natural monopolies⁴⁷. Due to accurate information, gas consumption rates should be calculated for the population (at retail prices) and for industrial consumers (at wholesale prices).

Disclosing the company's costs separately for the construction of domestic Russian and export pipelines will give an advantage to independent gas producers, aimed at reducing the cost of transporting their gas through Gazprom’s pipes. In this case, a more competitive gas price will have to be formed, and the share of Gazprom in the Russian market will decrease, which of course is not in the interest of the company. Thus, in July 2015 Rosneft offered to completely liberalize gas exports from 2025, while maintaining state regulation. In addition, Rosneft considers it appropriate to allocate the gas transmission system and underground gas storage in a separate company from Gazprom. Some experts also agree with this proposal, suggesting that Gazprom’s control over the unified gas supply system be removed and take away the monopoly

⁴⁷ Note: now Gazprom’s expenses on extraction and transportation are not publicly disclosed.

on the export of pipeline gas - in the best-case transfer to the state⁴⁸. In exchange, it is proposed to level the tax burden on the industry - to reduce for Gazprom by 20%, and for independent producers to increase by 30%. At the same time, all mining companies will have to guarantee supplies to the domestic market.

The basic problem is that liberalization in the full sense of the word is practically impossible today and consequently, its goals for building a market are unattainable. Creation of separate local monopolies will increase operating costs, as well as create risks for the implementation of long-term contracts, reduce investment in the construction of new gas pipelines and field development.

The only way today is to increase the transparency of the enterprise's activities. Of course, the company is not interested in increasing transparency and creating conditions for growing competition and may adversely affect the value of the company and the payment of dividends, which is disadvantageous to shareholders, including to the state. From the position of the state, increasing transparency also has its limitations, since in the conditions of Western sanctions and geopolitical struggle, ensuring national security becomes a priority issue.

III. Analysis of performance results

In planning its activities, Gazprom uses a two-tier system of strategic targets that characterize strategic objectives in the areas of production, marketing, economics, internal corporate processes, innovations and work with personnel. Targets for the first level and their threshold values were approved as early as 2009 (resolution of the Board of Directors No. 1528 dated December 29, 2009) (see *Table 2*). Target indicators of the second level decompose indicators of the first level.

Table 2 - The values of the strategic targets for the end of the 10-year period

№ in order	Indicator	Target value
1	Growth of economic profit	Positive
2	Return on equity (return on capital employed)	Not less than 6%
3	Ratio of own and terrestrial capital (ratio of borrowed capital to own one)	Not more than 40%
4	Gas production and sales volumes:	
A	Gross natural gas production	Not less than 550 billion m ³
B	Natural gas sales figure	Not less than 490 billion m ³
7	The value of the total gas reserves	Not less than 29 trillion m ³ of natural gas
8	Replenishment ratio	Not less than 100%

Source: *Gazprom*.

⁴⁸ Center for Strategic Research. Draft of the report "Development Prospects for the Russian Gas Market" // <https://www.csr.ru/>.

The positive point is that these indicators were approved for the long term and are sufficiently stable to understand the minimum requirements for the company's operations. The negative point is that these indicators reflect the achieved level of development of the company in 2009 and are poorly focused on sustainable growth. This is evidenced by the low results of the implementation of these indicators (*Table 3*).

Table 3 - Results of achieving targets by Gazprom in the period

№ in order	Indicator	2011	2012	2013	2014	2015	2016	2017
1	Growth of economic profit	35%	-7%	-7%	-87%	412%	24%	-23%**
2	Return on equity (return on capital employed)	19%	15%	13%	2%	8%	9%	7%
3	Ratio of own and terrestrial capital (ratio of borrowed capital to own one)	20%	18%	19%	27%	32%	25%	27%
4	Gas production and sales volumes:							
a	Gross natural gas production	513,17	487,99	488,39	444,90	419,52	420,13	472,05
6	Natural gas sales figure	519,0	482,4	477,0	441,5	445,9	476,4	506,9
7	The value of the total gas reserves	23	23	23	24	24	24	24
8	Replenishment ratio	1,40	1,18	1,33	1,86	1,27	1,10	1,82

Note: * – color highlighted not achieved targets.

** – profit increased, if not to take into account the exchange difference in 2016, as well as the amount to pay Naftogaz of Ukraine funds on the results of court proceedings.

Source: calculations based on Gazprom data.

In this case, the motivation of management is not associated with the adopted strategic targets, but with key performance indicators, which are adopted annually (*Table 4*).

Table 4 - Key performance indicators of Gazprom in 2017-2018

№ in order	Title KPI	2017			2018
		Initial	Refined	Actual	
1	Financial and Economic KPIs				
	Unit cost for the business segment "Mining", rub. per ton of fuel equivalent	1 001,69	993,19	955,06	933,3
	Unit cost for the "Transportation" business segment, rub. per unit of commodity-transport work in thousand m ³ per 100 km	74,22	71,86	68,83	69,9
	Decrease in operating expenses (costs),%	2	Without changes	2,14	2

№ in order	Title KPI	2017			2018
		Initial	Refined	Actual	
	Shareholder Return on Investment	0,10	Without changes	-0,102	0,10
	Return on equity,%	6	Without changes	6,29	6
	Labor productivity, thousand rubles / man-hour	62,92	66,39	70,56	68,89
2	Sectoral KPIs				
	Gas sales figure in kind, billion m ³	402,39	427,25	443,86	439,899
	Entry of priority production facilities	10	9	8	10
	Integral key indicator of innovation performance,%	95	Without changes	105,7	95

Source: Gazprom.

In fact, key performance indicators reflect the company's performance in the short term. These indicators are set by the Board of Directors and, accordingly, may be revised during the year. In particular, in 2017, the revision of indicators occurred twice, and the second time at the time of the actual completion of the calendar year - December 28. The revision of indicators was downward. For 2018, some indicators are set below the actual level of 2017, which also reduces the motivation for the work of managers.

Analysis of the results of the gas industry revealed certain reserves for the payment of additional taxes and dividends to the budget. At the same time, it is necessary to understand that an unreasonable increase in the tax burden on the gas field of activity can lead, at a minimum, to an increase in the price of gas and a decrease in investment.

In terms of tax burden, Gazprom is significantly inferior to other oil and gas companies in Russia (see Fig. 3). At the same time, Rosneft, having a higher level of tax burden, at comparable natural gas prices to Gazprom, provides an adequate level of profitability for itself, which indicates the potential for lower average prices.

In general, the share of taxes in Gazprom's revenues steadily is less than 30% with an effective severance taxes rate of less than \$ 30 per 1000 m³ of gas. At the same time, the share of

export duties in the price of gas exports since 2009 decreased from 20.8% to 18.9% in 2016.

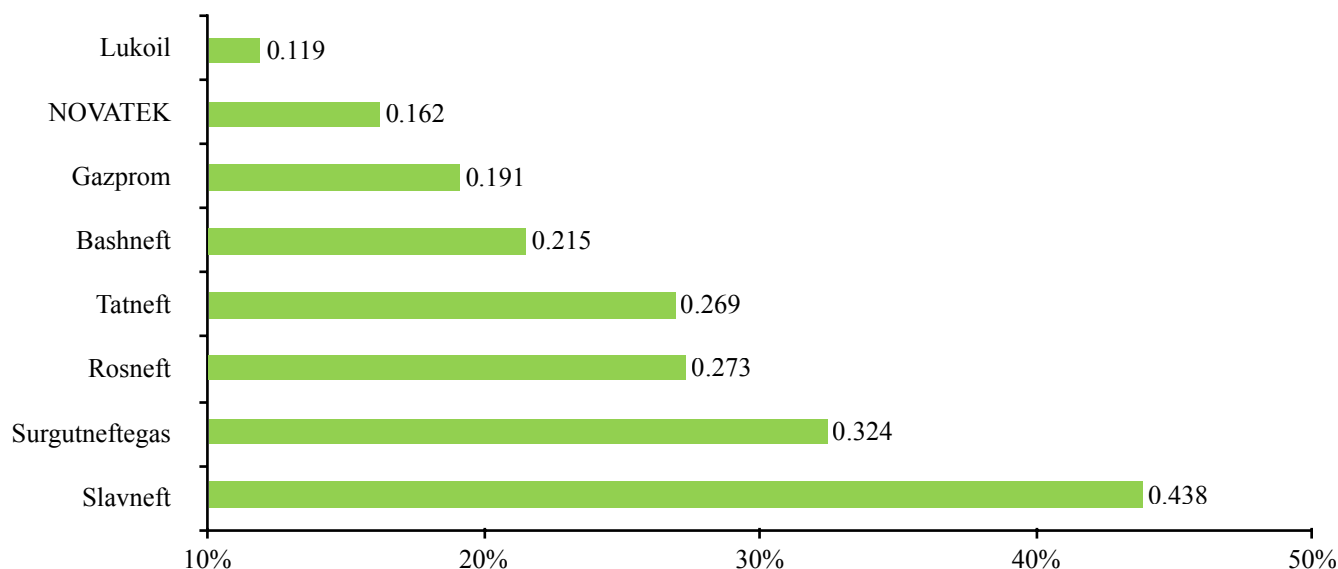


Figure 3 - Tax burden of the largest oil and gas companies in Russia, %

Source: financial statements of companies.

The relatively low tax burden allowed the company to begin implementing the largest investment projects. In 2018, 1,279 billion rubles will be spent on investment projects. (see fig. 4). This amount is comparable to the amount of tax payments to the state budget per year.



Figure 4 - Investments in the construction of main pipelines in 2018

Source: Gazprom.

Analysis of natural gas production over the past 10 years has revealed a current surplus of extractive power. Gas production is now relatively low in recent years. If in 2011, 513.17 billion m³ of natural gas was produced, then in 2017 only 472 billion m³ (excluding the countries of the former Soviet Union) (Table 5). The potential volume of natural gas production today may be at least 550 billion m³.

Table 5 - Gas sales by Gazprom Group in 2010-2017

For the year ended December 31	
--------------------------------	--

	2010	2011	2012	2013	2014	2015	2016	2017
Gas sales in Russia, billion m ³	277,3	280,7	265,3	243,3	234,0	221,2	214,9	229,9
Revenue, billion rubles	636,8	738,6	760,9	794,3	820,6	805,6	819,9	875,7
Gas sales to far abroad, billion m ³	148,1	156,6	151,0	174,3	159,4	184,4	228,3	242,0
Revenue, billion rubles	1 099,2	1 439,1	1 469,5	1 682,8	1 752,1	2 165,5	2 140,0	2 221,2
Gas sales to the countries of the former Soviet Union, billion m ³	70,2	81,7	66,1	59,4	48,1	40,3	33,2	35,0
Revenue, billion rubles	450,1	637,2	529,5	420,3	411,7	429,7	309,6	292,8
Total sales, billion m³	495,6	519,0	482,4	477,0	441,5	445,9	476,4	506,9
Revenue, billion rubles	2 186,1	2 814,9	2 759,9	2 897,4	2 984,4	3 400,8	3 269,5	3 389,7

Source: Gazprom.

There is also a surplus of capacities in export directions (Table 6).

Table 6 - Maximum capacity of existing projects of Gazprom, billion m³

№ in order	Project	Power, billion m ³
1	Nord Stream -1	55
2	«Blue Stream»	18
3	«Yamal-Europe»	33
4	Gazprom Transgaz Belarus	30
5	Ukrainian GTS	143
	TOTAL:	279

From the presented data, it is clear that the existing infrastructure allows exporting up to 279 billion m³ of gas to far-abroad countries. In 2017, only 242 billion m³ was delivered.

If we consider projects under construction oriented to the Western European market (2 projects), their implementation will lead to the fact that the total gas supply capacity will amount to 365.5 billion m³, and taking into account the Baltic LNG project, the supply of liquefied natural gas will be 375.5 billion m³. At the same time the average demand for natural gas in the entire European market amounts to 430 billion m³. In the event of the closure of the Ukrainian GTS, the production capacity will be 232.5 billion m³, which will already be comparable to the

current level of gas supply. From an economic point of view, it is more expedient to continue to supply gas through Ukraine, if this is practically possible. For Ukraine, if gas transit ceases, economic losses will amount to about \$ 3 billion dollars a year (3% of GDP).

Obviously, if there is no growth in demand for gas, Gazprom's established production facilities will not be in demand, and projects appear to be economically inefficient. Gazprom itself predicts that in the long term gas production will increase in all regions of the world, except Europe⁴⁹. The total increase in gas production in the world by 2035 will exceed 1 trillion m³, primarily due to growth in consumption in the Asian region. This statement is also agreed in the expert community⁵⁰.

Table 7 - Promising Gazprom projects, billion m³

Name	Purpose	Design characteristics		
		Length	Annual productivity	Implementation period
Gryazovets-Vyborg gas pipeline loopings with the aim of closing the second line on the Gryazovets-Volkhov section (extension)	Increasing gas supplies to consumers in St. Petersburg and the Leningrad Region	213 km	7,0 billion m ³	2017-2019
«Nord Stream – 2»	Gas supply to consumers in Western and Central Europe	About 1 225 km (to be determined on the basis of detailed design results)	55 billion m ³	IV quarter 2019
«Turkish stream»	Supplies of natural Russian gas through the Black Sea to Turkey and further to the border with neighboring countries	Two thread length 937 km and 939 km (sea area)	31,5 billion m ³	December 2019
Murmansk - Volkhov	Transportation of gas from the Shtokman field in the UGS of Russia	1 365 km	Up to 46 billion m ³ (depending on production at the Shtokman field)	The term of construction and commissioning of the gas pipeline will be determined after an investment decision has been taken on the Shtokman field.
«Bovanenkovo - Ukhta - 2»	The system of gas pipelines for the transportation of gas from the fields of the Yamal Peninsula	1 108 km	57,5 billion m ³	2014-2020

⁴⁹ Annual report of PJSC Gazprom for 2017. –http://www.gazprom.ru/f/posts/85/227737/gazprom_annual_report_2017_rus.pdf.

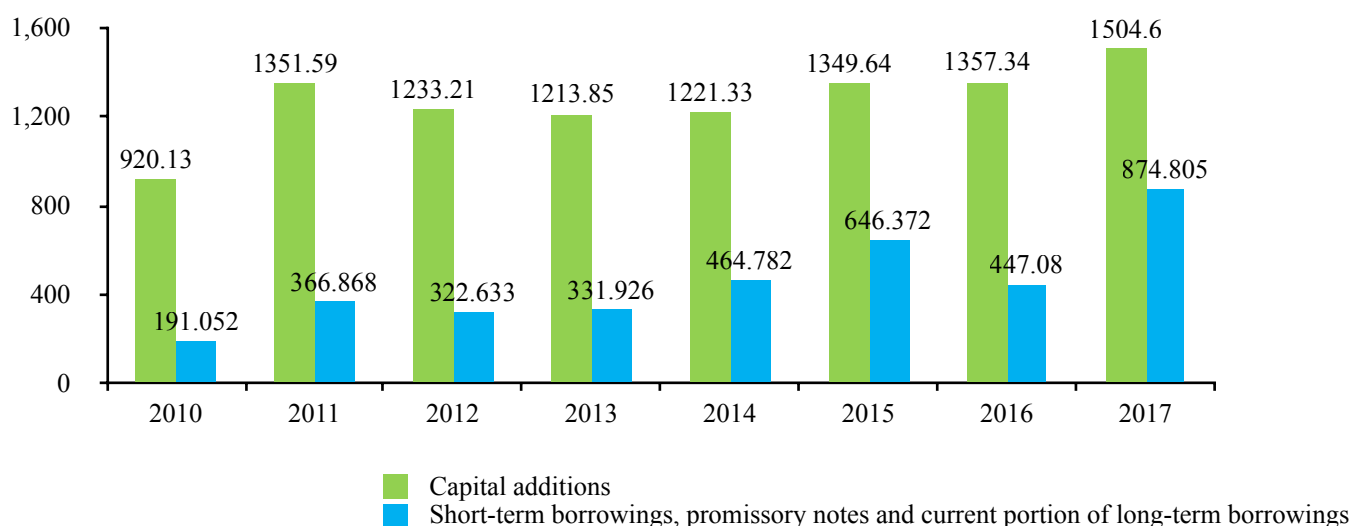
⁵⁰ See for example: V.A. Kulagin, S.I. Melnikov. Prospects for Russian gas in the European market in the context of changing market conditions, the regulatory environment and the EU energy policy // Bulletin of international organizations. V. 11. № 1. 2016. p. 28-47.

Name	Purpose	Design characteristics		
		Length	Annual productivity	Implementation period
«Ukhta - Torzhok - 2»	Supply of additional volumes of gas to the North-West of Russia for gas supply to Russian consumers, as well as export supplies through the «Nord Stream - 2» gas pipeline	970 km	45 billion m ³	2014-2020
«Power of Siberia»	Transportation of gas from the Chayandinsky OGCF and Kovykta GCF for gas supply to the regions of the Far Eastern Federal District and gas supply to the PRC market	2,960 km, incl. 2,156 km - the length of the Chayandinsky oil and gas condensate field - the PRC border	Up to 48 billion m ³	Phased commissioning from December 2019 in accordance with the obligations under the contract for the supply of Russian pipeline gas to the PRC via the “eastern” route.
«Power of Siberia - 2»	Organization of gas supplies from Western Siberia to China, diversification of export routes	2 622 km (will be updated according to the results of the design)	30 billion m ³	A technical and economic analysis was performed. Negotiations are continuing between PJSC Gazprom and CNPC on the harmonization of commercial and technical terms of gas supply.
Development of gas transmission facilities of the UGSS of the North-West region, Gryazovets section - CS Slavyanskaya	Providing additional gas supplies to consumers of the North-West region and for export	870 km	About 80 billion m ³	Phased entry from December 2019
Sakhalin - Khabarovsk - Vladivostok	Providing additional gas supplies to consumers of the Khabarovsk and Primorye Territories, as well as for export	About 380 km	About 20 billion m ³	Phased entry from 2020

Source: Gazprom.

In addition, the investment program for the construction of gas pipelines to China requires additional justification, taking into account possible alternative routes for gas delivery and tax benefits for the project.

From 2010 to 2017, the company invested in various investment projects (core and non-core) over 10 trillion rubles (see *fig. 5*).



5 - Capital investments and short-term loans in 2010-2017, billion rubles

Source: Gazprom.

This amount of investment is comparable to the annual federal budget. To make investments in this volume, the company is forced to borrow money, including to ensure dividend payments. In 2017, the volume of short-term debt amounted to 875 billion rubles, which is almost 2 times higher than the level of 2016. In addition, net cash from operating activities decreased from 1 571 billion rubles up to 1 187 billion rubles (-24,5%) in 2017, which indicates a lack of funds for the implementation of projects and the payment of dividends. The completion of investment projects by 2020 will allow the company to free up an additional 400 billion rubles, which shareholders and the government hope will be used to pay dividends. However, at present, Gazprom's net debt exceeds 2 trillion rubles (see *tab. 8*).

Table 8 - Gazprom's current liabilities by segment, billion rubles

	2016	2017	Change in %
Gas supply	636,2	841,4	32,3%
Recycling	337,7	335,1	-0,8%
Gas production	279	329,5	18,1%
Transportation	336,2	306,2	-8,9%
Oil and gas condensate production	139,9	213,3	52,5%
Production and sale of electricity and thermal energy	86,5	82,3	-4,9%
Gas storage	8,4	9,1	8,3%
All other segments	131,7	287,0	117,9%
Total:	1 955,8	2 404,1	22,9%

Source: Gazprom.

Significant reserves for increasing efficiency are concentrated in the company's operating expenses (see *Table 9*).

Table 9 - Operating expenses of Gazprom in 2016-2017

	2016		2017		2017 / 2016
	billion rubles	% to the total	billion rubles	% to the total	Change
Taxes other than income tax	900 397	17,2%	1 246 059	21,8%	38%
Purchased gas and oil	1 157 585	22,1%	1 236 201	21,6%	7%
Labor costs	641 036	12,2%	682 060	11,9%	6%
Amortization	571 564	10,9%	613 160	10,7%	7%
Transit of gas, oil and refined products	610 275	11,6%	593 327	10,4%	-3%
Materials	288 497	5,5%	261 642	4,6%	-9%
Goods for resale, including refined products	185 441	3,5%	207 689	3,6%	12%
Costs for repairs, operation and maintenance	147 608	2,8%	154 785	2,7%	5%
The cost of electricity and heat energy	98 992	1,9%	109 485	1,9%	11%
Rental Costs	30 152	0,6%	37 723	0,7%	25%
Social expenses	35 516	0,7%	34 461	0,6%	-3%
Insurance costs	29 967	0,6%	30 491	0,5%	2%
Transportation costs	28 923	0,6%	27 253	0,5%	-6%
Recycling services	15 568	0,3%	16 261	0,3%	4%
Research and development costs	28 990	0,6%	16 175	0,3%	-44%
Exchange differences for operational items	52 880	1,0%	-14 487	-0,3%	-127%
(Profit) loss from production financial instruments	9 863	0,2%	-18 344	-0,3%	-286%
Other	414 638	7,9%	610 782	10,7%	47%
Changes in finished products, work in progress and other effects	-2 909	-0,1%	-130 638	-2,3%	4391%
Total operating expenses	5 244 983	100,0%	5 714 085	100,0%	9%

Source: Gazprom.

In 2017, labor costs increased by 6% to 682 billion rubles, incl. due to the increase in the number of personnel for the year by 2,2 thousand people to 469,6 thousand people. Along with this, labor productivity has declined over the past few years. If in 2008, 1,4 million m³ accounted for one worker, then in 2017 - 1 million m³. At the same time, the share of managerial personnel for the period under review increased from 11,6 to 13,9%. In general, the increase in staff was due to the development of non-core business for the company. Indirectly, this is evidenced by the increase in expenses for such an opaque item of expenses as “Other expenses”. The volume of other expenses in 2017 increased by 47% to 610,8 billion rubles (10,7% of the total expenditure). As a result, Gazprom’s share capital has become extremely overwhelmed by financial participation in the management of non-core assets. The reserves for improving efficiency, as

well as for any other large company, are also available under the item “Materials” (261,6 billion rubles).

International comparisons show that Gazprom, having a high volume of assets, has one of the lowest capitalization among energy companies, reflecting an insufficient level of efficiency in the use of resources (*tab. 10*).

Table 10 - The world's largest public companies in the field of oil and gas, billion dollars

№ in order	Company	Rank in the world	Country	Revenue	Profit	Assets	Market price
1	Royal Dutch Shell	11	Netherlands	321,8	15,2	410,7	306,5
2	ExxonMobil	13	USA	230,1	20,4	348,8	344,1
3	Chevron	21	USA	139,4	10,2	256,4	248,1
4	Total	26	France	155,8	8,4	257	168
5	Sinopec	27	China	326,6	8	249,9	138,6
6	PetroChina	30	China	282,4	4,1	381,1	220,2
7	BP	36	Great Britain	251,9	4,3	275,3	152,6
8	Gazprom	43	Russia	112,2	12,2	316,8	57,8
9	Rosneft	73	Russia	94,8	3,9	214,2	69
10	Reliance	83	India	60,8	5,6	125,2	93,1

Source: *Forbes* (2018).

Among the factors that have a positive effect on the level of capitalization of the company, tax privileges can be distinguished, for example in the part of severance taxes, etc. The company's investment capitalization is negatively influenced by the high investment burden in the form of construction of a number of major projects, the lack of significant growth in gas demand, and various structural imbalances.

In relation to the activities of Gazprom, there can be identified the following main risks that are of increased importance in subsequent years:

- a) risks associated with the development of the world economy (a slowdown in the growth of the world economy will lead to a decrease in demand for energy and an increase in the cost of borrowed capital);
- b) risks associated with activities in the European gas market (European Union policy is aimed at diversifying gas supply sources and increasing the share of exchange trade, which reduces the reliability of gas supplies to Gazprom at reasonable prices for it);
- c) political risk (since 2014, Russia is under the sanctions impact of a number of countries, which creates barriers to borrowing and technological development);
- d) risks associated with the transit of natural gas (gas is provided through the territories of third countries, which creates risks of its delivery to the final buyer);

- e) risks of state regulation of the gas industry (the company is a natural monopoly, whose activities are regulated by a special law, there may be risks of introducing legal requirements that are not beneficial for the company, for example in terms of disclosure);
- f) risks associated with the development of gas production from unconventional sources (in a number of countries with limited reserves of traditional gas, there is an increasing interest in the extraction of gas from unconventional sources, primarily from shale deposits in the United States; energy balance).

To reduce the impact of these risks on the company's activities, new investment projects are being built (for example, the "Nord Stream – 2" project has geopolitical significance) and the company also conducts comprehensive cooperation with state authorities on improving pricing and tariff policies, as well as taxation of the gas industry as a whole.

IV. Recommendations and next steps

The analysis showed that Gazprom has great ambitions to preserve the status of the largest transnational energy corporation and the world leader in the extraction and sale of natural energy resources. However, today the company faces new challenges that it will need to overcome for successful development in the future.

First, over the past two decades, the company has not been able to fully settle internal structural problems aimed at improving the efficiency of its operations. The company is still inefficient and bureaucratic; it is difficult for management to make timely decisions in the face of changing market conditions and a volatile political environment.

Secondly, over the long years of its work, Gazprom has become accustomed to working under conditions of complete monopoly, in terms of not only exporting pipeline gas, but also gas production and production. The introduction of certain mechanisms within the country allowed at first to create opportunities for the development of domestic production to other Russian companies, and then because of the rapid growth of their efficiency, provide gas supply to Russian consumers at prices close to monopoly. The development of any market mechanisms, both in terms of creating conditions for competition and the use of an exchange for selling gas, are inevitable changes to which we have yet to adapt.

Third, the company has almost completely exhausted the possibilities for increasing its capitalization. Growth catalysts in the form of a low base effect and a high annual growth in gas prices were exhausted in 2008. Since 2008, despite the presence or absence of obvious political and economic crises, the company has not managed to grow in value. Increased efficiency of the company could turn to a new source of growth, including due to unloading the balance of non-core assets and successful adaptation in competitive markets.

Based on the analysis performed, the following recommendations can be made to improve the efficiency and transparency of Gazprom's operations:

1. *Public placement of the development strategy of Gazprom.* According to the company, it relies on the annually updated Long-Term Development Program to guide its activities. In December 2017, the Long-term Gas Business Development Program for the period 2018–2027 was approved. In public access on the official website of the company, there is no Long-Term Development Program. The information presented on the company's website in the “Strategy” section is more of an introductory, informational, and advertising nature and does not allow for evaluating the effectiveness of movement towards development targets. Periodic placement of presentations on certain aspects of the company's business strategy does not provide a systematic idea of the directions and expected results of its activities for several years in advance. Most large companies are sufficiently open in terms of publicity of their strategies. When developing and placing strategies, issues of commercial secrecy are taken into account, so this cannot be a reason for hiding information.
2. *Definition of the state as a key owner of the corporation.* Today, the Russian Federation participates in the company's capital through three different channels: directly the Federal Property Management Agency (38,37%), indirectly the Federal Property Management Agency through Rosneftgaz JSC (10,97%) and Rosgazifikatsiya OJSC (0,89%). According to the authorities, Rosneftgaz was created as a temporary phenomenon to perform specific tasks that were performed many years ago. According to the authorities, the income received by Rosneftgaz on dividends in some cases can be used to solve the tasks of the government. At the same time, the government has its own budget for carrying out such tasks, the volume of which is approved in the federal budgets by the country's parliament. As a result, the activities and functions of Rosneftgaz are not clear enough for society. It is recommended that the controlling share of Gazprom be directly assigned to the Russian Federation through the Federal Property Management Agency.
3. *Determination of economically reasonable tariffs for natural monopolies gas.* In recent years, much has been done in this direction, particularly from July 21, 2015, the Federal Tariff Service was abolished. The authority to determine the tariffs was received by the Federal Antimonopoly Service, the decision-making procedure has changed. As part of this direction, it is now proposed to change the procedure for deciding on the approval of tariffs. Now, for decision-making, 7 votes out of 11 are required. In fact, this requires only the consent of two authorities - the Federal Antimonopoly Service and the Ministry of Economic Development of Russia. It is necessary to create conditions for the possibility of taking into account the opinions of other federal ministries, as well as the admission of members of the public to attend meetings (without the right to vote, but with the opportunity to get acquainted with the materials).

4. *The transition to market pricing through the formation of prices for natural gas, provided, inter alia, by an increase in the volume of sales of natural gas in organized tenders.* This measure was approved by the government at the time of the preparation of this study and should be assessed positively⁵¹. At the same time, it is necessary to give a number of recommendations. First, the effectiveness of this measure will depend not only on the availability of the right to sell natural gas in organized tenders, but also on the volume of gas sales on market terms. The challenge is to make the sale of gas as much as possible. In accordance with the document approved by the government, the share of gas sold at exchange trading to the total volume of gas sold on the domestic market in the years 2019-2020 should be at least 10%. The problem is that Gazprom itself is interested in selling gas at prices free from state regulation, but it is interested in doing this only in a few Russian regions - in the Tyumen region, the Khanty-Mansiysk and Yamalo-Nenets autonomous districts - regions where the gas is produced. As a result, the absence of the creation of a real mechanism of competition can only lead to an even greater increase in prices in certain regions. It should also be noted that the adoption of this document occurred after the increase in gas tariffs from July 1, 2018, which cannot be considered reasonable for consumers.
5. *Increasing the transparency of the implementation of the investment costs of natural monopolies in the oil and gas sector.* For several years, amendments to the federal law on natural monopolies have been considered. One of the objectives of the amendments is the introduction of technological and price audit of investment projects of natural monopolies to independently evaluate the effectiveness and feasibility of planned capital investments of natural monopolies, sources and amounts of financing such capital investments, compliance with the requirements for the implementation of investment projects established by law. It should be noted that such requirements already exist in relation to the electricity monopolies and grid companies⁵². They need to be introduced in relation to monopolies in the oil and gas sector. In addition, natural monopolies are subject to disclosure on the costs of extraction and transportation of natural gas (wholesale prices at the outlet of the main pipeline), including through gas pipelines and gas distribution networks in order to calculate economically reasonable tariffs.

⁵¹ Decree of the Government of the Russian Federation of August 16, 2018 No. 1697-p "On Approval of the Action Plan (" Road Map ") on the Development of Competition in the Branches of the Economy of the Russian Federation and the Transition of Certain Areas of Natural Monopolies from the State of Natural Monopoly to the Competitive Market for 2018-2020".

⁵² Decree of the Government of the Russian Federation of February 16, 2015 No. 132 "On Amendments to Certain Acts of the Government of the Russian Federation on the Approval of Investment Programs of Electric Power Industry Subjects and Control over Their Implementation".

6. *Expansion of the ability of minority shareholders to participate in the activities of the company.* In accordance with Federal Law No. 208-ФЗ “On Joint-Stock Companies” and clause 14.1. Article 14 of the Charter of PJSC Gazprom the General Meeting of Shareholders is the highest governing body. Shareholders participate in the General Shareholders Meeting with the right to vote on all issues within its competence. Due to legal restrictions for exercising real rights, you need to have at least 2% of voting shares. The remaining small shareholders are quite difficult to exercise their rights. In part, this fact can be understood, given the scale of the company. At the same time, an opportunity should be created to create a coordinating committee at the General Meeting of Shareholders to collect and summarize requests from minority shareholders. Currently, Gazprom has a Coordinating Committee for Relations with Shareholders and Investors, which is accountable to the Chairman of the Board. Results of activity and the full order of its activity is not disclosed⁵³.
7. *Development of the institution of independent directors and exclusion of government officials from the Board of Directors.* The Board of Directors takes the key role in management decisions regarding Gazprom. This body consists of 3 independent directors (they have formal connections with Gazprom’s activities, as well as with the state and significant contractors of the company), government officials: Minister of Industry and Trade of the Russian Federation, Minister of Energy of the Russian Federation, Minister of Agriculture of the Russian Federation, and quasi - State official - Special Representative of the President of the Russian Federation for interaction with the Gas Exporting Countries Forum (not officially a civil servant). The current configuration of the collegial body does not allow it to be effective, a conflict of interests between the state and the company is possible, and does not correspond to the best foreign practices. Independent directors should be appointed on a turnover basis (the formal term is limited to 5 years, in fact, is not respected) and with the exception of government officials from the Board of Directors (this task was already set by the state in 2011). Instead of the Board of Directors, a Supervisory Board should be established, headed by the Chairman of the Government of the Russian Federation and accountable to the government.
8. *Improving the efficiency of operating costs and reducing the share of non-core assets.* The study showed the availability of opportunities for improving the efficiency of the company in terms of optimizing operating costs. Moderately optimistic estimates show the possibility of reducing costs to 500 billion rubles, primarily for reducing the share of non-core assets.

⁵³ Official site of Gazprom – <http://www.gazprom.ru/f/posts/00/302817/coordinating-committee.pdf>.

9. *Development of public policy measures taking into account measures of state support provided to natural monopolies.* In order to stimulate investment, natural monopolies receive tax breaks and other preferences. At certain moments, they lose them. Taking into account the scale of activity of large companies and their role in the development of the country, it is required to coordinate the results of state support of monopolies and decisions related, for example, to the development of the social sphere.
10. *Improving transparency in procurement.* In Russia, legislation in the field of procurement of goods, works and services is based on two main laws: Federal Law “On the contractual system in the field of procurement of goods, works, services for state and municipal needs” of April 5, 2013 No. 44-ФЗ (applied by authorities) and the federal law “On the procurement of goods, works, services by certain types of legal entities” of July 18, 2011 No. 223-FZ (used by state-owned enterprises). Despite control by the Federal Anti-Monopoly Service, the federal law applicable to state-owned enterprises allows for insufficiently transparent procurement procedures, including through noncompetitive procedures. Amendments to federal legislation are required in order to increase the transparency of procurement activities.