Business risks of Russian mineral companies realizing Arctic projects in the conditions of sanctions

I V Petrov and R A Krutov

Financial University under the Government of the Russian Federation, 49 Leningradsky pr., Moscow, 125993, Russia
E-mail: IvVPetrov@fa.ru

Abstract. The fuel and energy complex is the fundamental and systemically important basis of the economy of the Russian Federation. Stable development of the fuel and energy complex is possible due to the sustainable development of the country's mineral and raw materials base, including the Arctic territories. Today, in connection with the events connected with the conflicts in the east of Ukraine and Crimea's incorporation into Russia, restrictive economic and political measures or sanctions have been imposed against our state. One of the industrial sectors that felt their influence was the extraction of minerals and especially hydrocarbons. Effective management, which also includes risk management, will allow mineral raw materials and fuel and energy companies, if not to eliminate, but minimize the impact of sanctions on their activities. What is risk as a concept, features of business risks in the implementation of Arctic projects? What specific risks does the energy industry face in the course of its activities as a whole? What business risks are more likely to be affected by sanctions? What do fuel and energy companies first of all need to pay attention to? These questions are answered in the present paper.

1. Introduction
The problem of risk assessment and management has existed for a long time, it has been actively discussed both in foreign and domestic economic literature, since risk itself is objectively present in many areas of life, regardless of whether it is recognized whether it exists or not, whether it is taken into account or, on the contrary, it is ignored when choosing one or another solution.

In the conditions of sanctions the fuel and energy companies have faced the increasing influence of individual business risks on the companies’ activities, which forces them to optimize and modernize existing approaches to assessing and minimizing business risks, as well as actively seek new ones. The implementation of new projects in the Arctic requires consideration of additional risk factors.

What is risk and what business risks do energy and energy companies face in their operations? Which of them have increased their influence as a result of announced sanctions against our country, including energy companies?

2. Significance of risks in the activities of energy companies
In the field of entrepreneurship, “risk” is usually understood as a certain probability or threat of loss of a part of its resources by an enterprise, emergence of unforeseen expenses as a result of financial and production activities, or loss of expenses.
We can say that the very essence of the concept of “risk” is characterized by the possibility of some deviation of the result from the forecasted or planned earlier. Moreover, this deviation is not only of negative nature (associated with losses), but also of positive one (associated with additional profit). From this the conclusion can be made that, speaking of risk in general, we are talking not only about the possibility of losses, but also about the possibility of obtaining additional income or profit – that is, the risk of profit.

Thus, risk is understood as some situational characteristic of the activity of any businessman, which reflects the uncertainty of business activity associated with possible adverse (or favorable) consequences in the event of an unsuccessful (or successful) outcome [1, p. 20]. Since the resources that are at the disposal of an economic entity can be controlled differently from the point of view of the areas of investment of these resources and their quantitative proportions, profit in various scenarios can vary greatly. That is why in order to achieve the maximum possible results, using the optimal amount of resources, it is necessary to make managerial decisions taking into account the objectively existing risk, that is, existing regardless of whether the entrepreneur is aware of this fact or not.

Speaking about the risks of fuel and energy companies, it is necessary to take into account the strategic importance of this industry for the economy of our country. The fuel and energy complex is the most important structural component of the Russian economy, one of the key factors in the growth of labor productivity, ensuring the functioning of productive forces and the life of society. Fixed assets of the fuel and energy sector make up one third of the country’s production assets. In addition, the fuel and energy sector of Russia accounts for [2, p. 264-265]:

- More than 50% of exports;
- More than 40% of government revenue;
- More than 20% of GDP;
- About 2 million employees.

Thus, we can say that the quality of risk management in specific organizations of the fuel and energy complex affects the efficiency of the entire fuel and energy complex, which, in turn, determines the vector of development of our economy as a whole.

3. Business risks of PAO Gazprom and ways for their optimization

Since sectoral sanctions against Russia turned out to be the most considerable in the oil and gas sector of the economy [3, p. 100], in this paper we will talk about business risks using the example of PAO Gazprom and its subsidiary JSC Gazprom Neft, in terms of the implementation of Arctic and offshore projects. If we turn to their regulatory documents, it can be seen that the company identifies the following with the most significant risks [4]:

Strategic and country risks:
- Risks associated with the development of the global economy;
- Risks associated with the activities in the European gas market;
- Political risk;
- Risks associated with the natural gas transit;
- Risks of state regulation of the gas industry in the Russian Federation;
- Risk associated with the development of gas production from non-traditional sources;
- Risks associated with the development of renewable energy sources.

Risks of customs, currency and tax regulation:
- Risks of changes in the regime of currency regulation and tax legislation in the Russian Federation;
- Risks associated with changes in the rules of customs control and payment of duties in the Russian Federation.

Financial risks:
- Risks of changes in exchange rates and interest rates;
- Credit and liquidity risks;
• Market risks.
  Risks associated with the activities of PAO Gazprom:
  • Risks of early termination and suspension of licenses for the use of natural resources;
  • Risks associated with labor protection and industrial safety;
  • Risks of rising costs;
  • Risks associated with the operation of production facilities;
  • Risks of estimating hydrocarbon reserves;
  • Environmental risks.
  Risks associated with the activities of JSC Gazprom Neft:
  • Environmental risks in the Arctic territories;
  • Political risks of unresolved legal norms of international interaction in the Arctic;
  • Offshore security risks
  • Risks of sustainability of the Northern Sea Route functioning [5].

All the risks that companies face in carrying out their core business are listed here. It is worth highlighting here precisely the business risks that are more likely to be affected by sanctions. The following risks can be objectively recognized as such:

• Credit risk;
• Market risk;
• Risks of changes in exchange rates and interest rates;
• Political risks;
• Technological risks;
• Investment risks.

Market risk, as well as risks of changes in exchange rates and interest rates can be considered the highest priority and significant due to the specific activities of PAO Gazprom, the main activity of which (according to OKVED code rev. 2 – 46.71) is “Wholesale trade in solid, liquid and gaseous fuels and similar products”. Also, taking into account the scale of activity and the size of the company, technological and investment risks were identified, since for the successful functioning of many divisions of such large corporation high-quality equipment is needed, including for operation on the Arctic shelf, purchased abroad, which is used by Western countries – partners in organizing more and more sophisticated types of sanctions. In addition, investment risks appeared through the prism of participation of our energy companies, including Gazprom, in joint projects abroad, the withdrawal of foreign partners from which automatically led to their halt [6].

Ultimately, due to the introduction of economic and political sanctions against our country, Russian companies and individual citizens, there is a process of reducing the financial stability of companies, as well as falling profits as a result of an increase in the level of the above enumerated business risks. The instability of companies in the fuel and energy complex, due to its importance in the structure of our economy, affects the economy of the state as a whole. According to some sources, including the Ministry of Economy of the Russian Federation, the economy of our country is losing about $ 40 million annually as a result of sanctions [7, p. 35].

The solution to this problem is the correctly identified business risks most likely exposed to the sanctions. Moreover, it is important to highlight the main steps and stages of risk management in fuel and energy companies.

First of all, it is necessary to identify risks, directly describe, classify and determine the characteristics of each of the risks, as well as what they can lead to in the financial and economic sense. Then to quantify the impact of each of the risks, that is, determine their probabilities, evaluate the possible financial losses in the implementation of each of them, highlight the most significant of them. And finally, move on to practical risk management activities; find the most suitable measures aimed at reducing risks, as well as carry out continuous monitoring of risks [8].
When implementing offshore projects, including in the Arctic, risk-oriented mining safety is required in compliance with both Russian requirements and the most stringent requirements of environmental organizations using the best global production practices.

As part of risk management activities, it is necessary to choose the right management and response method, among which the following can be distinguished:

- Forecasting;
- Risk avoidance;
- Risk transfer;
- Insurance;
- Reservation of funds;
- Diversification of activities;
- Additional control.

4. Conclusions

The choice of a specific instrument for risk reduction depends, first of all, on the nature of the risk itself and the possibilities of its prediction. The most common, well-known and frequently occurring risks, or the risks, the magnitude of which is not characterized by strong fluctuations, can be completely minimized through special preventive measures. Relatively speaking, within the framework of energy companies, technological and investment risks are relatively understandable and their magnitude is constant; companies are already in a situation that does not allow the equipment from western partners to be purchased. The solution and the method to minimize these risks will be risk aversion and diversification of activities, which will be manifested indirectly through the search for other partners, suppliers of equipment (primarily domestic ones). It is impossible to predict accurately market risks and risks of changes in currency quotes and interest rates, here a greater movement needs to be done towards high-quality forecasting, insurance and reservation of additional funds, as well as enhanced additional control, which together will allow energy companies to be more prepared for unexpected changes in market and political situation, and therefore – new manifestations of these risks.

Today, companies in the fuel and energy complex should invest in the development of risk management in their organizations, since only through a competent analysis of risks, their identification and the choice of specific management methods, it will be possible to speak with confidence about an effective solution to the main problem for today day for the fuel and energy companies in our country – the problems of financial instability due to the introduction of sanctions restrictions and the relatively high volatility of energy prices.

Thus, having identified the business risks of highest priority in the context of sanctions (credit, market, risks of changes in exchange rates and interest rates, political, technological and investment risks, risks of tightening environmental requirements for Arctic and offshore projects), it seems possible to build a basis for effective risk management of mineral companies in Russia.

Acknowledgements

The paper is based on the results of the research on the topic “Increasing the investment attractiveness of the northern sea way to ensure the spatial connection of the country” financed by budget funds within the state task to the Financial University under the Government of the Russian Federation. Registration number -2019 AAAA-A19-119062790077-3.

References

[1] Algin A P 1989 Risk and its Role in Public Life (Moscow: Mysl) p 187
[2] Vorobyev V I 2017 Bulletin of Tula State University. Economic and Legal Sciences 2-1 264–274
[3] Tetushkin V A 216 National Interests: Priorities and Security 12(345) 94–110
[4] Consolidated Financial Reports prepared in Accordance with International Financial
Reporting Standards (with the audit report of an independent auditor of PAO GAZPROM)
URL: http://www.gazprom.ru/f/posts/65/760043/gazprom-ifrs-2018-12m-ru.pdf

[5] Myaskov A V, Zaitsev V A, Petrov I V and Shmelev V S 2018 Monitoring, Science and Technology 5(38) 7–15
[6] Grigoryev L, Gimadi V, Kudrin A and Mishina O 2015 Bulletin of the Analytical Center for the Government of the Russian Federation 27
[7] Chernenko V A and Shvedova N Yu 2017 Theory and Practice of Social Development 4 34–39
[8] Vartanov A Z, Petrov I V and Fedash A V 2018 IOP Conf. Series: Earth and Environmental Science 206 012014