

LUKOIL's Market Strategy in Central and Eastern Europe

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Abstract

The economic environment has undergone significant development over the past 20 years marked, in particular, by the globalization of the economy and increased competitiveness. The large oil corporations significantly influence national economies and the global economy in general, as a result of their huge financial power and their profit-oriented corporate management, by identifying the most appropriate strategies and the most effective methods of business management. Currently, oil market in Central and Eastern Europe is controlled by three major players: the Austrian OMV, Hungarian MOL company and the Russian company LUKOIL, whose investment strategies and policies contributed to a decisive extent to the development and consolidation of oil industry in the countries in this area, thus in Romania too. In this context, the paper aims to analyze the strategy of developing and consolidating LUKOIL's position on this market.

Key words: *strategic alliance, a global energy player, offensive strategy, territorial expansion*

JEL Classification: *M10*

Introduction

The greatest oil corporations significantly influence national economies and the global economy in general, the effect of their huge financial power and corporate management oriented to increase profit by identifying the most appropriate strategies and the most effective methods of business management. These elements underpin the development of management as a science and was later taken over and adapted by national companies.

These strategies aim to answers the following questions:

- What are the sources of the company's sustainable competitive advantage?
- How a company will position itself against competition in the market over the long run to secure a sustainable competitive advantage?
- What are the key strategic priorities?

Long-term corporate strategies focused mainly upon oil quality and diversification of products and services, in line with customer requirements, standards, rules, and regulations at national and international. The strategy-plan system of these companies is implemented by major investment projects caused by a number of factors such as: location in the area, tax incentives,

land cost, construction cost, transportation fuels, the cost of the necessary technological components and upgrades, ensuring environmental conditions, providing qualified personnel.

Through the opportunities they offer, the Central and the Eastern Europe are of particular interest for oil companies that have necessary resources to invest in this area. Acquisition by these companies of the crude oil processing capacity and sales in Europe is an objective process which meets the interests of all those involved in it. Currently, the oil market in the area is controlled by three major players: the Austrian OMV, the Hungarian MOL and the Russian company LUKOIL, whose investment strategies and policies contributed to a decisive extent to the development and consolidation of oil industry in the countries of Central and Eastern Europe.

LUKOIL is the first private company in the Russian Federation that has pioneered investment in Romania by acquiring in 1998 a majority of stakes in the refinery "PETROTEL" Ploiesti, one of the oldest refineries in Romania. The investment and business activity of LUKOIL create an impressive impact on the Romanian economy. Significant in this respect is that over 5,000 people work for LUKOIL in Romania in a network of 310 gas stations and 10 fuel depots, its share representing about 25% of the local market. LUKOIL filling station network is the second largest in Romania.

LUKOIL - The World Leader in Oil Reserves

LUKOIL is one of the largest international oil and gas companies vertically integrated, operating in 60 Russian regions and over 30 countries around the world. The main categories of activities of the Company are: execution of exploration and production of oil and gas, manufacturing and marketing of oil products and petrochemical products.

LUKOIL controls about 1.3% of global oil reserves and 2.3% of world production of crude oil, its main reservoirs are located in Western Siberia. LUKOIL is the world leader in confirmed oil reserves of the private companies listed category.

The company has a balanced value chain in all three sectors of the petroleum industry: upstream, midstream and downstream, and participates in numerous international projects, which offer the possibility of acquiring profitable assets and investing in the long run. This vertical integration gives the company a competitive advantage on a highly competitive market both internationally and regionally.

In the upstream sector, Lukoil has important assets in Kazakhstan, Egypt, Iraq, Iran, Azerbaijan. The regional market of Central and Eastern Europe has refining capacity in Ploiesti (Romania), Burgas (Bulgaria), Odessa (Ukraine) and the Downstream sector operates distribution networks in Romania, Bulgaria, Moldova, Ukraine and Turkey.

Company's securities are traded in the four countries of the world stock markets; it ranks first in terms of the degree of liquidity in the shares among foreign companies that are traded on the London Stock Exchange.

Thus, one can say that the Russian oil company LUKOIL has the largest international diversification and a development dynamics among the highest in the world.

The company's strategy in recent years has resulted in the following:

- Modernization of refineries in order to obtain organic petroleum products;
- Developing the company's own infrastructure to export oil and petroleum products terminals, rail and pipeline;

- Increasing the number of filling stations for petroleum products in Russia and other countries.

The company's competitive advantage derives from its ability to assemble and exploit an appropriate combination of resources. Sustainable competitive advantage is achieved by continuously developing existing resources and creating new ones in response to the rapidly changing market conditions.

LUKOIL's Economic Policy on Capital Market

In 1998, LUKOIL acquires the majority stake in the refinery-LUKOIL SA PLOIESTI PETROTEL.

In 1999, LUKOIL acquired the refinery Neftohim, Bulgaria. This is the only refinery in Bulgaria and owns 100% of oil processing market in this country. In the same year they purchased a refinery in Odessa (Ukraine), Petrochemical Plant from the city of Saratov (Russian Federation) and the oil company "KomiTEK" (Russian Federation).

Year 2000 brings another important LUKOIL acquisition by the take-over of fuel distribution company "Getty Petroleum Marketing Inc. United States of America (Approx. 1,260 fuel stations in 13 states in the northeastern United States).

A number of LUKOIL projects in the Caspian Sea lead to strengthening its position in the oil industry. In 2000, it was put into operation a new oil field ("Severn") in the north of the Caspian Sea. LUKOIL participates in building an oil pipeline in the Caspian Sea, in a consortium.

One factor to strengthen LUKOIL internationally was the establishment in 2000 of LITASCO company (Lukoil International Trading and Supply Company), which became the sole operator of international trade, providing all supplies and performing LUKOIL Group's business operations worldwide. Delegation of responsibility for all export operations allowed LUKOIL to optimize its export flows, to ensure transparency in the export of crude oil and petroleum products. Thus, LITASCO became international link through which LUKOIL is implementing its international marketing operations, trade and services.

LITASCO company's core activities are focused on *three directions*:

- Disposal of oil and petroleum products on world market;
- Supplies of crude oil and optimization of control over transfers at LUKOIL refineries located abroad, supplying finished products in the filling station network in Central and Eastern European, Caucasus and Baltic Sea;
- Third party business and international business development.

The company's strategy is based on the following *actions*:

- Promote petroleum products under the brand "LUKOIL" on international and local markets through an efficient distribution network;
- Ensure effective marketing of production from LUKOIL refineries in Russia and in Eastern Europe;
- Maintain a growth rate in the extraction of crude oil on international markets;
- Developing an effective global business;
- Provide information in the development of international markets in order to increase company profits and investment resulting from ordinary activities;
- The diversification of suppliers and customers.

In the processing sector, LUKOIL purchased in October 2001 85.36% stake of “Norse-Oil” company’s, which has one of the largest refineries in the Russian Federation. Also in this period the company’s position is reinforced by a series of acquisitions in the mining sector.

Starting in 2002, LUKOIL is listed on the London Stock Exchange. In the same period it has purchased 15 gas stations in Cyprus. The company’s presence in Cyprus will provide a new market for petroleum products processed at Neftohim refinery in Bulgaria.

In accordance with the modernization of PETROTEL-LUKOIL Refinery, the design stage was completed in December 2003, while in the first quarter 2004 the equipment acquisition phase. The refinery resumed its activity in September 2004. Total investments in LUKOIL refinery exceeded \$ 250 million.

In 2003, at the same time with the rebuilding of “PETROTEL”refinery, its network of retail outlets has expanded in Romania, Hungary and Moldova. The company operates 13 stores in the region of petroleum products and about 300 filling stations. LUKOIL’s goal is to control each of these countries from 20 to 30% of the market for retail petroleum products.

In 2004, LUKOIL and ConocoPhillips formed a strategic alliance. ConocoPhillips invests in LUKOIL. LUKOIL [LSE: LKOD] and ConocoPhillips [NYSE: COP] announced together in Moscow their agreement to form a strategic alliance with a broad base, according to which ConocoPhillips will become a strategic investor in LUKOIL shares. Also, two major integrated oil and gas companies have announced a joint venture to develop resources in the northern province of Timan-Pechora Russia, rich in oil and gas, and their intention of carrying out joint approaches in order to obtain the right to develop the giant West Qurna oil deposit in Iraq.

For LUKOIL, the alliance is an affirmation of his status as a leading international oil and gas company from Russia and a global energy player. In addition, LUKOIL will enjoy the following benefits:

- Management experience in international energy affairs transmitted by a long-term reliable partner;
- Accelerated growth and improved business efficiency, by adopting global best practices and technologies and by involving the best human resources;
- increased resources for accelerated “greenfield” projects, both in Russia and other countries;
- LUKOIL net income growth and shareholder value by efficiency improvement and other benefits of this partnership.

Year 2005 was crucial in implementing LUKOIL Programme of development. In financial matters, the long-term goal is to increase ROCE to the major international corporations, Chevron Texaco, Shell, British Petroleum, Exxon Mobil. The transparency of the company reached 64%, the best score among Russian companies.

In October 2005, the trading volume of LUKOIL securities of London Stock Exchange was about \$ 4.657 billion. This represented approximately 27% of the volumes of all securities of foreign companies traded on the London Stock Exchange (IOB trading system), which indicates that LUKOIL securities have the highest liquidity. There were 11,655 LUKOIL securities transactions, the company became the absolute leader as regards this indicator.

These figures show that LUKOIL fully respects regulations and requirements of the London Stock Exchange, which provide a high level of transparency, full disclosure of the information by submitting regular financial reports in accordance with international standards.

In 2005, it was founded LLK-International (LUKOIL Lubricants), a company entirely owned by LUKOIL and lubricants have become a separate business unit. The range of oils produced

includes engine oils, transmission oils, gear oils, hydraulic oils, oils for turbines, compressors, bearings, etc.

LUKOIL Lubricants has become a unified responsibility for this business segment, which allows LUKOIL to consolidate accounting, to ensure an objective evaluation of financial performance, to react promptly to market fluctuations, improve and develop the production of lubricants, to continue research and optimize marketing lubricants.

In 2007, LUKOIL made major investments in Petrotel - LUKOIL: making single control center, a turbine building, building a 245 MW boiler. Following the upgrading of processing activity, Petrotel-Lukoil company has introduced high performance catalyst in all catalytic processes, modernized deep sulfur recovery technologies, modern technology to protect the equipment, and has adapted the refinery's capabilities to the market requirements for the achievement of customized products in strict compliance with internal and external customer requirements

In 2008, LUKOIL's subsidiary in Romania ranked the first place among all organizations in the world of Russian oil concern. LUKOIL Romania was designated as the best organization in the LUKOIL group as regards petroleum products trading.

In 2009, major investments started at the refinery PETROTEL-LUKOIL SA Ploiesti (27 million euro) in ecological programs and with a view to the switch to euro 5 green fuels.

SWOT Analysis

Application of strategic management aims to anticipate changes and amendments to be made in an organization to ensure its development in a constantly changing environment¹. Therefore, determining the most appropriate strategy begins with a thorough analysis of the external environment by identifying opportunities and threats, for which the company must overcome its weaknesses.

Strengths are represented by the resources and capabilities that LUKOIL can use in acquiring a competitive advantage. These include:

- LUKOIL is ranked first among the largest private oil and gas companies in the world in terms of volume of proven oil reserves - 1.3% of total reserves of oil worldwide - and second in terms of volume proven hydrocarbons reserves - about 2% of total global reserves;
- LUKOIL is ranked the fourth among the largest private oil and gas companies in the world in terms of volume of crude oil extraction - 2.3% of total global oil extraction - and the sixth in the volume of extraction of hydrocarbons - more than 2.5% of total global hydrocarbons extraction.
- LUKOIL Motor Oils meet the requirements imposed by the international automotive and aircraft engineering company (SAE), American Petroleum Institute (API) and the European Union car manufacturers (ACEA). They are manufactured according to the most advanced technology using performance additives produced by firms Shell, Exxon, Lubrizol, Ethyl²;
- Lukoil has a strong position in the oil market in Central and Eastern Europe, with refineries in Romania, Bulgaria and Ukraine and a growing network of gas stations in the Balkan states;
- LUKOIL has a large portfolio in terms of its international projects in Kazakhstan, Azerbaijan, Egypt and Colombia, where the company has a good understanding of the political and commercial system applied;

¹Oprea, M., *Managementul întreprinderii*, Ed. Universității din Ploiești, 2004, p.77

² UNTRR, www.untrr.ro

Weaknesses are those characteristics that generate competitive disadvantages³. Some of these are listed below:

- The company recorded a net profit of \$ 7.011 billion for the year ended December 31, 2009, down by 23.3% to 2008 (9.144 billion dollars);
- Ploiesti refinery production declined by 7.4% in 2009 compared to 2008, a situation which led to a fragile asset solvency and low financial stability;
- Production costs are relatively high compared with levels achieved by its main competitors;
- The company's communication both inside and outside is slow and bureaucratic.

Opportunities are a combination of external elements that produce significant benefits in terms of its particular course of action. LUKOIL regional market for Central and Eastern Europe provides the following advantages:

- Absence of major companies BP, Exxon Mobil, Chevron Texaco in the area, allowing more efficient market monopolization by LUKOIL, allowing them to increase market share and turnover;
- Grasping new markets in Europe, the company reduces business risk and allows for further development;
- Forecasts show existence of a potential increase in fuel consumption in the region;
- The selling price of petroleum products registered a steady growth in the region.

The main *threat* is the increasing competition in the area; OMV became the undisputed leader, with extensive market experience in the region. In addition, the economic crisis that persists in some countries, including Romania, resulted in a decrease in sales in the first months of 2010 and a reduction in the refinery processes in order to diminish losses as much as possible.

Present and Future Strategy of LUKOIL

Despite having a relatively good position in the regional market of Central and Eastern Europe, LUKOIL faces strong competition from OMV and MOL. In this context, LUKOIL aims to increase its market share through an offensive strategy of territorial expansion and to attract new customer segments.

According to the statements made by the management of Lukoil Neftochim Bourgas, LUKOIL plans to invest one billion dollars in building new production facilities in Bulgaria. Scheduled to be completed in 2014, the new facility will have 300 employees and produce heating fuel at European standards.

Moreover, as regards Lukoil Romania, within the development strategy of the local subsidiary of Russian oil group, there is the possibility of extending the network of gas stations with 50 stations from the current level of 310 units, as new motorways will be built. This is justified by the existence of a relatively high growth potential in the area, as at present, statistics show reduced fuel consumption per capita, as compared to Central Europe. This approach is expected to increase market share in Romania from 25% currently to 30% over the next years.

Products and environmental quality of midstream sectors are two major strategic directions of the company. Fuel quality is a key factor that ensures sales and maintains competitive market position. In this sense, the company has implemented a comprehensive project on biofuel production and estimates future investment allocation of 44 million dollars to modernize the refinery Petrotel-Lukoil, in accordance with EU legislation regarding petroleum product quality

³ Băcanu, B., *Practici de management strategic: metode și studii de caz*, Ed. Polirom, Iași, 2006, p.133

and environmental protection. By their implementation, these projects provide a considerable reduction in emissions.

In addition, LUKOIL International Lubricants ensures implementation of new technologies for modern and efficient production of lubricants in terms of cost and continues its efforts to improve product quality and competitiveness, in order to meet international standards, including API and ACEA.

Development of information technology represents a strategic direction that will facilitate the future business and financial requirements of the company's market position and strengthens regional and global Europe. Information technology is the essence of modern business. A company that continuously adapts technology will always align business and financial standards internationally and globally and will be ready for future challenges and competition. According to official statements, it will allocate substantial sums for infrastructure investment, improvement of data centers, to facilitate the deployment and commercial operations and financial control of LUKOIL.

Another important trend is the application of marketing strategies on the downstream, taking into account the factors influencing consumer choice of stations: location, value for money, image, service, the existence of ancillary services. These strategies are reflected in the mix of marketing, in which both product and promotion play a central role.

Thus, the product strategy of filling stations is reflected in the development of new services and their diversification. The introduction of additional services such as: payment of utility bills, making money transfers, insurance conclusion will lead to implementation of the new gas station concept, which will become a real provider of services in the area. As part of the strategies to diversify the offered products, it is worth introducing corporate card fuel supply in response to high standard customer requirements. LUKOIL card is a standardized, secure and paperless transaction support. Depending on customer needs there can be two types of cards: corporate debit card and corporate credit card.

LUKOIL continued to grow steadily, becoming an increasingly important company worldwide and it plans to complete its product offer in order to enter other markets.

Conclusions

LUKOIL's market strategy has always been connected with the idea of sustainable growth, supplemented by a geographical expansion; the goal is to become one of the top global oil companies.

LUKOIL's objectives associated with corporate mission are: sales volume, equity, profitability, competitive position, product quality and the environment. To this end, the strategic approaches on the regional market in Central and Eastern Europe aimed at allocating significant investments in upgrading refineries and building new fuel distribution networks.

In the global competitive landscape, the development of Russian-American relations especially in the oil field is of topical interest, the trend is to diversify U.S. imports, while Russia exports energy resources. The combination of Russian scientific and production potential with the American financial and technological potential guarantees to yield impressive results.

Particular emphasis is placed upon continuous training of human capital, through courses and seminars on topics of interest with a view to corporate development. In this respect, Petrotel refinery is working with Petroleum-Gas University of Ploiesti, an institute with a great tradition of specialist training in oil industry.

An ongoing concern is the improvement of the management system by applying modern techniques of project management, identifying each sub-project monitoring indicators, monitoring and controlling them, in order to increase the operational efficiency in each production unit.

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Strategia Companiei LUKOIL pe piața Europei Centrale și de Est

Rezumat

Mediul economic a cunoscut o dezvoltare semnificativă în ultimii 20 ani, marcată, în special, de efectul de globalizare a economiei și de creșterea competitivității. Marile corporații petroliere influențează semnificativ dezvoltarea economiilor naționale și a economiei mondiale în general, ca efect a puterii lor financiare foarte mari dar și a managementului corporativ orientat permanent către creșterea profitului, prin identificarea celor mai adecvate strategii și a celor mai eficiente metode de gestiune a afacerilor. În prezent, piața petrolului din Europa Centrală și de Est este controlată de trei mari jucători: Compania austriacă OMV, Compania maghiară MOL și Compania rusească LUKOIL, ale căror strategii și politici investiționale contribuie într-o măsură decisivă la dezvoltarea și consolidarea industriei petroliere în țările din această zonă, printre care se află și România. În acest context, articolul de față își propune să analizeze strategia Companiei LUKOIL de dezvoltare și consolidare a poziției pe această piață.