

Landmarks of Effective Management Decisions in the Russian Raw Material Sector

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Abstract

To make effective managerial decisions, business needs development guidelines. It is shown, on the example of the Russian raw material sector, that traditional approaches to performance indicators have shortcomings. Part of the proposed models does not reach the set goals in practice. The issues of evolving management on the basis of the criterion of development and the validity of investors' choice remain unresolved. Business needs a system that allows obtaining objective data (both resultant and advanced) about the object as a whole and the risks for individual sites. The specifics of doing business in the raw material sector require correction of valuation methods. Based on the practice of using the cost concept by Russian raw materials companies, the author gives recommendations for developing an effective business management system, building a decision making system with the respect to the company's corporate strategy and strategies for competing business units. Analysis of the experience of raw materials companies allows us to state that the success of the activity can be achieved not only by the use of effective technology and new technologies, but also by the adoption of managerial decisions:

- the company's strategy is decomposed into a system of long-term and short-term target standards;
- the main criterion is detailed, responsibility for achieving its components is distributed;
- the strategy is translated into the language of concrete measures through plans and budgets;
- target indicators as a means of expressing the intentions of the company are based on key factors and correspond to the level of management, short-term target standards are tied to long-term ones.

The importance of taking into account the specific features of doing business in the raw materials sector (the company's security in proven reserves, etc.) is demonstrated. Analysis of independent rating agencies, which reduces information asymmetry, is needed while assessing the attractiveness of an asset. The investment attractiveness of the raw material assets is largely

determined by the fundamental factors of growth (the level of reserves, volumes of extraction and transportation, operating efficiency, the amount of capital expenditure). Their significance varies over time, but the role as a foundation remains.

Keywords

Strategy, development guidelines, information asymmetry, features of raw materials business.

Introduction

The Russian economy lives mainly due to revenues from the export of raw materials. The share of raw materials in export revenue prevails over the incomes from processed products. More than a quarter of the gross domestic product, almost 30% of the country's budget, is formed in the Russian fuel and energy sector.

Estimates of the raw materials business are carried out in accordance with the development criteria. Reliability and sufficiency are characteristics of effective development criteria. However, approaches to the formation of criteria differ even for companies in the same economic sector. Moreover, recommendations are developed on the basis of different ideas about the goals of economic policy, and a set of indicators may not satisfy the restrictions of national economy [1, 2]. This is significant under the construction of guidelines for Russia's Energy strategy for the period up to 2035, some provisions of which are contradictory. Thus, if liberalization in the hydrocarbon market leads to the consolidation of assets, the concentration of competition policy on limiting horizontal integration - to the strengthening of vertical integration, and the transition to clean energy sources, proclaimed in the draft of the strategy, creates a prerequisite for more active involvement of the state in the economy. Market assessments and public policy guidelines may not have common ground and lead to multidirectional actions, which ultimately hinders the achievement of the strategy aims and increases the risk of deviation from the declared directions.

Due to the difficulty of justification of the guidelines and complexity of the preparation process there are not so many strategic national programs, but Russia's Energy strategy is one of the few documents of its kind. The strategy is developed as a multi-vector document declaring the interconnection of the energy sector with various areas and spheres of activity: state regulation, competition, monopolization, pricing, social and environmental responsibility, innovative development, energy efficiency, export, etc. The prospects of energy development are considered not only in the sectors of the fuel and energy complex, but also taking into account regional and cross-sectoral aspects. The national energy strategy considers the introduction of modern technologies for oil and gas extraction and processing, high-performance equipment with a high efficiency, low energy consumption, and the restoration of the resource base. The

document reflects the increased competition in the world energy markets, the slowdown in the growth of the Russian economy in the context of the deterioration of the geopolitical situation, the introduction of restrictions on access to the key technologies, equipment and international capital. The difference between the topics of this program document and the thesis description of industry directions leads to a certain declarativity and erosion of its integrity. The strategy cannot be used to make specific management decisions without additional clarification.

The resulting indicators are mainly used as guidelines for the strategy, while the so-called leading (proactive) indicators that show risks of failure are more important for making effective management decisions. Therefore, such management technologies as the concept of key performance indicators (Key Performance Indicators, KPI), balanced scorecard (Balanced Scorecard, BSC) have not lost relevance and should be used in the formation of the Russian energy strategy.

National companies are focused on integrating external conditions and requirements of state policy into their corporate programs. Although the most important indicators do not always become guidelines for developing strategies and making effective decisions. For example, there was a fairly high demand for renewable energy sources (RES). In the world business practice, RES is considered as one of the factors of competition for leadership and energy companies increase the "green" assets. Despite the positive assessment of RES, Russian companies show little interest in renewable energy. The current system of drawing up national programs and assessing of their implementation does not provide stimulating conditions for reaching the required criteria. Also, in conditions of resource availability and energy security, energy production continues to be carried out in the same ways, which does not require the involvement of innovations, creativity of management decisions. At the same time, the goals of the programs are not achieved and initially evaluated by analysts as wishes [3]. The new edition of the Energy strategy of Russia for the period up to 2035 plans to increase RES by 2035 more than 20 times, but the realization is illusory because of the small validity, as Russian companies invest sparingly in the development of green energy. In the future, this may mean the displacement of Russian companies from the positions of energy market leaders and the risk of losing their share in the world market, as well as the threat of taking their place by those who actively invest in the development of RES. At the same time, Russian companies' adapting to changing conditions can trigger factors that distort them from the goals of the mentioned national Programme.

There are several reasons for consideration of guidelines and estimations on the example of the commodity sector: first of all, due to its role in the Russian economy; secondly, because of the necessity to find investors and the need to take into account their specific interests; thirdly, the size of raw materials assets (only one transaction for the acquisition of "Bashneft" assets by

"Rosneft" energy company is estimated at almost 330 billion rubles); finally, due to unresolved methodological issues of creating a management system based on strategic indicators.

Main body

Approaches to development guidelines are constantly being adjusted. Previously, companies were more focused on gross performance, later there were attempts to shift the emphasis on quality, at a certain stage indicators of profit, profitability and costs prevailed. Financial indicators became dominant in estimates at the first stages of formation of the modern Russian economy [4] that led to:

- reflection of the effectiveness of only past activity;
- orientation to the internal environment of a company and ignoring of external processes;
- lack of measurable risk of income generation;
- incompatibility of results of companies in comparative analysis;
- the possibility to use different accounting methods for data manipulation;
- underestimation of the importance of intellectual capital.

In crisis conditions the emphasis was shifted to current activities, so growth was limited by the production factors and concentration on operational tasks meant a deferred interest to long-term issues. Approaches, based on profit indicators and in "advanced" national companies on economic added value, began to come to the fore. Recommendations over the attractiveness of assets were sparingly supplemented by information of a non-financial nature (quality of management, etc.), and managerial technologies, tested in Western companies, began to spread [5, 6, 7]. The idea of presenting the final financial indicators in the form of a tree of interrelated indicators that affect the result, which are detailed to the factors of lower levels, was in demand (Gazprom, LUKOIL, Norilsk Nickel, Russian aluminium, Severstal). However, in practice, the preference for financial criteria without taking into account industry specifics gave incorrect guidelines, for example, many companies underestimated the rapid development of shale hydrocarbon production technologies.

Modern approaches to the formation of criteria for development allow obtaining resulting information about an object and advanced data about risks that can occur. Such methodological approaches provide a link between financial and non-financial indicators, strategic and operational levels (such as a balanced scorecard). The experience of Russian companies in the raw materials sector shows that if the system of criteria is not built as a tribute to trends, then the most important benchmark is the growth of capitalization of the company [8], which should be supplemented by industry data. High capital intensity for traditional fields (in shale oil

production the situation is different: the share of investments is lower and is about 40%), as well as long period of return on invested capital (due to exploration, commissioning of fields) are considered to be distinctive features of the raw materials business. In commodity business assessments, the financial criteria for a strategic investor are supplemented with key information on the timing of the development license - 20 years (excluding exploration) and 25 years (including exploration). Also, the conditions of subsoil use, the tax system (including the rental component) are significant for investors. In addition, the most important feature of the valuation of the commodity business is the methods of inventory accounting. The majority of foreign investors put forward a demand for in-depth data on reserves. Despite the recognized qualification of Russian specialists, foreign investors want confirm the results and hire consultants of foreign companies. For example, Micon conducted the audit of ore reserves and mineral resources of Talnakh, Oktyabr and Zhdanov fields by the JORC standard (Australasian code evaluation of mineral resources and ore) for "Norilsk Nickel". Audit of reserves of LUKOIL was carried out by the Miller and Lents, Ltd company.

Explored reserves, productivity, recovery factor, the volume of oil, gas, coal, etc. - these are the main factors on which the cash flows of the commodity company are formed, such a kind of proof of reality in the future. Their significance varies over time, but the role of the foundation of the raw materials business remains, therefore for companies in this sector such information is fundamental. When comparing oil giants, it is clear that in terms of resource base, geological exploration, production - Russian companies are world's leaders, they outperform competitors in production indicators and would have to provide an appropriate level of capitalization and attractiveness, but their multipliers (capitalization / reserves and capitalization / extraction) much lower. Normative values for multipliers do not exist, but in developed markets for investors, the benchmark level of the P / E ratio (the ratio of the stock price to the net profit per share) is from 20 to 30.

On the example of the unaccepted draft of the national energy strategy 2035, there is a lack of correlation between the national strategy and the strategies of individual energy companies, even in companies where a significant share of assets belongs to the state. The experience of large companies (Gazprom, Norilsk Nickel, LUKOIL) shows that it is important to implement a unified strategy for the state and companies, as it will help to take into account the peculiarities of exploration, production, processing, transportation:

- focus on long-term indicators, taking into account the indicators of exploration, high capital intensity, ore production, oil, gas, etc.;

- focus of the corporate center and structural divisions of the company on achieving strategic goals with the respect to the location of deposits;
- elaboration of corporate strategy and competition strategies for business units, as well as functional strategies considering the company's structure.

Building a management system based on the value concept allows accomplishing tasks to achieve the goals, distributing functions and powers among units, giving managers the rights and responsibility for fulfilling the goals. Decomposition of the development strategy into its components, planning and measuring the result using key performance indicators (Figure 1) creates the company model [10], which ensures the growth of efficiency through the management of cost factors.

Informing business community is the most important area of application of evaluation guidelines. The information should be prepared with the respect to the policy of potential investor, as it will help to bring to an effective decision quickly. The financial speculator does not need a long-term development of the acquired assets, he needs profit in the near future. Pension funds "all other things being equal" lay in the calculation of purchased assets a higher price they can get in a few years. The guidelines of institutional portfolio investors (financial investors interested in portfolio diversification, but they do not interfere in management issues) differ from the criteria of strategic investors from industries and especially from small individual investors. This circumstance was demonstrated in the context of the Ministry of Economic Development of the Russian Federation (2016) for the purchase of Bashneft - participation in the tender of only strategic investors. Private equity funds (investors claiming the role of strategic partners in the medium-term period of 3-5 years) are ready to participate in the resolution of operational issues, acquire blocking packages.

Effective decision-making is increasingly influenced by information openness: expanding the boundaries of transparency reduces information asymmetry [11, 12]. The incompleteness of the information forces companies to move towards greater openness and encourages investors to search for additional data. For commodity companies increasing of information openness is associated with vulnerability and certain market problems, as competitors can use open data to their advantages. In practice, such companies as Gazprom, LUKOIL and Norilsk Nickel sign confidential agreements that require the disclosure of additional information to the investor. In addition, investors get information from open recourses. The analysis shows that despite the differences in approaches to the development of programs and strategies, commodity companies are largely similar in their elaborations. If BP pursues exclusively commercial goals, Gazprom Neft's programs reflect the interests of the state and properly reflect the provisions of the concept for the development of the Russian energy sector. The strategic program of Gazprom Neft

distinguishes the production structure by type of activity: production, refining and sales, regardless of costs, also there is an attachment to a particular region of Russia and a certain static – maintaining a constant ratio of reserves to production, but no mention of the financial component.

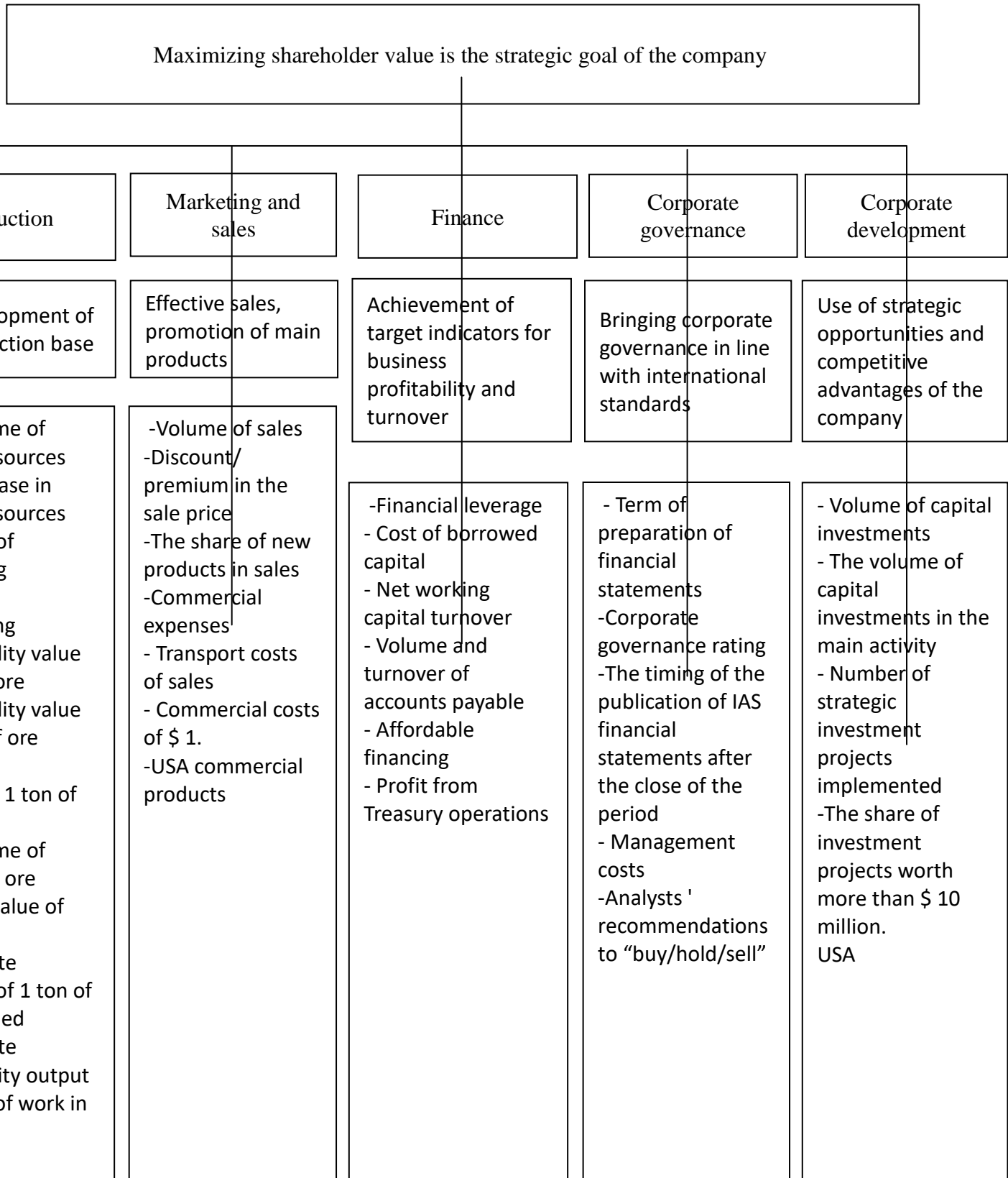


Figure 1. Practice of raw material companies in decomposition of strategic goal: functional strategies and key performance indicators

The direction of expansion of the resource base is determined by the shelf, the production of which is significantly more expensive, i.e. the basis for future development is to maintain and increase the volume despite the increase in costs. And BP admit reduction of oil production and implements only projects with the cost of oil extraction below the current one. Gazprom Neft is trying to take a place in the high-margin markets of motor oils and other highly profitable products, where there is already a great competition in the world market and it is more realistic to take better place in the national market. BP is committed to remaining a sustainable company in a changing environment, creating new products and developing new segments. An example is its cooperation with automakers, which will allow the company to more subtly feel the new trends in the functioning of the main consumers of BP products. At the same time, Gazprom Neft sets goals until 2025. BP annually reviews the strategy for 5 years. Unlike Gazprom Neft's strategy, BP's program pays more attention to potential threats and possible responses to them. Gazprom Neft's strategy can be described as balanced and filled with quantitative indicators for each area of activity, but at the same time static and not taking risks into account. Achieving the goals could lead to good financial performance of Gazprom Neft, but with the recent development of negative trends, financial well-being is being questioned. Hence: obtaining a high financial result for the period does not lead to a similar situation in the future.

World practice shows that for the adoption of an effective management decision, information is required not only from the owner of the asset, but also from information intermediaries. Investors are interested in evaluations of independent experts of rating agencies [13]. The assessments of leading international agencies (Fitch Ratings, Moody's, Standard & Poor's) are in demand. The most significant features for calculating of ratings for commodity companies are the conditions of the subsoil use regime, the tax system (including the rental component). The ratings allow formulating forecasts, providing information about risks and thus influencing the choice of the investor [14]. In the midst of the geopolitical conflict, the ratings of a number of Russian companies were withdrawn. The assessments affected the issues of technological cooperation. For example, Exxon Mobil, which for many years cooperated with Russian companies, turned exploration drilling in the Kara Sea. The downgrade of Russia's sovereign ratings by leading international rating agencies (Standard & Poor's, Fitch Ratings and Moody's) affected the outflow of investments and increased the cost of borrowing. Given the volatility of the market, decision-making in the raw material sector of the Russian economy is only permissible in the short term.

To make an effective management decision, it is necessary to know and take into account the specifics of doing business in Russia, and this causes the emergence of national rating agencies. Assignment of a credit rating on the Russian scale provides some advantages to

participants of the domestic rating system: obtaining a competent risk assessment of investment / lending in relation to other Russian borrowers; improving the conditions for attracting resources, increasing liquidity of ruble debt obligations; strengthening of positions in the competitive struggle for credit resources on the Russian market. The creation of a national rating system is a chance to create market institutions in Russia, although at first the return will be low. The diversity of approaches to the construction of ratings will lead to less bias and increase the objectivity of the results. Now companies and potential investors have a need not for speculative risk assessment, but for an assessment without a political component.

The problem of quantitative determination of the impact of irrational behavior of the investor, information asymmetry, the limited nature of the information disclosed by the company remains unresolved. It is difficult to calculate the measure of influence, but the name of such processes did not arise difficulties: it is the management of investor sentiment, regulated by the policy of revenue management and disclosure policy.

Conclusion

The criteria for making an effective decision have been tested by world practice, but they need to be laborious enough to apply in the raw material sector. "Price" and the objectivity of the development guidelines vary, but for a full-fledged picture, one can not rule out any part. The need for objectivity of benchmarks is steadily increasing, they are laid in forecasts and are the basis of management decisions.

Market participants smooth out information asymmetries by analyzing open data and entering into additional disclosure agreements. Leading international agencies assign low ratings to Russian assets despite objectively unattainable for many Western companies performance indicators (e.g. one of the world's leaders in the mining and metallurgical sector- Norilsk Nickel). External factors in the assessment of the Russian economy continue to dominate the fundamental ones. This situation is especially unfavorable for the commodity business, as it requires long-term investments in the arrangement of deposits, construction of mines, oil and gas pipelines, etc.

The experience of Russian companies shows that the reality of future cash flows should become an indicator of success. National development programs and strategies do not fully comply with modern principles of running, so far they have not become the basis for the development of corporate strategies, the guidelines of the Russian economy are not tied to the development of individual companies, even for ones where the state's share is significant. The criteria of the national strategy are not decomposed, as well as the presence of both cost and production indicators are insufficient.

Effective decision-making requires not only an objective assessment of the potential of Russian companies in the commodity sector, but also the disclosure of estimates on individual parameters. In conditions of instability of the macroeconomic situation, uncertainty of the geopolitical situation, the importance of production indicators is increasing: provision of reserves, exploration of subsoil, extraction factor, depletion of deposits, coal production volume, oil and gas processing volume, well productivity, etc.

The experience of Russian commodity companies shows that the value of estimates can be adjusted by using international approaches. The attractiveness of Russian assets increases when assessing reserves and resources according to recognized international standards. To make decisions analysts, in addition to calculating the effectiveness of investments, need information on risks from independent experts and rating agencies, which increases transparency, reduces information asymmetry and contributes to the fair valuation of business.

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