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Lessons for Investors From TNK-BP

By Chris Weafer

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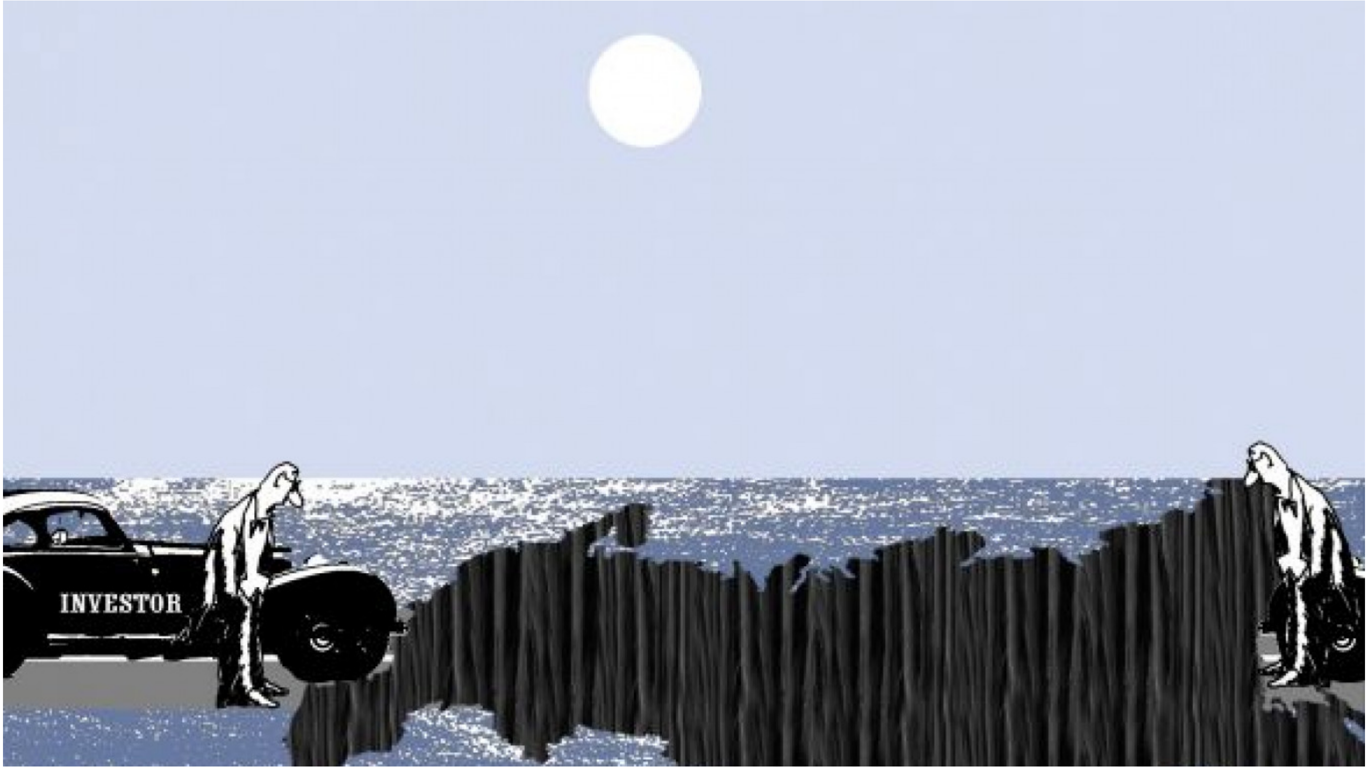

If ever there were a country for which the adage "snatching defeat from the jaws of victory" aptly applies, it is Russia. Time and time again, global investors and business leaders are left thinking that Russia is a dangerous place to invest in and is on the brink of yet another crisis. To be sure, the country certainly has had its fair share of crises, but the economic and investment volatility are, in reality, no worse than in other developing economies. Yet the highly depressed valuations on the stock market today would have you believe that Russia is some sort of a hybrid, blending a Las Vegas roulette wheel with an economic profile to make even Greece look attractive.

The reality is that the economy is still on track to deliver 4 percent economic growth this year, inflation is unlikely to be far off 5 percent, and retail sales and real wage growth will be in the high single digits. Even with the current oil price slide, the country's fiscal and budget position will not be far off target.

Although Russia is in relatively good shape compared to most of the world, the recent drops in the stock market are reminiscent of 2008, when the country ran headlong into a debt crisis and recession. In reality, Russia is a long way from repeating the 2008 scenario, but investors have been spooked by the ruble sliding more than 13 percent against the U.S. dollar last month and flashing red warning lights. The reason for the ruble's weakness is actually quite a sensible move on the part of the Central Bank as it allows for improved competitiveness in the economy to balance the falling oil price. But in the absence of a clear message to the market, the impression is again one of a building crisis.

Another and much clearer example of where reality is buried by negative perception is in the current controversy involving BP and its Russian partners AAR. Both parties hold a 50 percent stake in TNK-BP, the country's third-biggest oil producer with daily output of about 1.5 million barrels. The two business partners are now heading for divorce. That, in itself, is not a great surprise, as the partners have publicly squabbled several times since consummating their relationship in 2003. Both sides have benefited handsomely from the nine-year relationship, yet the impression now widely disseminated in the foreign media is that the partnership has been a disaster for BP and that the deal should serve as a warning for all others that Russia is a dangerous place for investment and should be avoided.

As is usually the case when it comes to perceptions about Russia's investment risk, the reality is quite different. BP's return from its investment in TNK ranks it as one of the best deals in recent history. BP paid $7 billion for its 50 percent stake in TNK in 2003. Since then, it has received $19 billion in dividends and, according to reports, is in line to receive $25 billion or $30 billion for its 50 percent stake should it sell it in the near future. That comes out to a profit of about $40 billion, or a nearly 600 percent investment return over nine years. Even though a lot of that profit was generated by the huge rise in oil prices, there are not many investments anywhere in the world that would have produced this huge return in the same timeframe.

Nonetheless, there are certainly plenty of lessons from this deal worth noting for investors looking at opportunities in Russia, as well as for those in government tasked with improving the perception of Russia as a business and investment location. The BP-AAR deal was done toward the end of President Vladimir Putin's first term. At the time, revised rules for investing in strategic industries had not yet been determined and, to a large extent, the 50-50 deal with a foreign investor helped shape the terms of the strategic industries law that now sets limits and clear rules for any similar investment. Deals structured under the new law should avoid any similar problems in the future.

Another important lesson, of course, is that you can make a great deal of money investing in Russia. But as in any developing economy, foreign investors often have to be flexible to adapt to those developing circumstances. The oil industry provides many examples of this. Typically, international oil majors gain a strong position in the early stages of an economy's development but then have to adapt. For example, they might have to change their equity position as the government exerts more control over strategic industries. Although Russia's oil industry has been around for many decades, the political and economic development of the country has really only been moving forward since the early part of the last decade. That's not to say that large-scale disputes like that with TNK-BP should be viewed as commonplace or be ignored by investors; they simply should be viewed in the proper context. The mantra for investing in developing economies has not changed for over 100 years: Do your homework, observe your corporate standards and adapt to local and changing conditions.

It is now obvious to everyone that Russia's economy needs a new long-term growth driver, and that has to come from expansion outside of extractive industries. For that to happen effectively, the country needs to attract a bigger volume of both domestic and foreign investment capital and a greater involvement of foreign businesses, either as joint-venture partners or as competitors to domestic companies. That is how those domestic businesses will start to become more competitive and grow. But not if the directors of those foreign companies are reading headlines about huge investment risk instead of huge profits. Getting the message right and getting the facts straight is as much a challenge for the new government as improving the infrastructure and creating the right fiscal environment.

As for the TNK-BP divorce proceedings, it could have clearly been handled better. But few divorces are ever pleasant. The most important aspect of any divorce is to execute the dissolution without causing too much psychological damage to the children — in this case, the minority investors of TNK-BP.

Chris Weafer is chief strategist at Troika Dialog.

The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.