The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

Global Experts See Role for Small Players in Big Business

By Alexander Panin

January 16, 2014

The Kupol mine in Chukotka, Russia, which operated by Kinross Gold.

Correction appended

Despite the transformation of Russia by its natural resources sector, red tape and governmental capriciousness will retard further growth, regional investment and any semblance of a competitive environment, executives and economists said at this week's Gaidar Forum in Moscow.

The money and enthusiasm of small private companies could also fuel high-risk projects such as shale oil and gas exploration, as they did in other countries, said participants in the event, which is organized and hosted by the Presidential Academy of National Economy and Public Administration.

The shale oil and gas revolution in the U.S. has resulted in a 50 percent increase in hydrocarbon extraction in the country over the last 5 years, said Philip Vorobyov, commercial director at JKX Oil & Gas. "This means a million new working places were created with two to three million more expected. $120 billion was invested in 2012 alone, contributing as much as $450 billion to the country's GDP each year," Vorobyov said, adding that this is the growth that Russia could take as a model.

According to a report released this week by BP, one of the world's largest oil firms, shale oil production will take off in Russia, rising to production levels of 800,000 barrels per day by 2035.

One of the reasons for the hydrocarbon miracle in the U.S. was an army of small companies who came to be pioneers in shale oil and gas exploration and then stayed in the field, Vorobyov said.

According to JKX, large corporations extract less than 40 percent of the oil in the U.S. This figure is even less for shale oil exploration — only 15 percent is done by the majors. There are in total more than 15,000 oil companies in the country.

In Russia, the 10 biggest companies account for 90 percent of all oil production and the number of small companies is decreasing.

"This number is so small because there is a lack of competition. We fully support the idea that competition in the sector needs to grow," Andrei Gaidamak, vice president of LUKoil, said on the sidelines of the forum. He did not say how this goal might be achieved.

Room for Small Players

At the same time the potential for small companies in the sector is quite high, JKX's Vorobyov said. "About 16 percent of all oil fields in Russia are considered small and are not being developed," he said.

One of the roots of the problem of why small companies are not active on the oil market in Russia, Vorobyov said, is excessive administrative barriers resulting in difficulties with licensing and obtaining drilling permission.

It is not such a big problem for large corporations, which employ whole departments whose task is to solve issues with the authorities on different levels, the executive said.

Administrative and regulatory challenges have deterred investors from other resource-oriented sectors, such as the mining industry.

Fraser institute, a Canadian think tank releases an annual report on the attractiveness of countries' mining sectors to foreign investment, based on a survey of mining executives. Russia routinely ranks among the countries with the highest levels of disincentives to business activity due to uncertainty concerning the administration and enforcement of regulations. In the latest report the country was rated at the same level as Niger, Kazakhstan and French Guiana in this category.

Institution as Barrier

"Bureaucracy and an often inconsistent myriad of regulations is an institutional framework that in itself is a barrier, especially to foreign investment and to economic growth," said Lou Naumovski, vice president of Kinross Gold, a Canadian gold mining company, which operates a gold mine in Russia's Far North.

One example of overregulation is the so-called strategic gold reserve. Today, a gold field containing more than 50 metric tons of the precious metal in Russia is labeled strategic.

"A foreign investor finding a strategic gold deposit runs the risk of having it confiscated by the government with no explanation or compensation," the Kinross executive said. "Changing this limit alone could boost foreign investment."

At the same time Russia has the opportunity to foster greater exploration investment in its mineral industry, Naumovski said, especially in the Far East, which has been declared a priority region for development by the government.

"Russia could rival the global leader in mineral exploration — Canada — and generate $1.6 billion to $2 billion of mineral exploration investments per year," Naumovski said.

But this requires the regulatory reforms the miners are asking for. Kinross has been very successful in Russia, but other foreign mining companies have not attempted to invest in Russia because of the apprehension they feel over strategic sectors legislation, Naumovski added.

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Correction: An earlier version of this article misspelled the surname of the vice president of Kinross Gold, a Canadian gold mining company. The correct spelling is Lou Naumovski, not Naumovsky.

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