

# The motives of Russian state-owned companies for outward foreign direct investment and its impact on state-company cooperation: observations concerning the energy sector\*

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This paper analyses cooperation between state institutions and state-owned energy companies of the Russian Federation on the basis of three examples of outward foreign direct investments (OFDI): the acquisition by nuclear power company Atomstroyexport of Nukem Technologies in Germany; the gas giant Gazprom and its South Stream investment package in Hungary; and the oil company Zarubezhneft's acquisition of the Optima Group in Bosnia-Herzegovina. The research is based on the analyses of media reports, official state and company documents, and interviews conducted with representatives of the state-owned energy companies and state officials. The analysis suggests that Russian state-owned energy companies only initiate cooperation with state institutions when the circumstances require certain financial and diplomatic support to conduct OFDI. This paper reveals that, despite usually being portrayed as channels for Russian political influence, the drivers for the OFDI of Russian state-owned energy companies in fact represent a complex range of commercial considerations.

**Key words:** Russian Federation; state-owned TNCs; outward foreign direct investment (OFDI); state-TNC cooperation

## 1. Introduction

Due to the importance of the Russian energy sector, both as the main source of revenue for the state budget and as one of the main sources of energy supplies for Europe, the outward foreign direct investment (OFDI) of Russian energy companies has been the subject of a lively academic debate. The debate is whether these OFDI by Russian state-owned energy companies

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are driven more by state interests of the Russian Federation or by the business interests of the companies themselves. The following quotation illustrates the way in which the motives of the energy companies are presented in the literature:

While Russia claims to pursue strictly economic interests in its energy policy, many outsiders – especially in the US – maintain that Russia is using energy provisions as a political tool. Some even claim that Russia is using energy provisions as part of a bargain to tie its neighbors and European partners into its orbit – just as the Soviet Union did when it sought to strengthen control over its Eastern European allies via the building of oil and gas pipelines. While the US is generally much more concerned about the political use of energy than the Europeans, some European governments also view dependency on Russia very negatively (Perovic, 2009, p.9).

At the same time, a number of studies about the domestic politics and economic transformation explicitly differentiate the Russian Federation's state/national interests from the interests of its energy companies and political elite (Shevtsova, 2005; Shevtsova, 2007; Treisman, 2011; Krastev and Holmes, 2012). For instance, Ivan Krastev and Stephen Holmes (2012) argue that the Russian political system has rather been a regime that ignores and pacifies the people "while amassing unbelievable riches from the sale of Russia's natural resources abroad" (p.40). This differentiation between the state/national interests and the individual interests of the political elite is important in the examination of OFDI from the Russian Federation. Equally important is the phenomenon of cooperation between Russian transnational companies (TNCs) and Russian state institutions abroad in the instances of OFDI (state-TNC cooperation), an aspect which is overlooked in the literature.

The objective of this paper, therefore, is twofold: first, it provides a constructivist account of state-TNC cooperation by looking closely at the processes of OFDI by three Russian state-owned energy companies, and the extent and nature of their contacts with Russian state institutions. Second, the paper explains under what circumstances and to what extent Russian state-owned energy companies follow the state/national interests, and to what extent these state interests are combined with other interests in instances of OFDI. The analysis of

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OFDI by privately-owned Russian energy and non-energy companies, as well as of Russian state-owned non-energy companies, is therefore out of the scope of this paper. This paper's analysis relies on media reports, official Russian state documents, company websites, and interviews conducted with representatives of the Russian state-owned energy companies and of Russian state officials. Three Russian state-owned companies of different sizes that represent different industries in the Russian energy sector are analysed, namely, the large nuclear power producer Rosatom (and its subdivision Atomstroyexport), the gas giant Gazprom, and the relatively small state-owned oil company Zarubezhneft.

Clearly, it must be borne in mind that the information provided by these companies and their representatives may not accurately reveal their "true" motives. Nevertheless, the analysis demonstrates that, although the analysis demonstrates that, although usually presented in the debate as channels of state interests, the motives for OFDI by Russian state-owned energy companies in fact represent a complex range of business considerations. The paper will first analyse how Russian state interests and the interests and strategies of the three Russian energy companies are defined in the state and company official documents, followed by a discussion on the extent to which these interests and strategies are implemented in the actual OFDI by these three companies.

## **2. Motives for OFDI by Russian state-owned energy companies**

The motives for OFDI by Russian state-owned energy companies vary depending on the size of the company as well as on the OFDI location (Liuhto 2006; Vahtra 2009; Poussenkova 2009; Kalotay 2006; Kalotay and Sulstarova, 2008). Still, scholars who analyze the motives for OFDI by Russian state-owned energy companies can be roughly divided into three groups. The first and largest group focuses on the meaning of Russian OFDI for its state/national interests (Liuhto and Vahtra 2004; Kuzio 2005; Nygren 2007; Liuhto 2008; Orban 2008; Orttung 2009; Closson 2009; Poussenkova 2010). For instance, Anita Orban (2008) examines Russian energy policy and investments in three of the four Visegrad group countries, and points out that "Russia's energy-centred foreign policy is not limited to the states of the former Soviet Union and is clearly designed to increase its leverage in key geostrategic theatres

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and over U.S. allies, and to achieve a far-reaching foreign policy goal” (p.177). Similarly, Peeter Vahtra (2009) points out that Russian state-owned enterprises “make purchases that seem to serve the purposes of Russia’s foreign policy rather than commercial logic” (p.7).

In contrast, the second group of scholars concentrate on the business motives for OFDI by Russian state-owned energy companies (Johnson 2004; Kuznetsov 2007; Kuznetsov 2010; Filippov 2008; Kalotay and Sulstarova 2008; Panibratov and Kalotay 2009). According to this view, the motives of Russian energy companies for OFDI in Europe can be explained from a purely business point of view. Alexei Kuznetsov (2007), for example, points out that, by investing in European retail companies, Gazprom attempts to control the profits from the gas supplies and improve the stability of its business.

While not dismissing Russian state/national interests and business considerations as the motives for OFDI by Russian energy state-owned companies, the third group of scholars tend to focus attention on individual profit-seeking motives. For instance, Robert Ortung (2009) points out that “the main conflict among the individuals at the apex of Russian power is for control over the rents generated by the energy sector” (p.65). Similarly, Alexei Kuznetsov (2010) highlights that some of the top managers of Russian TNCs under state control pursue their own interests, ignoring Russian national interests as well as the economic objectives of the TNCs.

### **3. Description of concepts and actors**

Overall, these insights suggest that the motives for OFDI by Russian state-owned energy companies can in fact be driven by the interests of two types of collective actors, i.e. the state and the companies, and two types of individual actors, i.e. politicians and managers.

The interests of the Russian state, the first type of collective actor, are set out in one of the most important official Russian documents, “National Security Strategy to 2020”, as “the aggregate of the internal and external needs of the state in ensuring the protection and stable development of the individual, society and the state” (National Security Strategy to 2020, 2009). Similarly, the Russian Foreign Policy Concept 2000 aimed to protect the interests of the individual and society and, within that framework, “ ... to achieve firm and prestigious positions in

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the world community, most fully consistent with the interests of the Russian Federation as a great power, as one of the most influential centres of the modern world” (Russian Foreign Policy Concept, 2000). These principles of foreign policy include interrelated economic and security interests within the broader interests of society. The 2008 Concept adds the creation of “favorable external conditions for the modernization of Russia, transformation of its economy along innovation lines, ... rule of law and democratic institutions, ... and, as a consequence, ensuring the competitiveness of the country in a globalizing world” (Russian Foreign Policy Concept, 2008). This principle highlights the increasing importance of economic interests in Russian foreign policy. It also hints at the possible role of Russian TNCs in reaching economic goals abroad. Moreover, the Energy Strategy also reflects the power aspirations of the political elite, beginning with the claim that:

the objective of the energy policy of Russia is to maximize the effective use of natural energy resources and the potential of the energy sector to sustain economic growth, improve the quality of life of the population and promote the strengthening of foreign economic positions of the country (Energy Strategy of the Russian Federation by 2030, p.10).

All of these objectives, especially the last, are in line with the argument of Andrey Tsygankov’s (2006) that the post-Soviet Russian Federation largely inherited foreign policy aspirations of the USSR. According to Tsygankov, the post-Soviet government merely changed its foreign policy strategy to using soft power, or, as he puts it, taking “by banks” rather than “by tanks”. Therefore, one can assume that by investing abroad, Russian TNCs serve broader national interests, including economic ones. Moreover, the Russian Foreign Policy Concept 2013 states that, in order to achieve principal objectives in the area of international economic relations, meaning primarily the innovation-based development of the country and ensuring its equal standing in the modern system of international economic relations, the Russian Federation “provides state support to Russian enterprises and companies in gaining access to new markets and in the development of traditional ones while counteracting discrimination against Russian investors and exporters”.

Similarly, business interests of Russian energy companies, representing the second type of collective actor, can encompass a

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variety of motives. Sergey Filippov (2008) outlines the most frequent business motives for OFDI by Russian companies in the following way: a resource-seeking motive refers to investments seeking to acquire natural resources or production assets; a market-seeking motive refers to investments which aim at either entering new markets or maintaining existing ones; efficiency-seeking investments aim to increase a company's efficiency by exploiting the economies of scale and scope, or common ownership; and asset-seeking FDI aims at the acquisition of technology and R&D-intensive units. Some of these motives are reflected in the official strategies of the three state-owned energy companies analysed in this paper.

Nevertheless, in their official discourse (which might be a part of public relations exercise), Russian state-owned energy companies put forward the fulfilment of the state/national interests as their main goals. For instance, nuclear producer Rosatom describes its mission as "maintaining national interests in defence, nuclear safety and nuclear power by achieving global leadership in advanced technologies, competencies and innovations" (Rosatom, 2014). Moreover, the company defines its international role as "...an official Russian Federation agency promoting international cooperation on peaceful uses of nuclear power. It is responsible for meeting Russia's commitments in the nuclear industry with a specific focus on the international nuclear non-proliferation effort" (Rosatom, 2014). In a similar vein, in its advertisements, Gazprom is represented as a "national patrimony" (*natsional'noe dostoyanie*). At the same time, Gazprom's mission and strategy are described primarily in commercial terms:

Gazprom views its mission as the reliable, efficient and balanced supply of natural gas, and other energy resources and their derivatives to consumers ... Gazprom's strategic goal is to become a leader among global energy companies by developing new markets, diversifying business activities and securing the reliability of supplies (Gazprom, 2014).

Similar to Rosatom, the smallest state-owned oil company, Zarubezhneft, describes its mission as "the development and strengthening of international economic relations of the Russian Federation, and the strengthening of the geopolitical position of Russia on the international market" (Zarubezhneft, 2014). It is stated that the company's strategy in foreign investment includes the "development

of innovation and technological potential by means of its own studies and acquisitions in the market of highly technological companies and technologies” and the “extension of the geography of strategic presence on the international market” (Zarubezhneft, 2014).

The interests of the third and fourth types of actors, i.e. individuals, can be defined as individual profit-seeking interests distinct from both the state/national interests and the business interests of a particular company. For instance, if an investment project is financed by the state, it is in the interest of both the company and the state to negotiate the lowest possible price. However, as the analysis in this paper will show, in some circumstances the cost of energy investment projects increases due to the rent-seeking behaviour of individuals who have control over the budget, by employing intermediaries in the process of implementation.

To sum up, the interests that drive OFDI by Russian state-owned energy companies are categorized as follows: a) state/national interests (both internal and external needs in ensuring the protection and stable development of the individual, society and the state), b) business interests (resource-, market-, efficiency-, or/and asset-seeking), and c) individual interests (undeclared and unrelated to national or/and business interests). These concepts are summarized in Table 1.

**Table 1. Russian state-owned energy companies’ declared interests for OFDI**

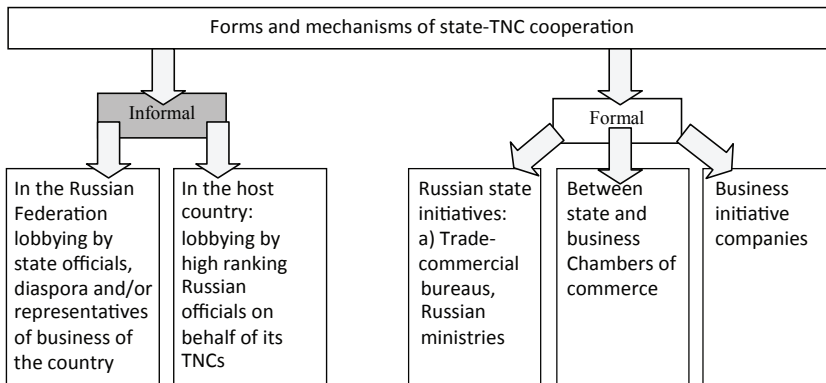
Company	Types of interests for OFDI	
	State/national interests	Business interests
Rosatom-Atomstroy export	“...to maintain national interests in defence, nuclear safety...”	“...achieving global leadership in advanced technologies, competencies and innovations...”
Gazprom	“National patrimony”	“...to become a leader among global energy companies by developing new markets...”
Zarubezhneft	“...strengthening of the geopolitical position of Russia on the international market...”	“...development of innovation and technological potential by means of... acquisitions on the market of highly technological companies”

Source: Rosatom, Gazprom, and Zarubezhneft websites.

It is, therefore, expected that these companies that declare serving Russia’s state/national interests as part of their mission and strategies do so by means of their investments abroad.

In the following sections, this paper will analyse cooperation with Russian state institutions abroad and the extent to which Russian state-owned energy companies follow their declared missions and strategies in three concrete examples of OFDI. Cooperation between Russian companies and state institutions (state-TNC cooperation) is broadly defined as the contact between Russian companies and Russian state institutions abroad regarding OFDI. The forms and mechanisms of this contact is presented in graph form in Figure 1 below.

**Figure 1. Forms and mechanisms of Russian state-TNC cooperation**



TNC-state cooperation can be defined as *high* when cooperation exists at both company and state levels and is both formal and informal, as represented in Figure 1; TNC-state cooperation is defined as *medium* when cooperation exists at some but not all levels and is formal and/or informal; it is defined as *low* when it is limited to one level and is either formal or informal.

#### 4. Description of the research strategy

The data were collected in two distinct phases. The first phase was dedicated to mapping the views of Russian officials regarding the cooperation between Russian state institutions and Russian state-owned energy companies in instances of OFDI, as well as their



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experience of this cooperation. The second phase was dedicated to mapping the views of the Russian state-owned energy companies and Russian economic institutions (such as Chambers of Commerce) regarding the cooperation between Russian state institutions and the Russian state-owned energy companies in these three instances of OFDI, and their experiences and perceptions of specific challenges in conducting OFDI. These views were mapped in two ways. First, mass media reports regarding the OFDI projects by the Russian state-owned energy companies were monitored both in the Russian Federation and in the host countries. Second, the author conducted interviews with representatives of the Russian state-owned energy companies, Russian state institutions, and with some representatives of business circles in the host countries. The interviewees were chosen on the basis of their position which allows them to have first-hand information on the internal policy decision-making of the state-owned energy companies and state institutions regarding relations with Russian companies abroad (all answers are treated anonymously and names replaced by the approximate positions held by the respondents). The questions were structured in such a way to allow detailed answers. For instance, the questions posed to the representatives of the Russian state-owned energy companies included the following: *To what extent does your company cooperate with Russian state institutions when conducting OFDI? Which side, if any, initiates this cooperation?* Similarly, the questions posed to the representatives of Russian state institutions included: *To what extent does the state institution that you represent cooperate with Russian state-owned energy companies in their instances of OFDI? If so, who initiates the cooperation?*

The data were thus gathered from interviews with representatives of the Russian, German, Hungarian and Bosnian business and state officials and representatives of non-state institutions. The questions were organized in two groups: a) the relations between the company/subsidiary and the Russian state institutions in Germany, Hungary, and Bosnia-Herzegovina; b) Russian-German/Hungarian/Bosnia-Herzegovina relations regarding specific investments. The interviews used in this paper were conducted with representatives of the Russian state-owned energy companies (Russian and German citizens), representatives of Russian state institutions (from Russian ministries, from the Russian embassies in Hungary and Bosnia-Herzegovina, and from the trade representative office in Germany), and representatives

of the host country's business community (Chamber of Commerce of the Republic of Srpska, Bosnia-Herzegovina).

The interviews were conducted in one of three forms: personal conversations, telephone interviews, and answers in written form sent by e-mail. Some respondents opted for telephone or Skype conversations which were electronically recorded. A smaller number of respondents preferred to answer in written form. Some respondents agreed to electronically recorded interviews during personal meetings, and the remainder preferred to provide information only in the form of a personal conversation with the author taking written notes.

Furthermore, as natural-resource-based firms account for four-fifths of the foreign assets of the top twenty-five Russian TNCs (Sauvant, Maschek, and McAllister, 2009, p.16), and oil and gas in particular are the top outward- investing industries from the Russian Federation, it is crucial to analyse Russian OFDI in the energy sector. It is also important to analyze Russian OFDI in Europe because the largest proportion of Russian OFDI is in non-CIS (Commonwealth of Independent States) Europe, as shown in Table 2 below:

**Table 2. Russian OFDI flows, total and in Europe (excluding CIS), 2007–2012**  
(Millions of dollars and per cent)

Year	2007	2008	2009	2010	2011	2012
Russian OFDI Total	44,801	55,663	43,281	52,616	66,851	48,822
Russian OFDI in Europe (excluding CIS)	34,594	35,941	32,255	36,559	44,930	32,283
Percentage of total Russian OFDI in Europe (excluding CIS)	77%	64.6%	74.5%	69.5%	67.2%	66.1%

Source: Central Bank of Russia (2014), author's calculations.

It is important to note here that this paper is based on an entirely qualitative analysis of three cases of OFDI by Russian state-owned energy companies, and hence cannot claim significance in the same terms as a statistical analysis would. However, the cases were selected in such a way to allow the findings to be extrapolated to other instances

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of OFDI by Russian state-owned energy companies. The paper analyses examples of OFDI by three state-owned energy companies.<sup>1</sup> They are of different sizes, represent different industries within the energy sector, and invested or planned to invest in three different European countries. A large nuclear power producer, Rosatom (and its subdivision Atomstroyexport), invested in the European Union's largest economy, Germany. The gas giant Gazprom planned a package of investment projects in a relatively small and new EU member state, Hungary. The smaller state-owned oil company Zarubezhneft invested in the small non-EU member country Bosnia-Herzegovina.

## **5. State-TNC cooperation in three examples of OFDI**

### **5.1. Atomstroyexport's acquisition of Nukem Technologies in Germany**

In August 2006, United States private equity group Advent International put up for sale the German uranium trader Nukem GmbH and its subdivision Nukem Technologies, a leading European engineering company that specializes in the dismantling and decommissioning of nuclear power stations. Atomstroyexport, a subdivision of the Russian state-owned holding company Rosatom, immediately expressed its interest in Nukem Technologies and began to negotiate its acquisition. The initial price for the two assets was approximately €70 billion. However, as Nukem GmbH and Nukem Technologies represent two very different business profiles, there was little interest in the acquisition of both companies. Negotiations between Rosatom and Advent International lasted three years and in December 2009 they agreed on Atomstroyexport's acquisition of Nukem Technologies for €23.5 billion (Gileva, 2009). According to Atomstroyexport's vice-president, Alexander Glukhov, during the negotiations Advent International requested banking guarantees of approximately €500 million, in accordance with German law. Nevertheless, Atomstroyexport negotiated a guarantee of only €66 million for operational responsibilities.

Nevertheless, it seems that the acquisition was mutually beneficial. Alexander Glukhov stated that by acquiring Nukem

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<sup>1</sup> In the Russian Federation, there are eight state-owned energy companies, including large corporations Rosatom, Gazprom, Rusnano, Rosneft, Transneft, and RosGidro (the remnant of electricity giant RAO UES)

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Technologies, Atomstroyexport gained access to the unique technology for the dismantling and decommissioning of nuclear power stations, which at the time of the acquisition did not exist in the Russian Federation (Gileva, 2009). Moreover, according to Rosatom's director of nuclear security Oleg Krukov, as Nukem Technologies was a relatively well-known company in Europe, the acquisition was expected to provide Rosatom with new contracts in the European market (Vedomosti, 2013). Similarly, Nukem Technologies' managing director Ulf Kutscher pointed out that with Atomstroyexport, Nukem Technologies obtained a strategic investor who perfectly understood the company's business and would develop it further: "I am convinced that we can extend the activities and therefore also the employment situation at NUKEM Technologies" (Nukem Technologies Website, 2009).

According to Alexander Glukhov, Atomstroyexport cooperated with several Russian banks: in cooperation with VneshtorgBank, Atomstroyexport provided guarantees to Commerzbank for Nukem Technologies' responsibilities in existing contracts. Similarly, Atomstroyexport employed the Russian GazpromBank as its financial consultant in the acquisition (Gileva, 2009). These forms of cooperation among Russian state-owned commercial organizations suggest that, by following primarily its business interests, Atomstroyexport also considered Russian economic state/national interests. Nevertheless, Atomstroyexport collaborated not only with the Russian partners, but also non-Russian companies Norton Rose and KPMG for law and taxation consultations.

Interviews with other participants in the acquisition process suggest a dominance of business interests in Atomstroyexport's decision making. For instance, Nukem Technologies' Communication Director pointed out that the roles of the Governments of the Russian Federation and Germany were limited to technical contacts, as all negotiations were conducted directly between the companies, and that this pattern has not changed since the acquisition. "Due to the fact that Nukem is active worldwide, we don't cooperate with Russian institutions any more than with other foreign institutions, besides some technical contacts like applying for visas for colleagues travelling to Russia" (online interview, 12th July 2012). Russian state officials working at the diplomatic mission in Germany confirm that there is little cooperation between Russian state institutions in Germany and

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Russian investors, stating that Russian state institutions abroad provide support for Russian companies only when they receive a directive to do so from Moscow. Otherwise, companies, including state-owned energy companies in general and Atomstroyexport in particular, act independently.

In Soviet times, the state had the power to say what amount of production the organizations should export to Germany. Now, we have a market economy and all we can do is establish the contacts and support Russian business abroad, when required. However, we have no tools to make them useful for Russia itself (Deputy of Russian Trade and Commercial Bureau in Berlin, personal interview, December 13th 2011).

Moreover, according to the director of Communications at Nukem Technologies, even after acquisition by the Russian state-owned energy company, Nukem Technologies continued to be recognized as a German rather than Russian company.

More than 90 % of our staff is German; the majority of the remaining 10 % [are] international colleagues but no[t] Russians. Only two Russians (from about 250 employees) started working at Nukem after the acquisition by Atomstryexport. Only recently [was] our Management Board expanded [to include] the Russian Managing Director (online interview, 12th July 2012).

These observations suggest that, when acquiring Nukem Technologies, Atomstryexport did not encounter any political obstacles and thus did not need political and diplomatic support from the Russian state. Therefore, it can be argued that in this particular example of OFDI, Russian state-TNC cooperation was very low and that it took place in the Russian Federation mainly among various state-owned commercial structures. Moreover, the willingness of the management of Atomstroyexport to endure a lengthy negotiation to obtain a significantly lower price suggests that the acquisition was driven primarily by business motives (rather than state/national or personal) of the company (as a collective actor). These business motives, namely access to new technologies and access to new markets, only coincidentally turned out to be economically beneficial for the Russian Federation's broader state/national interests.

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## 5.2. Gazprom's South Stream project in Hungary

The instance of Gazprom's investment in the Hungarian section of the South Stream project represents an almost opposite picture of Russian state-TNC cooperation to Atomstroyexport's acquisition of Nukem Technologies. At 2,400 kilometer long, South Stream represented one of Gazprom's largest international pipeline projects (Gazprom, 2013).<sup>2</sup> Its aim was the diversification of the gas supply routes from the Russian Federation to Europe in view of the disputes with Ukraine in 2006 and 2009 which led to gas cut-offs (Marson, 2013). The total cost of the project was forecast to be about €56 billion, of which €46 billion was to be financed by Gazprom (€31 billion domestically, and €15 internationally), and the rest by its European partners (Korchemkin, 2013).

The pipeline was to cross the territories of Bulgaria, Serbia, Hungary and Slovenia before terminating in Italy (Pinchuk, 2013). An alternative trajectory bypassing Slovenia and reaching Italy through Austria was also considered. The Hungarian section of South Stream was a relatively small 229 kilometres and the cost of investment was estimated at €600 million (Marnitz, 2012). The participation of Hungary in the South Stream project seemed to be a high priority for the Hungarian government as it gave the project the status of national importance (Gazprom, 2012).

Negotiations about Hungary's participation in the South Stream project started in 2007 and were finalized at the end of 2013. As the project itself was infrastructural and international, it required an active involvement of the governments of all the participating countries, including the Russian Federation. According to a representative of the Russian Ministry of Energy, the foreign economic interests of the Russian state coincide with Gazprom's business interests to invest in Europe because the Russian state budget receives most of its revenues from the energy sector, thus the cooperation between Gazprom and Russian state institutions abroad is usually relatively intensive.

Our relations with state-owned energy companies should be analysed within the context of Russia's Energy Strategy up to

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<sup>2</sup> In December 2014, the Russian government officially abandoned the South Stream pipeline, citing EU objections, and instead named Turkey as its preferred partner for an alternative pipeline.

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2030, which is part of the broader Strategy for Russia's Economic Development. ... Energy is the leading sector of Russia's economy. Therefore, Russia's state budget to a large extent depends on the revenues of state-owned energy companies. In order to increase these revenues, and consequently to increase the state budget, not only our Ministry but other ministries also have to support our energy companies, both in Russia and abroad. (Representative of the Russian Ministry of Energy, telephone interview, August 5th 2011).

In a similar vein, Gazprom sees the role of Russian state institutions as the provider of political and diplomatic support when required. "As we are a majority state-owned company, it is logical that the state has the same interests as we do, and, therefore, Russian state institutions provide help if Gazprom needs it" (Gazprom official, telephone interview, May 20th 2012). Moreover, according to the Gazprom official interviewed, the role of all Gazprom's European subsidiaries and joint-stock companies is primarily commercial:

Similarly to other countries which participate in the South Stream pipeline project, in Hungary we established a joint venture with our Hungarian partners. ... Our partnerships are based on simple mutual interests: the goal of all our foreign partners is to secure gas supplies, and our goal is to reach our final consumers in Europe and to increase revenues (Gazprom official, telephone interview, May 20th 2012).

The CEO of Gazprom's Hungarian partner company MVM, Csaba Bajo, shared a similar view, pointing out that the Hungarian stretch of the pipeline would have had the capacity to fulfil domestic needs (Marnitz, 2012). At the same time, an official from the Russian Ministry of Foreign Affairs (MFA) pointed out that the state interests were not always taken into consideration when cooperating with Russian TNCs abroad:

Although we are a political institution and, consequently, our tasks are exclusively political, we are obliged to provide support to Russian business in the form of favourable political conditions and in order to avoid discrimination against Russian companies. ... Unfortunately, companies hardly consider Russian state and

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national interests in their activities abroad (Expert on Russian-Hungarian relations from the Russian Ministry of Foreign Affairs, personal interview, July 23rd 2011).

In general, it can be argued that the South Stream project would have been commercially beneficial for Gazprom and also for the Russian budget. However, some analyses indicate that the observation of the official at the Ministry of Foreign Affairs (mentioned above) could also be applied to the South Stream project: “this investment will increase the gas transmission costs and reduce the profits of Gazprom shareholders. ... The high cost of the Southern Corridor pipelines cannot be explained by climatic, geographic or terrain conditions of Southern European Russia” (Korchemkin, 2013). Thus, it seems that the rationale behind this Gazprom project can partly be explained by “the maximization of profits of pipeline contractors and intermediaries” (Korchemkin, 2012).

In summary, while planning investments related to the South Stream project in Hungary, Gazprom enjoyed extensive support from Russian state institutions, in particular from the Ministry of Energy and the Russian Embassy in Hungary. It is also possible that, while Gazprom’s business interests that drove its investments in Hungary coincided with the economic interests of the Russian state, this project was, to some extent, driven by the individual interests of the decision-makers.

### **5.3. Zarubezhneft’s acquisitions of oil capacities in the Republic of Srpska<sup>3</sup>, Bosnia-Herzegovina**

The smallest wholly state-owned oil company and the oldest Russian foreign economic enterprise (founded in 1967), Zarubezhneft has become one of the largest investors in Bosnia-Herzegovina. By using credit from the Russian VneshTorgBank (literally, the Bank of Foreign Trade), Zarubezhneft’s affiliate in the Republic of Srpska, NeftgazInkor, provides an important example in the analysis of Russian state-TNC cooperation. According to a former Zarubezhneft official, the main motive for investment in oil capacities in Bosnia-Herzegovina was the company’s easier access to customers in the EU markets.

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<sup>3</sup> Bosnia-Herzegovina emerged in its current form in 1995, based on the Dayton Peace Accord. Since then Bosnia-Herzegovina has been divided into two entities: Bosnia-Herzegovina Federation composed of Bosniak and Croat ethnic counties; and the Serb entity Republic of Srpska, with its own government and local governing bodies.



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Bosnia-Herzegovina is geographically close to the EU and as a potential EU member it has more favourable conditions for trade with the EU than Russia. Our main goal is to gain access to the EU markets not only for crude oil but for refined oil products. However, we are too small a company to invest directly in the EU as the competition there is much greater than in Bosnia (former Zarubezhneft official, personal conversation, October 15th 2011).

This comment explains Zarubezhneft's choice to locate its Bosnian office as close to the Western European markets as possible. As a result, NeftegazInKor was established in Banja Luka (located only 30 kilometres from the Bosnian-Croatian border) in 2007 (when Croatia's prospects for EU membership were already confirmed). Largely destroyed during the Bosnian war and out of use since 1992, the Oil Refinery Bosanski Brod became NeftegazInKor's first purchased capacity. The purchase of Refinery for Oil Derivatives in Modrica followed soon after. The responses from both a Zarubezhneft representative and their hosts in Bosnia-Herzegovina indicate that the conditions of purchase were favourable for both contractors. On the one hand, Zarubezhneft's investments had a positive effect on Bosnia-Herzegovina's economy: during 2007–2011, the sale of assets to Zarubezhneft raised €120 million. As a result, the credit rating of the country increased for the first time in the post-war period. On the other hand, the Zarubezhneft representative recognizes Bosnia-Herzegovina's advantages as an FDI destination:

The investment climate in the Republic of Srpska is quite favourable: we pay only property tax to the local government, which is only 0,03% of the revenues. ... The labour force is also cheaper than in neighbouring countries (former Zarubezhneft official, personal conversation, October 15th 2011).

The management of the refineries in the Republic of Srpska and the entity's government tried to find an investor for the deteriorating oil capacities by using all possible networks around the world. Finally, in 2005 the representatives of the former-Yugoslav business diaspora in the Russian Federation succeeded in attracting the attention of state-owned Zarubezhneft. Negotiations lasted until the end of 2007 when the first official contracts were signed in Moscow. These contracts were

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an official guarantee that Zarubezhneft henceforth had all rights on decision-making regarding Bosnian oil capacities.

After receiving these guarantees, the company's top management decided to apply for state credit to conduct the acquisition. According to the former Zarubezhneft official, this application resulted in uneasy negotiations in the Kremlin and even in disputes between various Kremlin factions and their members in the ministries over the next two years. Resistance to Zarubezhneft's application came from the politicians considered to represent the Kremlin's liberal wing.

In spite of the widely shared view in the Ministry of Energy that this acquisition could be useful for the state's oil sector, there was strong resistance to providing the credit on the part of the Ministry of Finance, and Minister Alexei Kudrin in particular, who was responsible for the state budget. The former Minister of Economic Development, German Gref, supported Kudrin. In their view, Bosnian and other Western Balkan markets were too small and too poor to be attractive for Russian investment (former Zarubezhneft official, personal conversation, October 11th 2011).

According to the former Zarubezhneft official, the management of Zarubezhneft realized that the only way to receive credit for the planned acquisition in Bosnia-Herzegovina was to bypass the ministerial level. Personal networks in the Kremlin were the main means of lobbying for the credit. Some managers used personal friendships with some of the most influential decision-makers in VneshEkonomBank. Others used personal relations with representatives of the presidential administration and with President Putin himself. The final agreement was reached by the representatives of the presidential administration, VneshEkonomBank and the company when they recognized that they all had a mutual interest in the deal, whether that be commercial or as individuals. As a result of these two years of non-transparent negotiations and disputes among the factions, VneshEkonombank granted the credit to Zarubezhneft and the acquisition was finalized in 2009. An official explanation for the decision was again ascribed to Russian foreign policy interests in the Balkans.

After Zarubezhneft's intention to acquire the oil capacities in Bosnia became the top business story in both the Russian and Balkan media, it became a matter of pride and dignity for the

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state to finalize the project. We received the credit and finalized the acquisition in 2009 (former Zarubezhneft official, personal conversation, October 11th 2011).

For the local economy Zarubezhneft's investments were more than simply beneficial. According to a representative of the Republic of Srpska Chamber of Commerce, once Zarubezhneft re-activated the Brod refinery, former workers finally received their long-awaited salaries and in only two months 200 cars were bought in the town of Brod. "The small and medium enterprises for technical and cleaning services and restaurants appeared, and life came back to Brod" (representative of the Republic of Srpska Chamber of Commerce, personal interview, December 6th 2012).

In terms of the cooperation between the Russian state and Zarubezhneft, apart from using the above-mentioned informal personal contacts to gain financial support directly from the Russian state budget, Zarubezhneft's cooperation with Russian state institutions in Bosnia-Herzegovina has been limited to official formalities unrelated to investment.

There are about 100 Russian citizens in Banja Luka, which represents a kind of Russian business community. When there were elections, we organized a polling station in Banja Luka for them (Russian Embassy official in Bosnia-Herzegovina, personal interview, December 2nd 2012).

Since conducting this major acquisition in Bosnia-Herzegovina, Zarubezhneft has needed the state's support only once, when the company experienced certain problems with the importation of its oil through the territory of neighbouring Croatia. According to an economic expert in the Fourth European Department of the Russian Ministry of Foreign Affairs, officials at the Russian Embassy in Bosnia immediately contacted their colleagues at the Russian Embassy in Croatia for support.

The price for the importation of Zarubezhneft's oil was considerably higher than that for the Croatian company INA. In turn, the Russian Embassy in Croatia contacted the Croatian government and negotiated a lower price for oil importation for Zarubezhneft (Economic expert in the Fourth European

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Department of the Russian MFA, personal interview, July 20th 2011).

Overall, in the case of Zarubezhneft's investment in Bosnia-Herzegovina, the initiative came from the host country's diaspora in the Russian Federation. This initiative triggered negotiations between Zarubezhneft and Russian state institutions. In its initial phase, state-TNC cooperation consisted of informal personal contacts between Zarubezhneft's management and very high-ranking Russian state officials, where the business and individual commercial interests were drivers for the particular investment transactions. Abroad, Zarubezhneft initiated cooperation with Russian state institutions regarding its investment activities only when it experienced difficulties with the importation of its oil through Croatian territory, while within Bosnia-Herzegovina the company's contacts with the Russian Embassy have been limited to official formalities unrelated to Zarubezhneft's investment activities. To summarize, the case of Zarubezhneft's investments in Bosnia-Herzegovina demonstrates first that the initiative for OFDI can come from the host country. Second, it shows that what constitutes economic interests of the state is sometimes disputed among factions within Russia's political elite.

## **6. What are the drivers for OFDI by these three Russian state-owned energy companies?**

While all three companies analysed above declare to various extents that the state interests are a priority in their official missions and strategies (Gazprom in its advertisements, and Rosatom and Zarubezhneft in their missions and strategies), the analysis of the processes of their investments abroad shows that drivers of their OFDI are much more diverse and complex. The motive of Atomstroyexport for its acquisition of Nukem Technologies was relatively close to its declared mission "to maintain national interests in defence, nuclear safety and nuclear power". Nevertheless, any possible long-term benefits for the Russian Federation are coincidental rather than Atomstroyexport's main intentions, as the process of the acquisition indicates. The negotiation regarding the acquisition as well as the forms and mechanisms of cooperation with Russian state institutions and other commercial state-owned institutions reflect the dominance of the company's business interests.

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The case of Gazprom's planned investment in the Hungarian section of the South Stream project suggests that the size of the company matters when Russian state support is in question. As the largest Russian company, Gazprom enjoys state support in all stages of its foreign investment projects. While the company's declared goals are mainly commercial, its importance for the Russian economy is very significant, creating a situation in which the state interests coincide with Gazprom's business interests. However, the South Stream project in its later stages no longer seemed commercially beneficial for Gazprom; rather the beneficiaries would have been – in Mikhail Korchemkin's words – the contractors and intermediaries, i.e. the individuals who control the company or the powers of the state.

Similarly, Zarubezhneft's OFDI in Bosnia-Herzegovina was driven by the company's business interests, while the personal network of its top managers was a decisive factor in receiving financial support from the Russian state. Both the business interests and the individual interests resulted in cooperation between Zarubezhneft and state institutions being of an informal nature. Moreover, despite the fact that the Russian Foreign Policy Concept declared that there was a state obligation to support Russian companies in their investment activities abroad, smaller Russian companies cannot always count on this support even if it is wholly owned by the state. Thus, the extent and pattern of the state's support to Zarubezhneft's acquisitions in Bosnia-Herzegovina confirms that the size of the company matters when it comes to Russian state support. A summary of these findings is presented in Table 3.

### **6.1. Possible explanatory factors**

So far, the analysis has shown that there is no single Russian government strategy vis-à-vis OFDI by state-owned energy companies. At the same time, the differences in the three cases of OFDI by Russian state-owned energy companies with regard to conformity between Russian state interests, the declared missions and strategies of the companies, and state-TNC cooperation can best be explained by the differences between the three host countries and the characteristics of their markets. The destination for Rosatom's foreign expansion, Germany, is the largest European economy and an established member of the European Union (EU). Thus, Germany represents one of the

most attractive markets for foreign investors in general and for Russian energy companies in particular for three major reasons: the first is the size of the German market (about eighty million people); the second reason is the high market sophistication, with GDP per capita of about \$39,100 in 2012 against Russia's GDP per capita of \$17,700 in the same year (indexmundi.com, 2013); and lastly, there are strict regulations of FDI, which provide low political and economic risks.

**Table 3. Conformity between Russian state-owned energy companies' declared and demonstrated interests for international expansion**  
(based on the state-TNC cooperation)

Company	Conformity between declared and demonstrated interests for outward foreign direct investment (OFDI)		Driving interests for OFDI
	State/national interests	Business interests	Individual profit-seeking interests
Rosatom-Atomstroyexport	Potential (long-term) conformity	Conformity	Not declared in the company's official policy; not found in case study; there is conformity between declared and demonstrated interests for OFDI
Gazprom	Potential (long-term) conformity	Conformity	Not declared in the company's official policy; found in case study; there is non-conformity between declared and demonstrated interests for OFDI
Zarubezhneft	Conforms with regional state interests, and contradicts economic ones	Conformity	Not declared in the company's official policy; not found in case study; there is conformity between declared and demonstrated interests for OFDI

In contrast, Hungary is considered part of the Central and Eastern Europe (both for historical and geographical reasons). It represents a less significant market to Russian energy companies for three reasons: first, the Hungarian market is relatively small in size (about ten million people); second, it has a medium level of GDP per capita at \$19,800 GDP in 2012 (accounting for less than one percent of total EU GDP); and third, its regulations of FDI are less rigorously enforced with limited political and economic risks. The latter is, as Bohle and Greskovits (2012) point out, due to attempts to attract TNCs by adopting generous incentive packages, creating investment promotion agencies, and

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launching expensive infrastructure development programs” while keeping in place “relatively generous systems of social protection”, which resulted in “contested and ineffective institutions of macroeconomic coordination” (Bohle and Greskovits, 2012, p.138).

In contrast to both these countries, Bosnia-Herzegovina is a small non-EU member state (of approximately only three million people) with the GDP per capita of only \$8,300 in 2012. There are also lax FDI regulations resulting in high political and economic risks. Nevertheless, the near absence of competition by other foreign investors has attracted a limited number of Russian companies to invest in Bosnia-Herzegovina.

These differences between these three countries are also reflected in the Russian Foreign Policy Concept. For instance, according to the Russian Foreign Policy Concept 2013, Russia’s foreign policy interests also include a geographical dimension in which relations with the EU are second only to the Commonwealth of Independent States on the list of regional priorities. However, while most of the older EU countries are specifically named in the Concept as states of high economic and political importance to the Russian Federation (namely, Germany, Italy, the United Kingdom, France, and the Netherlands), the newer EU member states of in the Central and East Europe are merely mentioned under the title “other European states” and are important only in the sense that they provide a buffer with Western Europe. “Southeast Europe” and in particular the Balkan states are depicted as a region of a “great strategic importance to Russia” (2013), but no mention is made of their economic importance.

The three examples of OFDI by Russian state-owned energy companies analysed in this paper reflect to varying extents this dimension of the state interests abroad. In Atomstroyexport’s acquisition of Nukem Technologies, business interests coincide with Russia’s state interests in terms of security. It also coincides with the state interests from a geographical point of view: the Russian Foreign Policy Concept names the EU as its second regional priority and Germany as the most important partner in the EU. At the same time, it is clear that for the South Stream project Hungary was important as a transit route rather than as a target market. Thus, Gazprom’s investment in the South Stream section in Hungary shows that the country was

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more important to Gazprom's business considerations than to Russia's state interests. Finally, while Bosnia-Herzegovina has no particular economic importance for Russia's state interests abroad, it is located in a region of a "great strategic importance to Russia" as stated in the Russian Foreign Policy Concept 2013. In that sense, the process of negotiations and cooperation between Zarubezhneft and Russian state institutions regarding the company's acquisitions in Republic of Srpska, Bosnia-Herzegovina, reveals certain inconsistency between Russia's geostrategic and economic state/national interests. Zarubezhneft's acquisitions to some extent comprise some geostrategic Russian state/national interests, but not necessary its economic interests. Nevertheless, the analysis above shows that conformity between Zarubezhneft's acquisition and Russian geopolitical state interests is largely unintentional.

Overall, the analysis of the OFDI processes and cooperation between Russian state institutions and state-owned energy companies in the three instances of OFDI discussed above implies that the most typical relationships between the four types of actors and their interests in OFDI by Russian state-owned energy companies can be summarized as follows. Both managers and politicians pursuing their individual interests usually portray them as the interests of collective actors, either as the business interests of the Russian state-owned energy companies or the state/national interests. At the same time, Russian state-owned energy companies also often purport their business interests as being Russian state/national interests. Thus, the business interests of Russian state-owned energy companies and the individual profit-seeking interests of the managers and of some Russian politicians are often interrelated, and all are usually presented as being state interests.

## **7. Conclusions**

By reconstructing the processes of OFDI by Russian state-owned energy companies through the analysis of Russian state-TNC cooperation in three examples of OFDI by Russian state-owned energy companies in Germany, Hungary and Bosnia-Herzegovina, this paper demonstrates that the motives for OFDI by Russian state-owned energy TNCs is a much more nuanced phenomenon than the existing literature would imply. Moreover, the analysis presented in this paper provides



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four more general conclusions about the motives that drive OFDI by Russian state-owned energy companies. First, the three analysed cases show that the motives of Russian state-owned energy companies vary depending on the location. In developed countries – represented here by Atomstroyexport's investment in Germany – they expand to gain access to markets and new technologies. In less developed countries, such as Zarubezhneft's acquisitions in Bosnia-Herzegovina, they attempt to take advantage of relatively cheap labour and the absence of other foreign investors. This finding confirms the claim by Alexei Kuznetsov (2007) that Russian energy companies' motives for OFDI do not differ from those of multinationals from developed countries. At the same time, this finding contradicts Peeter Vahtra and Kari Liuhto's claim (2004) that OFDI decisions of Russian energy companies are based on political goals rather than on a business rationale.

Second, this paper reveals that Russian state-TNC cooperation in these three instances of OFDI by Russian state-owned energy companies was always initiated by the companies. This finding implies that the primary drivers for OFDI by Russian state-owned energy companies are business interests. More specifically, the cases analysed in this paper suggest that Russian state-owned energy companies act predominantly according to their business interests rather than official Russian foreign policy, which reflects broader state interests. Therefore, the findings of the present paper supports Olga Oliker et al. (2009), who point out that most large Russian energy TNCs act in their own business interests, which do not necessarily coincide with Russian national interests.

Third, this paper reveals that the motives for OFDI by Russian state-owned energy companies also depend on the host countries. As the analysis of Zarubezhneft's acquisition of the oil capacities in Bosnia-Herzegovina indicates, the main trigger for this investment was the initiative by the Bosnian diaspora in the Russian Federation. The other two cases of Russian investments discussed in this paper also confirm this finding.

The fourth conclusion is that the motives for OFDI by Russian state-owned energy companies are case specific. As the case of Zarubezhneft's OFDI in Bosnia-Herzegovina demonstrates, Russian politicians and the top managers of the state-owned TNCs can act as individuals, and instead of following national interests and business

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motives, they pursue their individual interests. Each of these four types of actors' interests can be combined with those of the other three types of actors. In all three cases, business interests were evident. In the cases of Gazprom and Zarubezhneft, business interests were also combined with individual interests. Andreas Wenger (2009) confirms this view by pointing out that "while the state has attempted to formulate a long-term energy strategy, its energy politics remain dominated by short-term personal gains and by the interests of competing elites, rather than by the long-term interests of the Russian people" (p.228). Finally, this paper demonstrates that in OFDI by Russian state-owned energy companies, Russian state interests may well be fulfilled in the long run, but largely as an unintentional outcome.

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