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TNK-BP is a joint venture company owned by British Petroleum, more commonly known as BP, and the Alfa, Access/Renova group, more commonly known as AAR. Both BP and AAR each own 50% of TNK-BP. TNK-BP was created in 2003 after a merger between BP and TNK that settled the dispute between the two companies over Sidanco and its subsidiary Chernogorneft's ownership that had been on-going for years. The partnership combined BP's knowledge, equipment, and experience; and Russia's new supply of oil fields. The business relationship that seemed to begin as a win-win for both parties has seen its share of issues over the years. Being a profitable business has not seemed to be a problem that TNK-BP has faced. From 2002- 2011 they have shown revenue growth year after year. In 2002 they showed sales revenues of \$9.2 billion, and have grown this number every year to \$54.9 billion in 2011. They have also shown a positive net income every year ranging from \$1.5 billion in 2002 to \$9.2 billion in 2011 (Annual Report, 2011).

Symptoms

The first issue arose in the very beginning of the merger in June 2003, Robert Dudley, TNK-BP CEO said, "With all due respect for BP, it had a fairly vague idea about what was going on in Russia" (Moffett, 2011). BP as a company was very interested in the huge amounts of oil that were in Russia, but they did not do a very good job of understanding the political or economic climate of Russia at the time. The long line of disagreements in the joint venture began in June 2003 as well when AAR informed BP that they had issues with the bonuses and entitlement for expatriates. In 2004, AAR wanted payments for their fraction of the company to be made sooner. In May 2008 the three

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oligarchs of AAR met with Tony Hayward, then CEO of BP, and insisted that Robert Dudley be removed as CEO of TNK- BP because he was showing favor to the BP side of the joint venture over the Russians, and the disputes would continue to this day. BP and AAR would also have disagreements about expanding TNK-BP operations outside of Russia and Siberia because of the direct competition it would place against BP. During all of these disputes between AAR and BP, TNK-BP was also running into governmental issues in Russia. In April of 2005, TNK-BP was hit with a \$1 billion tax bill from the Russian government that related to earnings from 2001.

Later that year, the Russian government not only canceled auctions on three major oil fields, but also declared that companies that were more than 50% owned by non-Russians would not be allowed to participate in the upcoming auctions the following year for new fields. In 2006, a licensing dispute began over the Kovykta gas field in Siberia that forced TNK-BP to keep the oil development there strictly for Russia in fear of the license being revoked. After angering Vladimir Putin, who was serving as the Russian President at the time, TNK-BP eventually sold its stake in the Kovykta gas field to Gazprom. In 2008, TNK-BP offices were raided by Russian officials and an employee was detained on charges of espionage. That same year BP faced issues when trying to renew visas for expatriate employees getting only about half of the needed visas approved by the Russian government.

Problems Statements and Analysis All of these issues lead to three main problems that TNK-BP faced. The first problem is that BP was not prepared to deal with the cultural and political differences that come with conducting

business in Russia. The second problem is that there is no controlling party in the joint venture.

The third problem is that TNK-BP is constantly the recipient of seemingly targeted, unfair treatment by the Russian government. As previously stated, BP was not prepared to deal with the cultural and political differences of conducting business in Russia. They had previously purchased an oil company in Russia that had grossly overstated its worth, the contracts were fuzzy, and there was much confusion over what BP actually owned. BP however, wanted to stay in Russia because of the oil that was there so they seemed to just take the cards that they were dealt and attempt to make something out of it. Russia was a communist country known as the USSR until the fall of the Berlin Wall in 1989. A communist government holds all businesses as a public entity: the government controls business. Although Russia is no longer a communist government, they have not completely evolved into a democratic republic either. They are still in transition and somewhere in between the two, and so are the people and its culture.

The culture of Russia during communism was clouded with fear and government control. One does not simply wake-up the day after the fall of communism and become no longer afraid and free. Change takes time, especially cultural and political changes. A joint venture is a strategic alliance between two or more organizations that establishes a legally autonomous organization in order to share resources and capabilities to compete in tentative markets. The joint venture between AAR and BP brought together AAR's resources of oil and contracts and BP's capabilities of tacit knowledge of the business. This would seem to be a match made in <https://assignbuster.com/business-case-analysis-of-tnk-bp-essay-sample/>

business heaven. However it became more of a match made for divorce court. Constant disputes and arguing have plagued this 50/50 joint venture from the beginning. TNK-BP was created to settle the dispute over contracts involving the control of Sidanco and its subsidiary Chernogorneft. The formation of TNK-BP created the third largest oil company in Russia. TNK-BP would be comprised of BP's Russian assets including a retail network in Moscow and its stakes in Sidanco.

This joint venture also required BP to pay AAR \$3 billion in cash in the beginning and three subsequent annual payments of \$1.25 billion in shares of BP. Regarding this deal a BP executive stated, "Of course, we had qualms, given the history. But sometimes you don't get the chance to choose your partners. It was the only deal available" (Moffett, 2011). It would appear that BP was willing to pay significantly for this deal, and in return BP was getting access to the one resource it needed, oil. TNK-BP is a 50/50 joint venture, meaning that no one party has control or the ability to force the other party into making a decision. This is all well and good on paper however, when you consider that AAR was bringing the access to the oil fields, and that AAR was conducting business on their home field, BP has had to constantly compromise to keep the Russians happy. Basically AAR has received a lot of cash and knowledge out of the deal, and they have maneuvered BP into compromising to keep the peace. AAR has been conducting business like they have a controlling share in the business. AAR would not have been able to control BP the way that it has if it were not for the Russian government being on their side.

The Russians in charge of the government, namely Vladimir Putin, are used to the communist mentality where it is acceptable for the government to just do what it wants. Vladimir Putin is former KGB and has been either the President or Prime Minister of Russia since 1999. Also, the Russian government still owns Gazprom which is Russia's largest oil company and a direct competitor of TNK-BP. The Russian government has been a thorn in TNK-BP's side from the start. The deal that was created was done very quickly and there was speculation that this was to stay under the radar of the Russian government. Vladimir Putin himself stated that, " he had warned both sides that the 50-50 structure would be problematic" (Moffett, 2011). off on the right food with the governing powers of Russia. As a former communist country Russia does not look brightly on foreign investors inside of Russia. There are several regulations that limit the amount of foreign ownership in Russian companies to fifty percent or less.

The US Department of State's website states, " The Russian market presents many Needless to say, TNK-BP did not start promising investment opportunities. Capitalizing on those opportunities, however, requires that firms navigate a complicated and fluid set of challenges ranging from corruption to a weak judiciary to excessive red tape" (2012 Investment Climate Statement - Russia, 2012). TNK-BP has seen more than its fair share of these complications when it comes to dealing with the Russian government. Alternatives Identification and Evaluation TNK-BP is a profitable business but is having problems with conducting business in Russia, disputes between the powers-that-be, and unfair treatment from the government of Russia. There are three alternatives that TNK-BP could take to resolve these

problems. First BP could sell its half of TNK-BP to anyone else. Second AAR could sell its portion to another Russian investor. Third BP could sell one percent to the business partner and give up decision making control, but still maintain access to the oil. The first alternative, BP selling its stake of TNK-BP, would remove BP from the situation all together.

The sale could be very profitable for BP as a company. This is an alternative that is taking place currently, and the current bidding price placed by AAR is around \$30 billion as of October 11, 2012 (Hulbert, 2012). While this number definitely covers the initial expenses that BP had getting into the Russian oil business it does not take into account the loss that BP will see in its overall operations from the As of 2008 TNK-BP accounted for twenty-five percent of BP's total production, twenty percent of BP's reserves, and ten percent of BP's net-income. The loss of the access to the oil fields in Russia will have a significant impact on BP's current and future supply of oil. The loss of this current and future supply without any prospect of for replacement will cause an increase in BP's costs and a possible increase in their prices; therefore reducing BP's long-term profits. The second alternative is for AAR to sell its stake of TNK-BP to another Russian investor. They would need to sell to a Russian investor due to the regulations regarding foreign ownership in Russia. The potential sale of AAR's portion of TNK-BP is also an alternative that is currently taking place.

Both AAR and BP are currently on the market and looking for a buyer. If the current price for BP's stake in the company is \$30 billion, then the value of AAR's fifty percent stake would be equal to this current bid as well. The argument can be made that since both parties are potentially looking for <https://assignbuster.com/business-case-analysis-of-tnk-bp-essay-sample/>

sellers and AAR has made the bid on BP, then AAR is stating what the value of TNK-BP is and they would be right. AAR selling its stake of the company for around \$30 billion would be a significant return from its initial investment. If AAR sells its stake it would be removing itself from the oil business all together and would not have to consider any future operational issues regarding oil supply. The sale of AAR's portion could be either good or bad for BP. They could end up with a partner that they can work with without the constant disputes, or they could end up with a partner that is worse. These are the risks you take when entering into any partnership. The third alternative is for BP to sell one percent to its business partner and give up decision making control, but still maintain access to the oil fields. Based on the current valuation from the bids BP could potentially sell one percent of its holdings in TNK-BP for nearly \$3 billion. Giving up decision making control could be a relief for BP.

With regards to the many disputes that they have had with AAR over the years, BP would eventually be maneuvered into giving in to AAR's request anyway, and the sale of this one percent would just be a formality that made it official. A term of the sale would require that BP would retain its access to the oil fields in Russia for current production and future reserves. The driving factor behind BP's desire to enter the Russian oil market was to gain access to the vast amounts of oil that are there. Without access to this oil, BP's future as a company could be in jeopardy. Course of Action The recommendation that I would make is for AAR to sell its stake of TNK-BP to another Russian investor, and for BP to sell one percent of its stake to the new partner as well. Both AAR and BP currently have their portion of TNK-BP

on the market and are looking to get out of the partnership. There is also currently a company that is showing quite a bit of interest, Rosneft. Rosneft is a Russian oil company that ranks amongst the world's leading publicly traded oil and gas companies. "The Company is primarily engaged in exploration and production of hydrocarbons, production of petroleum products and petrochemicals and marketing of outputs" (About Rosneft). Rosneft is also primarily owned by the Russian government.

AAR selling to Rosneft takes care of most of BP's problems in one simple stroke. Individual Case Analysis TNK-BP Rosneft-BP will first and foremost remove the hindrance that TNK-BP faced with regards to the Russian government, because they would now be in business with the Kremlin and Putin himself. I do not foresee Putin and the Russian government not allowing for bids on fields, government security raids, or large tax bills to be placed upon a business that it owns a stake in. There will no longer be any disputes with AAR because they will no longer be in the picture. However to avoid disputes with Rosneft, I would recommend that BP sell one percent of its stake to Rosneft as well. Since Rosneft is primarily government owned they will have the power in the 50/50 joint venture regardless of the joint venture structure. It would be in BP's best interest to obtain some cash out of the deal, while maintaining access to its current and future oil supply in Russia. Rosneft's purchase of AAR's portion could be a happy ending for both AAR and BP. AAR gets a very nice return on their investment and BP not only gets to maintain access to Russian oil, but will have the support of Putin and the Russian government behind them as well.