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RUSSIAN INVOLVEMENT IN FINNISH COMPANIES – THE ENERGY SECTOR IN FOCUS

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EXECUTIVE SUMMARY

As the statistical overview clearly pointed out, the involvement of Russian nationals in the net creation of joint-stock enterprises in Finland has experienced an upsurge since the collapse of the Soviet Union, a fact not requiring lengthy elaboration. Currently the number of such entities is around 1915. An interesting matter on the other hand is the share of Finnish companies with Russian involvement of the total annual net creation of enterprises. During the first years of the millennium the share has been fluctuating between 5 and 7 percentage points. The reader should again bare in mind the nature of the data; indicating the creation of legal entities and not necessarily functioning and value creating enterprises. More than half (50.2%) of the sample companies have been unable, or simply neglectful on the requirement to raise equity level to 8000 EUR minimum. This might indicate either lack of maintenance in the companies in question, or unsuccessful business operations. The year 2006 will show the real state of such entities, as the NBPR will start expunging the inactive companies at that time.

Of the sample companies 68.7% were engaged in providing services, while 27% generated revenue from marketing functions of various sort. Only 4% were active in mainly processing activities. Due to the lack clarity in the principal industry description in the data, many of the entities were difficult to categorize by industry. The ones with clear descriptions indicated the following to be the most prominent industries among Finnish companies with Russian involvement: timber, wood products 4.3%; machines, instruments 3.8%; construction 6.3%; transportation, warehousing, telecommunications 7%; financing, investments 4.8%; business services and consulting 6.6%. A closer look to the companies involved with the wholesale of fuel and oil products (the focus industry of the study), revealed the often inactive status of many companies. One rare exception was engaged in large scale business with subsidiaries in the Baltic States, Western-Europe and Cyprus. The most prominent energy sector companies were given more attention by the means of case studies.

Russian involvement in Finnish companies has traditionally been most active in the energy sector. The Finnish natural gas sector is dominated by the Russian supplies and the world's largest gas producer, Gazprom, holds an ownership interest in Finnish natural gas distributor, Gasum. The equity involvement is considered viable for the efficient co-operation between the partners, adding to the Russian strategic interests in Finnish natural gas sector and, thus, the supply predictability. Our evaluation based on economic rationale, the new Fortum Oil company incorporating the oil operations of the Finnish energy concern Fortum Oyj in April 2005, would benefit from the involvement of a strategic Russian investor. Increased predictability of oil supplies to the supposed venture and the benefits derived from the potentially extensive international network of the investor would add to the value of Fortum's operations.

1 INTRODUCTION

The continuing positive economic development in the Russian Federation implicates the strengthening of economic ties and relations with the western markets. Improving revenues encourage the Russian companies to seek opportunities also outside the home country, even though the home arena cannot be described as a one of lacking business and investment opportunities for the dynamic enterprises endowed with cash. Both sides of the conceptual classification of economic relations are relevant as we analyze the current phenomenon, namely foreign trade and foreign direct investment (FDI). The aspects are undisputedly connected to each other, in a successive or complementary manner. The Russian companies are active in both, and importantly, with more elaborate operation methods both in trade and investments.

The phenomenon under our focus is the Russian outward foreign direct investment in Finland. There has been extensive media attention towards the Russian involvement in the Finnish markets, and some scholars have forecasted the continuing strengthening process of our economic relations. For example Liuhto (TS 2.10.2004) considers Russia to be the most important trading partner for Finland already in the year 2005. To complement the picture, we consider it worthwhile to contribute to the discussion with an academic study on the Russian companies' operations in Finland.

Furthermore, there have been interesting corporate developments especially in the Finnish energy sector. The role of Russian electricity in the energy supply has been discussed, with the notion of its role gaining too much significance (TE 35/2004). From the Russian side the trend has been supported by investments on infrastructure. Additionally the incorporation of Fortum Oyj's oil business raised heated political debate, sometimes on an unfortunate populist note. Indeed the speculations have been abundant on the fate of the 15% of company shares promised for the initial public offering, which is also available for the possible strategic investor. The fact that the Russians have a natural interest towards the Finnish energy sector and oil business, opens avenues for discussion on the more salient involvement of for example Russian oil majors in the developing energy scene. We also attempt to contribute to that specific area of discussion with a constructive and academic line of thought.

The report is structured as follows. At first we elaborate on the overall state of the Finnish-Russian economic relations, with glimpses on the trade and FDI issues. Secondly, we provide results from a statistical review of Finnish joint-stock companies with Russian involvement. The time wise creation of such entities, and the industries involved, are some of the things we look at. Thirdly we provide a closer look at the prominent players with Russian involvement in the Finnish energy sector. Lastly we contribute to the discussion on Fortum Oil and Russian capital, with a viewpoint based on a theoretical framework.

2 RUSSIAN INVESTMENTS AND COMPANIES IN FINLAND

This Chapter provides the reader with a macro-economic overview of trade and investment patterns between Finland and Russia. The emphasis is understandably on the Russian investments in Finland. We provide a statistical overview on the companies in Finland controlled or owned by Russian investors and managers.

2.1 Finnish-Russian Trade and Investments – Recent Trends

Russia's importance as a Finland's trade partner has grown steadily during the past few years. Most recent estimates place Russia at the first rank among the Finland's trade partners during the next couple of years. In the first half of 2004, Russia nearly climbed to the par with the Finland's traditionally most important trade partners, Germany and Sweden (see Table 1). For Finland, Russia is currently by far the fastest-growing export region; the growth of Finnish exports to Russia was 22%, when, simultaneously, the overall growth of Finnish exports remained at a modest rate of 1%. The latest figures from July 2004 suggest Russia was already the largest importer to Finland, due to the record-high value of oil imports. Also in exports, Russia advanced to the second position, only marginally behind Germany.

Table 1 **Finland's Largest Trade Partners,** *Jan-Jun 2004*

Country	**Value,** *€ mn*	**Share of total,** *%*	**Change y-o-y,** *%*
Exports			
Sweden	2 639	11.4	+ 11.1
Germany	2 526	10.9	- 9.7
Russia	1 869	8.1	+ 22.2
Imports			
Germany	2 700	14.3	- 0.3
Russia	2 585	13.7	+ 12.4
Sweden	2 143	11.4	+ 3.8

Source: National Board of Customs, Finland 2004, Finpro 2004.

The most important Finnish export articles to Russia include phone and radio appliances, the exports of which grew by impressive 44.6% in the first half of 2004, compared to the previous year. The strongest growth of 248.1% was, however, witnessed in the automobile exports through Finland to Russia. Finnish imports from Russia remain dominated by the natural resources. The imports of energy-related products from Russia account for two thirds of Finnish total imports from the country (see Table 2).

Table 2 The Most Important Export and Import Articles in Finnish-Russian Trade

Article	**Value,** *€ mn*	**Share of total,** *%*	**Change y-o-y,** *%*
Exports, *Jan-Jun 2004*			
Phone, radio appl.	422.2	22.6	+44.3
Other electronic devices	153.4	8.2	+21.6
Vehicles	145.3	7.8	+248.1
Imports, *Jan-Nov 2003*			
Crude oil and oil products	1 672	41.7	+19.0
Natural gas	483	12.0	+24.0
Wood	446	11.1	+5.0

Source: National Board of Customs, Finland 2004, Finpro 2004.

Of particular interest in the current study are the Russian energy exports to Finland, which have nothing but decreased during the recent years. The energy imports from Russia have shown impressive growth, and the country accounted for two thirds of Finnish oil imports already in the end of 2003. Along with the high-profile updating of the Fortum oil refinery in Finland, exclusively designed to process the high-sulphur Russian crude, the strategic dependence on Russian oil becomes even more highlighted.

Russia remains the only natural gas supplier to Finland, and through its 25% ownership in Finnish gas distributor, Gasum, Russian Gazprom retains strategic interests in the country. The year 2003 also saw almost 50%-increase in electricity imports from Russia, amounting to impressive € 250 million. Russian electricity monopoly, RAO UES, carries out the electricity sales in Scandinavia through its fully-owned Finnish subsidiary, RAO Nordic.

The overview of the Finnish-Russian trade structure thus suggests foremost the high dependence of Finland on the Russian markets, both in exports and imports. The dependency on Russian primary energy supplies is indisputable, along with the rapidly growing importance of Russia as a target market for Finnish technology-intensive exports. It is further to be noted, that whereas Russia accounts for well over 10% of Finnish foreign trade, the corresponding share of Finland in Russian foreign trade structure remains around 3%. However, Finland’s share in Russia’s total trade has grown notably during the past years and is expected to increase further due to mutual strategic interests and dependencies in several sectors of economy.

Despite the growing trade volumes between the countries, the investment flows between Finland and Russia have remained comparatively modest. The Bank of Finland (2003) suggests that Russia's FDI stock in Finland was € 307 million at the end of 2002. With this figure the Russian firms possess mere 1% of Finland's inward FDI stock.

Table 3 **Recent Development of the Russian FDI Stock in Finland**

	1998	1999	2000	2001	2002
Russia's FDI Stock in Finland, *€ mln*	272	241	240	306	307
Russia's Share of Finland's Inward FDI Stock, %	2	1	1	1	1
EU's Share of Finland's Inward FDI Stock, %	77	84	87	90	91

Source: Bank of Finland (2003).

The current study includes several case studies on the largest Russian investments in Finland The case companies selected rank among the 500 largest corporations in the country. All of them operate in the energy sector and thus largely mirror the overall patterns of internationalisation of the Russian companies, driven by the country's energy majors. The Russian gas giant, Gazprom holds a 25%-stake in Gasum and a half of North Transgas. Correspondingly, Nafta Moskva owns Teboil and Suomen Petrooli. These sister companies were already operating in Finland during the Soviet era. Their combined turnover was € 1.5 billion in 2003, ensuring the companies a combined 20%-share of Finland's petroleum retail market (see Table 5).

Table 4 **The Companies with Russian Ownership among the 500 Largest Corporations in Finland** *(by annual turnover)*

Company	**Sector**	**Turnover**, *€ mn*	**Rank among the companies in Finland**
Teboil	Oil trade	1082	49
Gasum	Energy	653	71
Suomen Petrooli	Oil trade	458	93
RAO Nordic	Energy	83	379

Source: Talouselämä 500 (2004).

2.2 Russian involvement in the Finnish joint-stock companies – statistical overview

The following section will provide a statistical view on the involvement of Russian capital in the Finnish enterprises. The analysis is based on the data provided by the National Board of Patents and Registration (NBPR) in Finland, which maintains records on the companies, foundations, and legal bodies of various sort. Our focus is on the certain type of legal entity, namely the joint-stock company, and essentially on the time-wise creation of such entities with Russian involvement. The involvement being a relatively broad concept, some specifications must be provided. Russian involvement is in this case operationalised by the following simple rule: if a Russian national is registered to be among the board members (chairman of the board, member of the board, deputy member of the board), higher management (chief executive officer, executive vice president), or is the holder of procuration, the joint-stock company is included in the sample of Finnish joint-stock companies with Russian involvement. The relationship of invested capital and the right to be involved in the higher levels of management is assumed to have some causality, thus we suggest that our population of companies is also an indication of Russian capital in Finland. The exact amount of it cannot be analysed with the available data.

The NBPR provided the records as a text file, which induced the authors to code the data to a form which would facilitate the sought after statistical analysis. SPSS was chosen for the task due to its rigorous data handling abilities. Eight variables were chosen to represent the data (Table 5).

Table 5 Employed variables in the statistical analysis

Variable	Label	Type	Values
name	company name	string	..
est	year of establishment	numeric	..
equity	shareholders' equity	numeric	..
industry1	broad categorization of industry	string	primary production, processing, marketing, service
industry2	narrow categorization of industry	string	agriculture, forestry; fishing; mining; mining of energy minerals; mining of other minerals; food, drink, tobacco; textiles; leather products, timber, wood products; pulp, paper, paper products, printing; coke, nuclear fuel; chemicals, synthetic fibers; rubber, plastic products; non-metal mineral products; metals, fabricates; machines, instruments; electronics, appliances; vehicles; electricity, gas, water supply; construction; consumer products; lodging, catering; transportation, warehousing, telecommunication; financing, investments; real estate, rentals; education, research; health and social services; business services and consulting; IT; tourism; oil and oil products; miscellaneous
russian	highest position of the Russian national in the company	string	member of the board of directors, chairman of the board, member of the board, deputy member of the board, executive officer, executive vice president, holder of procuration

Most of the variables and their meanings are self-evident, but some may be in need of brief elaboration. *Industry1* is meant to give a very broad view on the nature of activities by the sample firms, i.e. what kind of position the hold in the value adding chain of activities. The *industry2* variable is meant to focus the industry categorization further, while the combination of the industry variables reveals the whole picture. Some firm might for example be involved in the *processing* of *timber*, *wood products*, while another might be engaged in the *marketing* (e.g. export, import, sales, distribution) of the same.

At this point it must be said that due to the vague nature of industry information on the data provided by the NBPR, the company's principal industry was sometimes next to impossible to determine. Many of the descriptions on the companies' activities involved every possible business and activity in "land, sea, or air". Consequently in many cases the industry variables were simply given values such as *service / miscellaneous* or *marketing / miscellaneous*. These cases amounted to 43,9% of the sample companies.

2.2.1 Russian involvement in Finnish joint-stock companies during 1932-2004

The NBPR database provides an interesting time series based view on the involvement of the Russian capital in Finland. It must of course be remembered that the picture provided includes those companies that have been entered to the registry of NBPR, and have never been invalidated, i.e. the net increase in new enterprises. Until recently the NBPR has not actively pursued to remove inactive companies from the registry, but starting in 2006 the process will be initiated to remove entities from the registry that fail to comply the compulsory notification defined in the Limited-liability Companies Act 13:4 § section 4. The removal will concern some 50 000 Finnish companies with (1) equity less than the required 8000 EUR, and (2) no activity (according to the Tax Administration).

Our data starts from year 1932, with Suomen Petrooli. Teboil Oy follows two years later. Until the late eighties and the nineties, the annual amount of company registrations with Russian capital is fairly low, in the range of 0-9. The reasons are obvious: strained relationships, war, and socialist command economy. The upsurge in annual net registrations started in 1989 (Figure 1).

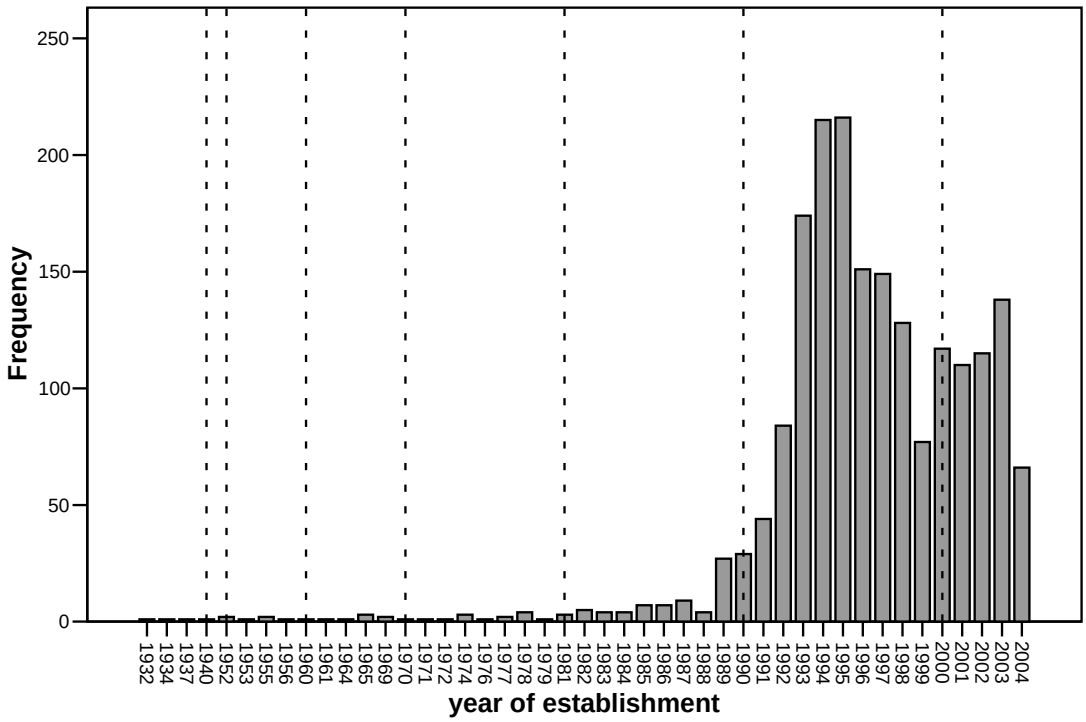

Figure 1 Net registrations of joint-stock companies with Russian involvement

The decades are indicated with dash lines in order to facilitate the perception of the significance of different decades in the phenomenon. The 1940s are obviously quite insignificant, while the registrations per decade seem to increase all the way to the nineties (see the widening gap between decade markers). During the period of 1932-2004 (July), 1915 joint stock companies were registered in Finland that pass the sample decision rule presented previously. The majority of them (1784) were registered after the year 1991, which can be considered the year of collapse of the Soviet Union. Visual analysis of the growth rates in annual registrations result in the perception of almost exponential growth during the beginning of the 1990s, the peak years being the 1994 (215) and 1995 (216). Since then the amount has almost depleted. Since the beginning of the new millennium the numbers of annual registrations have been as follows (Table 6).

Table 6 Net creation of new companies in Finland and the share of Russian involvement

	2000	**2001**	**2002**	**2003**
Total	2249	1517	1637	2440
With Russian involvement	117	110	115	138
% of total	5.2	7.3	7.0	5.7

Source: Tilastokeskus, own calculations

The figures on the last row can be considered quite high, with the indication of significant numbers of new enterprise creation from the side of Russian nationals. We must of course bear in mind the nature of our data, which is the formation of legal entities and not of actual enterprise activity. Later chapters will elaborate on some active companies with Russian involvement.

2.2.2 Equity levels in companies with Russian involvement

As was touched upon previously, the NBPR planned to discard companies with equity less than 8000 euros during 2004-2005. The deadline for the capital increase in equity was due in 31 August 2004, but according to the Ministry of Justice the reform will come to effect in the beginning of 2006 at the earliest. The used data shows the situation of companies' equity levels at the time of data extraction (July 2004). It seems that the slight majority (50.2%) of the sample companies still seem to have equity levels below the required 8000 EUR (Figure 2).

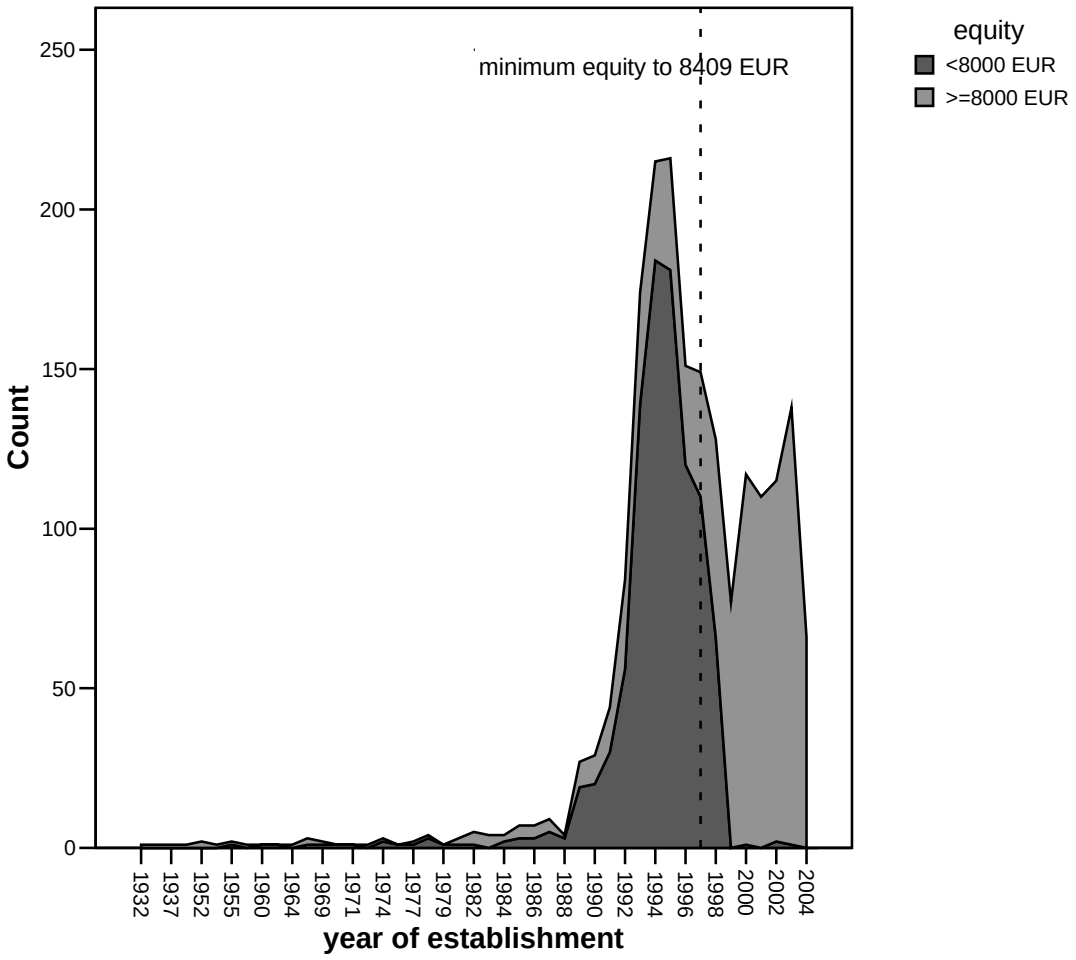

Figure 2 **Years of establishment and the current level of equity**

There is a shallow portion of before 1997 established companies that have managed to raise their equity capital above 8000 EUR. The year 1997 is indicated with a dashed line to mark the year of reform concerning the joint-stock company minimum equity. At that time the minimum was set to 50 000 FIM (8409 EUR), and later to 8000 EUR. Many of the sample companies (962) have failed to raise their equity to the required level. The fact possibly indicates passive, inactive, or withering status of the companies in question. On the other hand many other Finnish companies have also failed to raise enough equity, thus the delay in reform implementation.

As elaborated on previously the number of firms with low level of equity is quite significant. On the other hand the sample firms include also firms with large amount of equity. Figure 3 depicts the structure of sample firms in terms of equity.

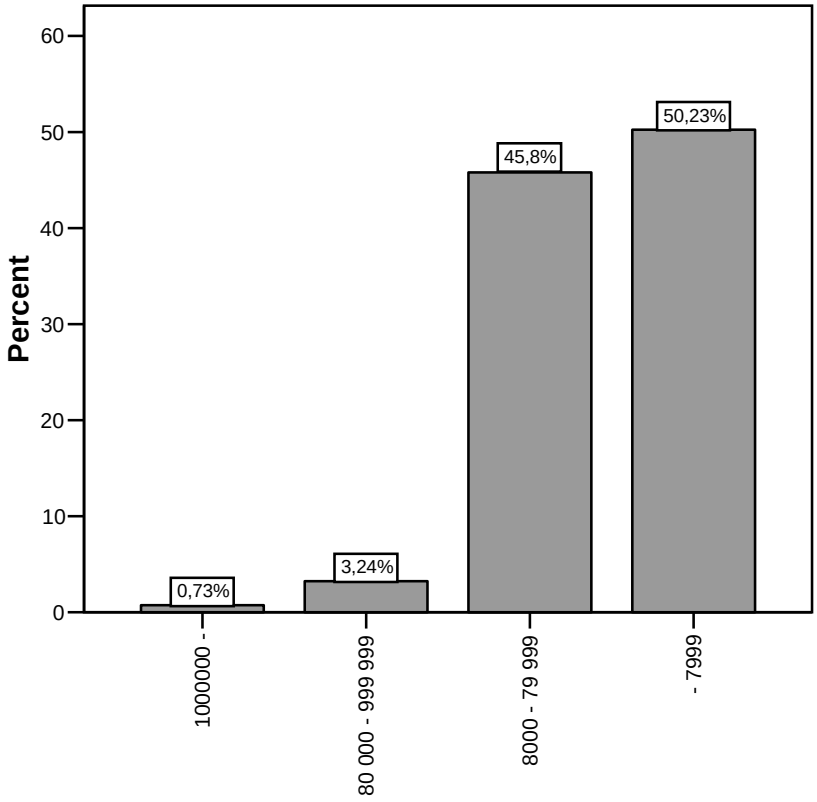

Figure 3 Sample firms in terms of equity, %-shares of total

As was laid out previously, the 50.2% share of sample firms fail to meet the required 8000 EUR equity capital. A large share of firms (45.8%) falls into the category between 8000 – 79 999 EUR. Firms that have enough equity to fulfil the requirement for publicly traded company (80 000 EUR) take a mere 3.2% share, while the majors with an equity exceeding 1000 000 EUR are only 15 in numbers. These large companies are presented in Table 7.

Table 7 15 firms with equity capital exceeding 1000 000 EUR

Company	Equity (EUR)	Industry	Year of registry	Highest position of Russian national	Turnover (year) MEUR	Turnover change% (year)	ROE (year)	Number of personnel	Comments
Gasum Oy	178 279 205	marketing of natural gas	1994	member of the board	653 (03)	12 (03)	16 (03)	165	Owners: Fortum 25%, Gazprom 25%, Finnish State 24%, Ruhrgas 20%, Finnish forest companies 6%
IngoNord Insurance Co.	6 000 000	insurance	2001	chairman of the board	n.a.	n.a.	n.a.	n.a.	n.a.
Suomen Petrooli Oy	4 877 449	marketing of oil products	1932	chairman of the board	458 (03)	-5,8 (02)	6,3 (02)	162	Suomen Petrooli Oy and Teboil Oy are sister companies
Teboil Oy	4 369 522	marketing of oil products	1934	chairman of the board	1082 (03)	0,6 (02)	9,1 (02)	213	
Kiinteistö Oy Kouvolan vuokratalot	3 307 926	real estate	1982	deputy member of the board	5,46 (02)	3,1 (02)	4,5 (02)	7	
NMC-Holding Oy	3 080 000	other medical services	2000	member of the board	n.a.	n.a.	n.a.	n.a.	Subsidiary of Scanfert Oy
Koneisto Oy	2 588 244	marketing of machinery	1964	chairman of the board	7,0 (02)	85,7 (02)	1,7 (02)	9	
RR Offshore Oy	2 507 711	technical services	1992	chairman of the board	0,63 (02)	311,6 (02)	-160,4 (02)	19	Until 2001 known as Merma Oy
Ritec Finland Oy	1 440 000	technical testing	1993	chairman of the board	1,28 (03)	-84,4 (03)	25,2 (03)	10	Subsidiaries: OOO Ritex Holding, OOO Ritex Ltd, Exonic Oy
RAO Nordic Oy	1 350 000	marketing of electricity	2002	chairman of the board	83 (03)	n.a.	n.a.	6	Owners: RAO UES 60%, RosEnergoAtom 40%
Delta Motor Group Oy	1 187 159	marketing of vehicles	1937	chairman of the board	18,22 (02)	18,22 (02)	11,9 (02)	0,7 (02)	Several Delta-Auto subsidiaries
Delta-Auto Oy	1 110 040	marketing of vehicles	1965	member of the board	58,93 (02)	3,2 (02)	63,9 (02)	98	Subsidiary od Delta Motor Group
Kiinteistö Oy Louhenevä	1 084 812	real estate	1990	chairman of the board	n.a.	n.a.	n.a.	n.a.	
North Transgas Oy	1 009 127	marketing of natural gas	1997	chairman of the board	0,35 (02)	-26,1 (02)	3,0 (02)	n.a.	Fortum Oyj owns a share

Source: Talouselämä 500, Suomen Asiakastieto Oy, Yritys- ja yhteisötietojärjestelmä.

Of these firms the following will be given further consideration in a latter part of the study: Teboil Oy, Gasum Oy, Suomen Petrooli Oy, and RAO Nordic. These companies have reached the Finnish TE 500 ranking in terms of their turnover size. Since our focus is on the energy companies, we present some of the oil industry related companies in the Appendix 1.

2.2.3 Russian involvement in the Finnish industries

The following Table 8 demonstrates the activities that the sample companies could be connected to by the means of data analysis. Only those 16 industries are represented in the table whose share of the total were above 1%. As was already discussed, in the majority of cases (43.9%) the principal industry was largely indeterminable.

Table 8 Categorization of sample firms by industries: cross tabulation

			Broad categorization				
			primary production	processing	marketing	service	Total
Industry	food, drink tobacco	Count	0	6	17	1	24
		% within industry1	,0%	7,8%	3,3%	,1%	1,3%
		% of Total	,0%	,3%	,9%	,1%	1,3%
	timber, wood products	Count	0	25	55	3	83
		% within industry1	,0%	32,5%	10,6%	,2%	4,3%
		% of Total	,0%	1,3%	2,9%	,2%	4,3%
	machines, instruments	Count	0	21	44	8	73
		% within industry1	,0%	27,3%	8,5%	,6%	3,8%
		% of Total	,0%	1,1%	2,3%	,4%	3,8%
	electronics, appliances	Count	0	5	17	3	25
		% within industry1	,0%	6,5%	3,3%	,2%	1,3%
		% of Total	,0%	,3%	,9%	,2%	1,3%
	vehicles	Count	0	1	23	12	36
		% within industry1	,0%	1,3%	4,4%	,9%	1,9%
		% of Total	,0%	,1%	1,2%	,6%	1,9%
	construction	Count	0	3	17	101	121
		% within industry1	,0%	3,9%	3,3%	7,7%	6,3%
		% of Total	,0%	,2%	,9%	5,3%	6,3%
	consumer products	Count	0	1	49	5	55
		% within industry1	,0%	1,3%	9,5%	,4%	2,9%
		% of Total	,0%	,1%	2,6%	,3%	2,9%
	lodging, catering	Count	0	0	0	33	33
		% within industry1	,0%	,0%	,0%	2,5%	1,7%
		% of Total	,0%	,0%	,0%	1,7%	1,7%
	transportation, warehousing, telecom	Count	0	0	0	135	135
		% within industry1	,0%	,0%	,0%	10,3%	7,0%
		% of Total	,0%	,0%	,0%	7,0%	7,0%
	financing, investments	Count	0	0	0	92	92
		% within industry1	,0%	,0%	,0%	7,0%	4,8%
		% of Total	,0%	,0%	,0%	4,8%	4,8%
	real estate, rentals	Count	0	0	1	60	61
		% within industry1	,0%	,0%	,2%	4,6%	3,2%
		% of Total	,0%	,0%	,1%	3,1%	3,2%
	health	Count	0	2	8	17	27
		% within industry1	,0%	2,6%	1,5%	1,3%	1,4%
		% of Total	,0%	,1%	,4%	,9%	1,4%
	business services and consulting	Count	0	0	1	126	127
		% within industry1	,0%	,0%	,2%	9,6%	6,6%
		% of Total	,0%	,0%	,1%	6,6%	6,6%
	IT	Count	0	0	8	32	40
		% within industry1	,0%	,0%	1,5%	2,4%	2,1%
		% of Total	,0%	,0%	,4%	1,7%	2,1%
	oil, oil products	Count	0	0	26	1	27
		% within industry1	,0%	,0%	5,0%	,1%	1,4%
		% of Total	,0%	,0%	1,4%	,1%	1,4%
	tourism	Count	0	0	0	49	49
		% within industry1	,0%	,0%	,0%	3,7%	2,6%
		% of Total	,0%	,0%	,0%	2,6%	2,6%
	other / unknown	Count	6	13	251	637	907
		% within industry1	100,0%	16,9%	48,5%	48,4%	47,4%
		% of Total	,3%	,7%	13,1%	33,3%	47,4%
Total		Count	6	77	517	1315	1915
		% within industry1	100,0%	100,0%	100,0%	100,0%	100,0%
		% of Total	,3%	4,0%	27,0%	68,7%	100,0%

Some 70% of the sample companies were engaged in the service business, while approximately a third derived their revenue from marketing related activities. Processing and primary production classes were represented quite marginally (4% and 0.3% respectively). Some points worth noticing: (1) *timber and wood products* is well represented in processing, but especially in marketing (imports); (2) the same applies to *machines and instruments*; (3) *construction services* share of total 6.3%; (4) *transportation, warehousing and telecom* have a 7% share of the total (includes number of transportation facilitators and for example the mobile operator Cubio Communications); (5) *financing and investments* take a 4.8% share of the whole; (6) *business services and consulting* is also well represented (6.6%); (7) primary production was mainly represented by quarrying and fishing; (8) *food industry processing* was represented for example by a pelmen factory "Suomen pelmen" (9) relevant to our research focus on the energy related industries, it can be said that *oil and oil products* have a 1.4% share of the total, mostly in marketing (import).

2.2.4 Russian nationals in companies

Figure 4 depicts the highest position of Russian national in the sample companies provided by the NBPR.

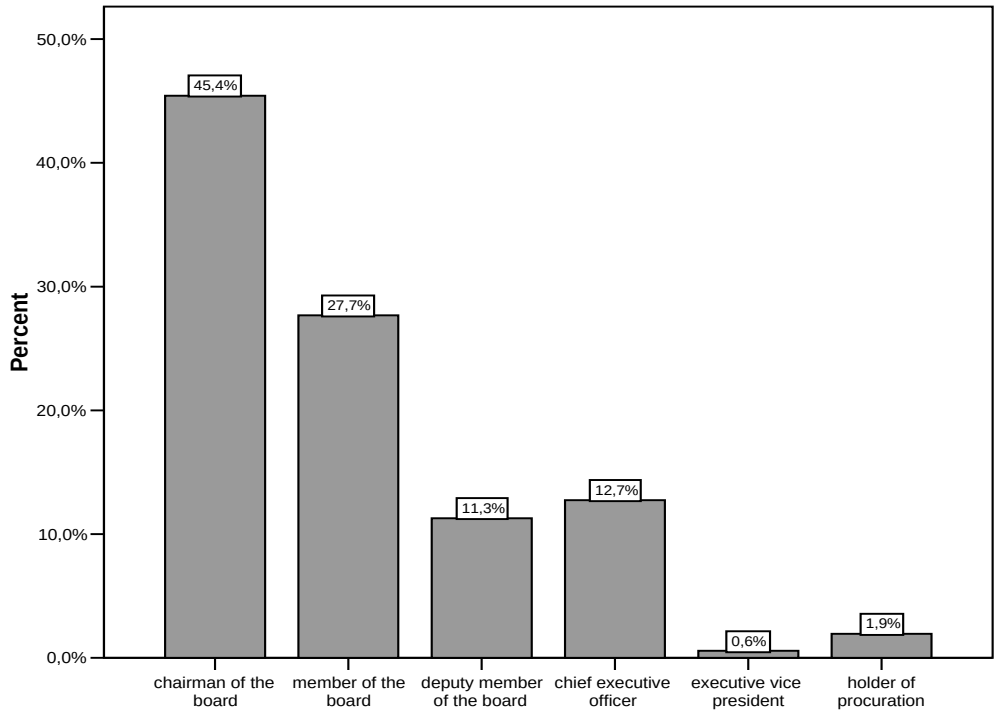

Figure 4 Russian nationals: position in the sample firms

Russian nationals as board members dominate the sample, with most of them (45.4%) as chairmen. The number of CEOs is 244 (12.7%), indicating marginal roles in the “hands on” management. In some cases for example the deputy members of the board were clearly persons with family ties to Finnish members of the company management (e.g. some real estate administration firms). In such cases the involvement of Russian capital can very much be doubted.

3 RUSSIAN INVOLVEMENT IN THE FINNISH ENERGY SECTOR – A CASE APPROACH

In the current Chapter, four cases are provided on the Russian involvement and capital investments in the Finnish oil, gas, and electrical energy sectors. The first two cases provide a brief overview on the activities of two companies with 100% Russian ownership. The third case, Gasum Oyj, is an example of Russian minority equity ownership in the Finnish natural gas distribution company. The governance structure of the company will be elaborated on the basis of theoretical approach to organisation of industrial relationships. The fourth case provides policy considerations on the incorporation of Fortum Oil, regarding the potential Russian involvement in the new company.

3.1 Suomen Petrooli Oy and Oy Teboil Ab

The following elaborations on the companies in question are mostly based on the Annual Report 2003 of Oy Teboil Ab, and an interview with the Financial Director of the concern, Mr. Pekka Arte (19.10.2004).

Suomen Petrooli Oy and Oy Teboil Ab have both been operating in Finland since the 1930s. The former originates from Viipuri, while in the process of incorporation the concern chose to continue operating from Helsinki, the registered office of Teboil. As the incorporation took place in 1948, the reasons behind the location decisions are obvious. The concern's history of incorporation is quite interesting and can be reflected with general developments in the political history of the region during the 1940s. After the war the German ownership changed hands to Soviet entities. Later the ownership structure included SojuzNefteExport, which could benefit from the nation wide distribution network of Teboil. Other companies, for example the British Petroleum, attempted for ownership but were not rewarded for their efforts. In the beginning of the 90s the Russian owner was privatized, which a process resulted in the involvement of private citizens, Surgutneftegaz, American pension funds, and the Russian Federation in the ownership structure. Currently the company is 100% owned by the Nafta Moskva, a Swiss based holding company. Investors in this company are unknown private investors of Russian origin. According to various sources the Finnish concern is intended to be sold for a strategic investor, among who might potentially be such Russian oil giants as for example Lukoil and Surgutneftegaz. For Teboil this would provide improvement in prospects, as the new owner might potentially consider it as a target worth of further development and investment.

Being one of the major Finnish companies in terms of turnover, both Teboil and Suomen Petrooli are ranked among the TE 500 list. Following Table 9 presents key financials of the two companies, with some major competitors for the sake of comparison.

Table 9 Key financials of Oy Teboil Ab and Suomen Petrooli Oy from 2003, and some competitors

	Oy Teboil Ab	**Suomen Petrooli Oy**	**Oy Shell Ab**	**Oy Esso Ab**
Sector	oil marketing	oil marketing	oil marketing	oil marketing
Registered office	Helsinki	Helsinki	Vantaa	Espoo
Turnover, *MEUR*	1082	458	634 (2002)	310 (2002)
Turnover change, *%*	8	6	-3.3	-15.5
Operating profit, *MEUR*	9	-3	..	..
Return on equity, *%*	9	-3	11.8	-16.9
Gearing, *%*	33	41	..	..
Equity ratio, *%*	36	38	..	..
Gross investments, *MEUR*	15	3	..	..
Number of personnel	205	152	324	..
TE grading	7.8	6.0	..	..

Source: Talouselämä 500, Suomen Asiakastieto Oy.

Both case companies have grown slightly in terms of turnover (8% for Teboil, 6% for Suomen Petrooli) since 2002. The company expects improving financial results in the near future as the demand for its products continues on a positive trend. Teboil is significantly larger in terms of turnover in comparison with the competitors. Shell and Esso have been struggling with the adequate organization of activities, and the business seems to have suffered as a result.

The two sister companies have a common management and even functions. The concern is divided into five business units, namely Direct sales unit, Service station unit, Lubricants unit, LPG (liquefied petroleum gas) unit, and Oil product and acquisition unit, of which the four former ones operate under Teboil and and the last one under Suomen Petrooli. The concern has traditionally been managed by a Russian national. In the Soviet times even 15-20 Russian nationals were involved in the management of the Finnish subsidiary of SojuzNefteExport. Currently Mr. Boris Diyachenko heads the company as the General Manager, while a Russian national also holds the position of Deputy General Manager, and the Export Manager to certain Slavic speaking areas of operation.

Teboil is currently the second largest oil company in Finland. It enjoys a sizeable market share of 23% of the petrochemical sales for consumption. As was briefly elaborated on previously, Teboil is involved in the sales and marketing functions of the concern, while Suomen Petrooli is engaged in the acquisition and production of oil products, mainly for the needs of Teboil. Thus Teboil has only one supplier: Suomen Petrooli, which in turn acquires oil products from the international market according to purely economic principles. Reliability and trust are considered key issues in supplier

selection. Currently the suppliers of petrochemicals for the concern can roughly be divided among three general groups: Russian suppliers, Western suppliers, and Fortum Oyj. Fuel oil is almost entirely supplied by Russian oil producers, while gasoline is mostly supplied by Fortum. Roughly a quarter comes from the direction of the North Sea. The supply contracts are annual in nature, and the company experiences no mentionable breaches of contracts in terms of reliability in shipments and supplies. Production of lubricants takes place in the Hamina production facility, and the produce is marketed also to other retailers. A storage network of seven depots (5 coastal locations, 2 inland locations) supports the distribution network of more than 300 service stations (Shell has 293). The catering operations in the service stations are managed by the fully owned subsidiary Suomen Tähtihovit Oy.

The sister companies and their combined operations can be considered an interesting target for a foreign strategic investor. The existing distribution network and other operation facilities would provide a strategic extension for an expansionist oil company desiring to enter Finland or solidify its Finnish market share. Interesting avenue for thought is of course the possible role of for example Russian oil majors in the future of Oy Teboil Ab and Suomen Petrooli Oy.

3.2 RAO Nordic

A fully owned subsidiary of JSC RAO UES International, the RAO Nordic Oy was registered to the Finnish Trade registry in October 2002. The sole owner of RAO Nordic is in turn jointly owned by two major Russian corporations, namely the RAO UES of Russia (60%), and RosEnergoAtom[1] (40%). The former is the energy holding company in charge of Russian electricity supply, while the latter serves as the holding entity of Russian nuclear power plants. The Russian Federation Ministry of State controls the majority share of stock in both of the monopolistic energy companies.

RAO Nordic holds the 379th position in the TE 500 ranking of biggest Finnish companies. First time appearance in the list was supplemented with following financial information (Table 10).

[1] Recent discussion in Russia implicates the possible integration of RusEnergoAtom assets in the Gazprom holding structure.

Table 10 RAO Nordic financials from 2003

RAO Nordic Oy	
Sector	energy
Registered office	Helsinki
Turnover (MEUR)	83
Operating profit (MEUR)	4
Return on equity %	..
Gearing %	574
Equity ratio %	10
Gross investments (MEUR)	2
Number of personnel	6
TE grading	7,0

Source: Talouselämä 500.

The company is directed by Oleg Zakataev, and the post of Sales Director is held by Marja Rasi-Kurronen.

RAO Nordic Oy is a sales company that imports electricity to Finland, and sells the energy either straight to the power companies or via the NordPool Elspot to the Nordic market. Imports include for example electricity from the hydropower plant in Paatsjoki Russia. The import contract with Fingrid Oyj (electricity transmission system operator) in 2004 is set to the 250 MW level (250 MW in 2003, and 50 MW in the three operational months 2002). Competition for the import quotas of Russian electricity for the year 2005 has proven significant. International majors have demonstrated interest towards the Finnish market, with a capacity of 900 MW. Cumulative applications so far have reached a level of 2860 MW, RAO Nordic applying for a major share (500 MW), which would double the current level of planned imports if realized (Tekniikka&Talous 7.10.2004).

Currently the share of Russian imported electricity from the Finnish electricity supply is 13%, which exceeds the 10% limit for one external supply source set by the Ministry of Trade and Industry. In principle the sentiments concerning the increased dependence of Finnish energy supply on the Russian energy sources are on the negative side, while the increased energy consumption contributes to the growth of Russian electricity demand. (Talouselämä 35/2004). The increased import of the Russian electricity has been enabled by the investments made during the last few years to the supply infrastructure in the Vyborg DC link (Unit 4) and Vyborg-Kymi line (3rd 300kV line).

RAO Nordic considers the Finnish market a strategic one with opportunities for extended operations. The import of electricity has been in operation since the 1980's via the Vyborg DC link. Finland is considered a staging ground for operational expansion to the other Nordic and European countries. According to the company, the participation in the Nordic Power Exchange NordPool and NordPool Clearing facilitates improved efficiency of Russian electricity supply. Another point considered useful in operating in the Finnish market, is the acquisition of particular kind of knowledge concerning the

efficient operation of liberalized market trading of electricity. RAO Nordic thus has a role in facilitating the planned liberalization of the Russian electricity market. (www.raonordic.fi.)

3.3 Theoretical Framework on Governance Form Evaluation

3.3.1 Organizational governance in industrial relationships

The value creating economic system is essentially about the exchange of products, services, and money. In order to facilitate exchange between economic actors, be they individuals, firms, or groups of firms, relationships are developed and nurtured. We can thus without difficulty value the arguments in benefit of business relationship oriented research, salient in contemporary academic endeavours. Indeed, over the years the interest on business relationships has generated an abundance of theories and concepts that improve our understanding on for example business strategy and marketing management (e.g. Kauser & Shaw 2004, Inkpen 2001). At the same time the reality of business markets provide plenty of examples on elaborately constructed industrial consortiums, R&D networks, and streamlined supply chains, that are better understood in the light of the available body of theories.

In the analysis of the exchange relationship, we begin with a basic theoretical construct. According to the New Institutional Economic theory, the organization of economic activity ranges in the continuum between the market-based spot transactions and hierarchy, where technologically separated activities are placed under the same authority and ownership, i.e. the firm (Williamson 1975; Richardson 1972). Clearly these are *alternative methods of co-ordinating production*. Markets are based on price mechanism that allocates resources in the invisible-hand fashion, while firms are likened to *islands of conscious power in the ocean of unconscious co-operation* (Coase 1937). Later research refers to spontaneous and planned orders in the network, referring to market and hierarchy based relationships respectively (Tikkanen & Parvinen 2004).

Obviously a range of alternative ways of production lie also in the continuum between the polar outcomes elaborated on previously. Williamson (1996, 378) speaks of *hybrids* as the alternative form of organization, referring to *long-term contractual relations that preserve autonomy but provide added transaction-specific safeguards, compared with the market*. Thus firms, wishing to remain autonomous, implement hybrid forms of governance structures in order to reach certain strategically desirable

objectives. The strategic issue of safeguards, referring to contracts and incentive alignment, must naturally be considered.

The definition of a *strategic alliance* (SA) is quite close to the one of hybrid, indicating strong similarity in concepts: (global) strategic alliances *are the relatively enduring inter-firm co-operative arrangements, involving cross-border flows and linkages that utilize resources and/or governance structures from autonomous organizations…, for the joint accomplishment of individual goals linked to the corporate mission of each sponsoring firm* (Parkhe 1991, 581). The broad definition of strategic alliances thus embodies the wide variety of co-operational arrangements between market-based transactions and mergers and acquisition, i.e. vertical integration (Inkpen 2001).

Firms enter into strategic alliances in order to reach certain predetermined objectives. Wide ranging research on these hybrid forms of organization identifies several of theses objectives that include for example the following: risk sharing, knowledge gaining, market access, resource exchange, economies of scale achievement, and synergy and competitive advantage attainment (e.g. Chen & Chen 2002; Inkpen 2001, 405; Dacin-Hitt-Levitas 1997). Kogut (1988) elaborates on three main motivations on alliance formation, namely (1) transaction cost minimizing, (2) strategic behavior aimed at position and power improvement, and (3) organizational learning desire. Chen and Chen (2002) take the industrial network approach on alliance formation considerations, and elaborate on alliances as follows: *SA is seen as a formal agreement between partners to invest in a relationship for the purpose of exchanging resources on a sustained basis*; *SA represents a commitment to investing in certain relation-specific assets*; appropriation of relational rent motivates the investment into relation-specific asset; and strategic alliances *build a foundation for recurrent exchanges whereby the partners cooperate in utilizing committed resources*. Ireland, Hitt, and Vaidyanath (2002) consider the strategic alliances as an important source of competitive advantage for a firm, and propose a hybrid theory of transaction costs, social networks, and resource-based view for the study of the subject. Yasuda (2004) underlines the importance of resource-based view (RBV) of the firm and the transaction cost economic (TCE) theory in explaining the ‘two different angles’ of the alliance formation.

Drawing on the previously presented research, we argue for a three fold theoretical consideration on organizational governance of industrial relationships. Figure 1 depicts the proposed framework in a developing state.

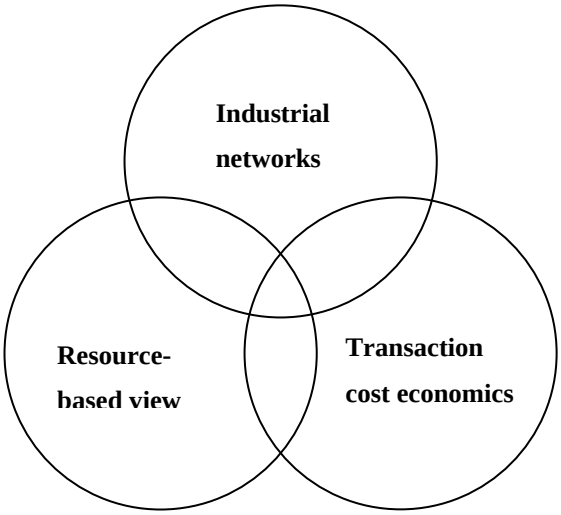

Figure 5 **Preliminary framework of organizational governance considerations in industrial relationships**

In order to facilitate the later framework development we elaborate on the theories included in the framework, namely the industrial network theory, resource-based theory, and the New Institutional theory of transaction costs.

3.3.2 Industrial networks

In the past years relationships and networks have become increasingly salient topics in business research. The industrial network paradigm originates from the IMP Group related research projects in which Nordic and European scholars in general have had an important role (e.g. Ford 1997; Turnbull-Ford-Cunningham 1996). The relatively young paradigm offers concepts for the study of business markets in general that often contrast significantly from the typical business-to-consumer marketing setting, in which the individual customers cannot be identified and considered even in the age of mass customization. So instead of resorting to customer segmentation regime specific marketing strategy, business marketers find themselves in markets were economic actors are few, and at least identifiable, a situation that calls for careful consideration of each customer relationship. The same applies of course to the supply side and in fact to all company stakeholders. The acknowledgement of the business market characteristics has given rise to business policies that underline the importance of relationship management in the focal network of the firm. Widely popularized buzzwords of the day are for example such concepts as the supply chain management (SCM) and customer

relationship management (CRM), in which ICT plays an important role (Gadde-Huemer-Håkansson 2003, 363).

The essence of the paradigm of industrial networks is to take the holistic view on the economic exchange landscape, and sensitize the practising managers and academics alike to the broader perception of the firm, its dyadic relationships, and its focal network of which it is a part. Håkansson and Johanson (1992) presented a model for industrial networks that effectively provide the framework for analyzing the business networks. According to this model, three basic classes of variables can be identified, namely *actors*, *activities*, and *resources*. The network actors can be identified in many organizational levels (e.g. individuals, groups of individuals, business units, firms, groups of firms), all of which have five characteristics: (1) actors control and perform activities; (2) potential economic exchange initiates the development of relationships between actors; (3) engagement in an activity is based on resource endowments and their control; (4) actors are oriented towards profit and control in the network; and (5) actors' knowledge level is a variable characteristic. These characteristics bring about the formation of an industrial network, where actors are connected to each other by the means of relationships of economic exchange with appropriate governance structures in place; resources are utilized in activities and processes that succeed in the satisfaction of time, place, and product specific demand of consumers and firms; and requirements, goals, and aspirations for *economic rents* and network control are achieved (Håkansson & Johanson 1992, 30; Williamson 1996; Mahoney & Pandian 1992).

What are then the practical implications of the industrial network paradigm to business strategy issues? Business strategy has been discussed extensively since 1960s and has been defined in many ways. Andrews (1980) defines economic strategy as a process of *matching opportunity and corporate capability at an acceptable level of risk*, while competitiveness and bargaining power is at the hart of the Porterian view on corporate strategy (Porter 1980). As the essence of the industrial network theory is about relationships and position in the network, the main strategizing issue thus becomes a one of interaction, i.e. *how should companies interact in business networks*? Furthermore, one is concerned about managing the firm's relationships that by definition are complex, long-term, and a result of previous interactions between the firms as actors. Importantly, the network approach requires the examination of an exchange relationship in a wider context of other connected business relationships, as events and transactions in one, will influence the others directly or indirectly, substantially or marginally. (Håkansson & Ford 2002.) Strategic action is taken to influence firm's position in the network towards a more favourable one (Gadde-Huemer-Håkansson 2003, 358).

The fundamental issue in the network approach to strategy is the concept of cooperation and mutual dependence among network actors, and thus the aim in

strategizing *shifts from that of pursuing a victory over others to somehow making it together with customers and suppliers, distributors and development partners* (Ford et al. 1998, 107). Along this issue we shall explore the strategizing implications of the industrial network approach.

Håkansson and Ford (2002) suggest three managerial paradoxes in networks that are useful in considering the implications of the paradigm to business strategy. In the business market setting, strong relationships are essential to the firm from a survival point of view. Firm's relationships may in some cases be considered the most valuable resource the firm enjoys, while they also enable the firm to tap to other resources. It is paradoxical that these very relationships that enable the firm's development, simultaneously lock the firm in the current operation mode and hinder exploitation of opportunities to innovate in the market. According to Gadde et al. (2003, 358) *the first strategizing issue for a company, then, is to identify and establish appropriate levels of involvement in its relationships with individual partners*.

Striving towards influence and network position improvement, are key drivers in a dynamic business network. Relationships are the venues in which influence is exerted in order to gain access to resources and execute economic exchange. The venues are two-way streets implicating influence exercised both ways. While exerting influence through the relationships, it is again paradoxical *that the company is itself the outcome of those relationships and of what has happened in them* (Håkansson & Ford 2002, 136). Thus *the second issue for strategizing is about balancing the interplay between influencing others and being influenced* (Gadde et al. 2003, 358).

Finally, firms strive to control their focal network by managing relationships in order to facilitate achievement of objectives, and in so doing, risk the possibility of implementing hierarchical governance structures to relationships where innovativeness and market incentives should reign. Thus the *third paradox is that the more that a company achieves this ambition of control, the less effective and innovative will be the network* (Håkansson & Ford 2002, 137). Consequently *the third strategizing issue for a company is thus to identify adequate ambitions regarding control* (Gadde et al. 2003, 358).

Obviously the common denominator in the earlier presented three strategizing issues is the relationships between firms that facilitate economic activity. One is to ask: how to design the interface, or the governance structure, between companies in order to take in to consideration all the strategizing issues and their implications to a specific business context. For example a company might wish to reconsider its supplier relationships, and consequently engage in more close relationships with some suppliers, while some supplier relationships might be based on pure and occasional spot market transactions. There is in fact a great variety of possibilities in designing the interfaces that facilitate the business relationships along the continuum between market and hierarchy, and they

all should be carefully considered in the specific business context one wishes to redevelop. It must of course be remembered that what happens in one relationship inescapably affects other relationships in the network. It is a fallacy to concentrate on one interface design only, in a neoclassic ceteris paribus manner, and hope the rest of the world to remain intact while tinkering with a part of it (Anderson-Håkansson-Johanson, 1994). *Third party* considerations are consequently important part of relationship assesments.

In order to facilitate the research objective, we aim to present a framework for the design of interfaces in the company relationships, and provide considerations to support decision making in this matter of strategic importance to a company. The three strategizing issues presented by Gadde et al. (2003) provide a good starting point for the framework creation, by underlining the fundamental issues of relationship design: how involved should a company be in a relationship; how to balance the influence interplay in a relationship; and how ambitious should a company be regarding network control?

3.3.3 Resource based theory of the firm

According to the resource-based view, the firm is seen as a combination of resources that ultimately define the competitive position of a firm. The often firm-specific and immobile nature of resources generates heterogeneity among the firms, which in turn yields possible competitive advantages. (e.g. Wernerfelt 1984, Barney 1991, Grant 1991) The resource-based view thus embodies an approach emphasizing the internal assets and knowledge on the firm (Barney 1991). The firm's competitive strategy and its subsequent accomplishments, is thereby strongly influenced by the firm's accumulated resources, i.e. what the firm possesses or controls (e.g. Das and Teng 2000).

The resource-based view offers an appropriate means of examining the inter-organizational relations and networks, since in the core of strategic inter-firm relations lies the purpose to access the other firms' potentially valuable resources. The resource-based view thus suggests that the strategic alliances between firms are based on the value-creation potential of the firms' combined resources (Chen and Chen 2003). As the inter-organizational strategic alliances often incur considerable governance expenses (e.g. Osborn and Baughn 1990), entering the strategic alliances is reasoned only if the firm cannot efficiently get the resources directly from factor markets (Das and Teng 2000). The resources not acquirable in factor markets often embody the characteristics of imperfect mobility, imperfect imitability or imperfect substitutability, acting as barriers to directly obtaining the resources (Barney 1991, Peteraf 1993). Thus, the more imperfect the mobility, imitability or substitutability of the desired resource, the higher

the possibility that the other firms will seek for that resource through some form of strategic alliance, as opposed to market transactions (Das and Teng 2000).

Assuming the resources are not accessible through simple market transactions, the firm resources can be further typified according to their characteristics, influencing the choice of the structure of inter-firm relationship. The scholars have proposed various typologies, the most popular of which include the differentiation between tangible and intangible resources (Grant 1991) and differentiation between physical resources, human resources and organizational resources (Barney 1991). A useful typology is further provided by Miller and Shamsie (1996), who classify the resources into categories of property-based and knowledge-based resources. Property-based resources include legal properties owned by a firm, protected by clear property rights, which are thus complicated to obtain by other firms. Knowledge-based resources, on the other hand, refer to a firm's intangible know-how and skills. Due to the knowledge and information barriers, these knowledge-based resources are mostly inimitable, i.e. hard to copy by the other firms.

According to Das and Teng (2000), the presented typology of resources has a direct influence on the desired mode of inter-organizational relationships between the firms. Consequently they propose a normative framework for the design of such relationships (Table 11).

Table 11 Resource Types and a Firm's Structural Preferences

	Partner Firm (B)	
Firm (A)	*Property-Based Resources*	*Knowledge-Based Resources*
Property-Based Resources	Unilateral Contract-Based Alliances[2]	Equity Joint Ventures
Knowledge-Based Resources	Minority Equity Alliances[3]	Bilateral Contract-Based Alliances

Source: Das & Teng 2000.

A good is example of the above presented reasoning is the case, when the firm has primarily the knowledge-based assets to provide to the alliance, with its partner having primarily property-based resources. This combination is suggested to yield the preference for minority equity alliances as opposed to contract-based alliances or joint ventures. Minority equity alliance structure is seen to provide the necessary protection for altering the firm's knowledge-based resources, compared to the insecurity of the

[2] Unilateral contract-based alliances: e.g. licensing, subcontracting, distribution agreements etc.; light engagement of partners.

[3] Bilateral contract-based alliances: e.g. joint production, joint R&D, joint marketing and promotion; heavy engagement of partners.

contract-based relations, or the higher risk of the partner firm to appropriate the valuable resources under a joint venture-structure.

3.3.4 The new institutional economics

The New Institutional Economics, or more commonly transaction cost economics (TCE), is predominantly concerned about the governance of economic activity, the origins of which can be traced to the seminal paper of Ronald Coase, *The Nature of the Firm* (1937). Instead of taking the organization of economic activity as given and primarily technologically driven, it should be in fact derived and planned, submitting an activity either as market or hierarchy based, depending on the specific business context. Essentially we are talking about the classic *make or buy decisions* of the firm, where one may ask: should a firm perform activities inside the firm or buy the resultant product or service from the market. Later research has introduced the continuum of governance structures that range from pure spot market transactions to hierarchical governance (firm) and authority, having the so called hybrid governance structures in between, i.e. cooperative arrangements of various sorts. (Williamson 1998, 75.)

Transactions that take place in inter-organizational relationships of economic exchange, have diverse attributes that make the implementation of a governance structure into a business relationship a challenging managerial decision. The cost of transacting thus varies depending on the governance structure (market-hybrid-hierarchy) in place. The objective of the firm should be a one of transaction cost economizing, i.e. the alignment of transactions with a proper governance structure that facilitates the inter-organizational economic exchange. (Williamson 1998, 76.)

Along Commons' (1936) proposal that the transaction be made the basic unit of analysis, the firm should identify its relation specific transaction costs, along the framework that incorporates certain *key constructs* introduced in the contemporary TCE, and *behavioral assumptions* that the neoclassical micro economic theory lacks. The TCE key constructs include (1) uncertainty, (2) asset specificity, and (3) fundamental transformation. First, uncertainty is one of the most salient causes of 'friction in the economic machine', the physical science equivalent of transaction costs. Misinformed decisions are made due to nondisclosure, disguise, or distortion of information, which lead to inefficiencies in economic activity, examples of which are delayed investments, inadequate inventories, and safeguards against business partner noncompliance of contracts. (Williamson 1996, 60.)

Second, *asset specificity has reference to the degree to which an asset can be redeployed to alternative uses and alternative users without sacrifice of productive value* (Williamson 1996, 59). A specific asset can be tied to a location, such as an oil

pipeline, or it may take the form of a physical object, such as a die dedicated to serve the needs of a particular customer. Human asset specificity arises as personnel acquire task specific skills in the learning-by-doing fashion, and temporal assets preserve their value in the specific time frame. Asset specificity may give rise to transaction costs, as the exchange parties become dependable to each other through incurred sunk costs.

Third, in the initial phase of business partner search, it is often the case that the large number bidding applies, thus keeping prices and contractual terms competitive. As cooperative agreements are reached and investments are made to relationship specific assets, a *fundamental transformation* takes place from large numbers bidding situation to small numbers context, as the sunk costs encourage the continuation of for example a supplier relationship even on suboptimal or non least-cost terms. In order to be safe from undesirable situations in inter-organizational relationships, various contractual safe-guards may be implemented, coupled with proper governance structures. In the world of incomplete contracts, the issue of contracting needs to be examined in its entirety, taking into consideration the possible transformation of favorable ex ante terms to ex post hold-up position. (Williamson 1996, 60-63.)

Behavioral assumptions of bounded rationality and opportunism have a fundamental role in transaction cost economic theory. In contrast to the neoclassical assumption of rational and calculative behavior of utility maximizing, TCE endorses the view of 1978 Nobel prize winner Herbert A. Simon (1955), who argues that economic actors are in fact *intendedly rational, but only limitedly so*. Coupled with opportunism, which is popularized as *self interest seeking with guile*, the TCE behavioral assumptions help us understand the reality of contracting as follows: (1) it is impossible to draft complete and comprehensive contracts to govern economic exchange ex ante, making the ex post considerations all the more important; and (2) contracts as promises of commitment and obligation to certain terms of exchange cannot be regarded as universally reliable (Williamson 1996, 55-57). Consequently ex ante screening of exchange partners and ex post safe guarding activity need to be implemented, that effectively give rise to transaction costs, even though they aim for the containment of the same.

In summary we present the key propositions of TCE as follows: (1) bounded rationality and opportunism give rise to transaction costs, (2) transaction costs are higher under conditions of high asset specificity and high uncertainty, (3) the most efficient governance structure (market-hybrid-hierarchy) needs to be chosen in order to organize economic activity and economize on transaction costs. In general, relatively high transaction costs favor hierarchical structures (i.e. vertical integration), whereas relatively low transaction costs favor markets. Obviously in hierarchical settings control and audit can be utilized in order to encourage compliance, while markets offer greater incentives for competitiveness and efficiency. It is important that a situation where the parties' motives to act according to the benefit of the relationship and thus both

companies, can be reached. This *incentive alignment* is at the heart of transaction cost economic orientated design of inter-organizational relationships.

3.3.5 Framework for the organizational governance considerations in industrial relationships

The review of the three theoretical bases for our framework has provided us with normative suggestions and important matters of consideration on the task of industrial relationship design. While precise hierarchy and interplay of the theoretical elements is difficult to define at this point, with the extensive research conducted by established scholars we can certainly claim the relevance of each element. The managerial decision-making will potentially be improved, as one considers the relationship to be redeveloped with the help of the provided framework (Figure 6).

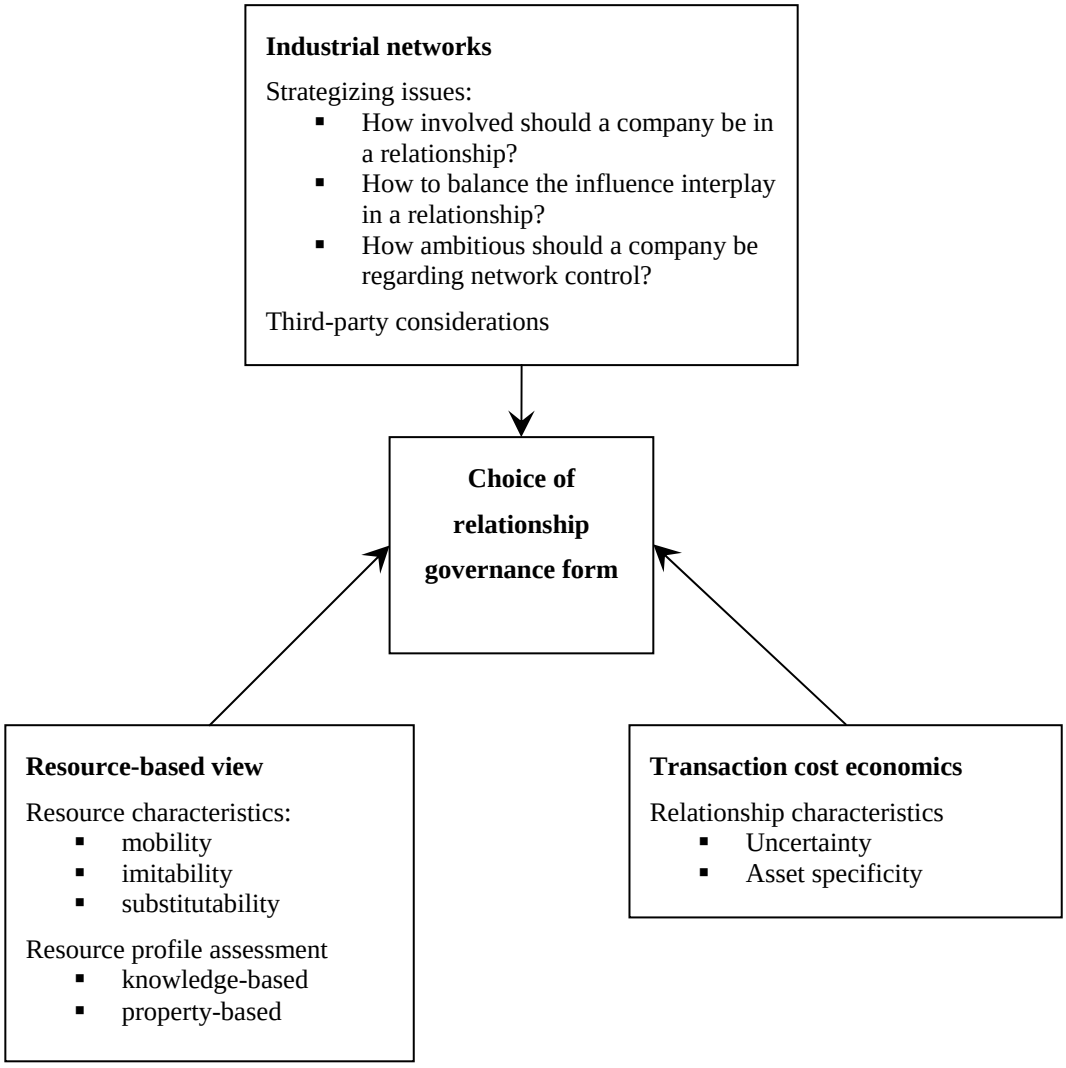

Figure 6 Organizational governance considerations in industrial relationships

Based on the elements presented in the assessment of the three theoretical approaches above, we propose a process model structure for operationalising the above concepts in decision-making process. The model consists of four stages, beginning with potential external rationale for structuring the industrial relationships (e.g. political or shareholder pressure). The Internal rationale considerations are based on the need of a company, either to obtain new resources or retaining the existing ones (e.g. the change in a firm's competitive environment or supply conditions). The General governance form assessment –stage includes considerations on governance form determined by two variables – the resource characteristics and level of transaction costs for acquiring them. Based on these considerations, the possible outcomes include all the governance forms in the continuum between hierarchy and market. When the previous considerations support the choice of strategic alliance as a governance form, the assessment proceeds to its final stage determining the organisation structural outcome. In this final stage, assessments are made on the resource profiles of both firms and the transaction costs involved in the exchange process. The assessment results ultimately determine the optimal governance form for the alliance. (Figure 7)

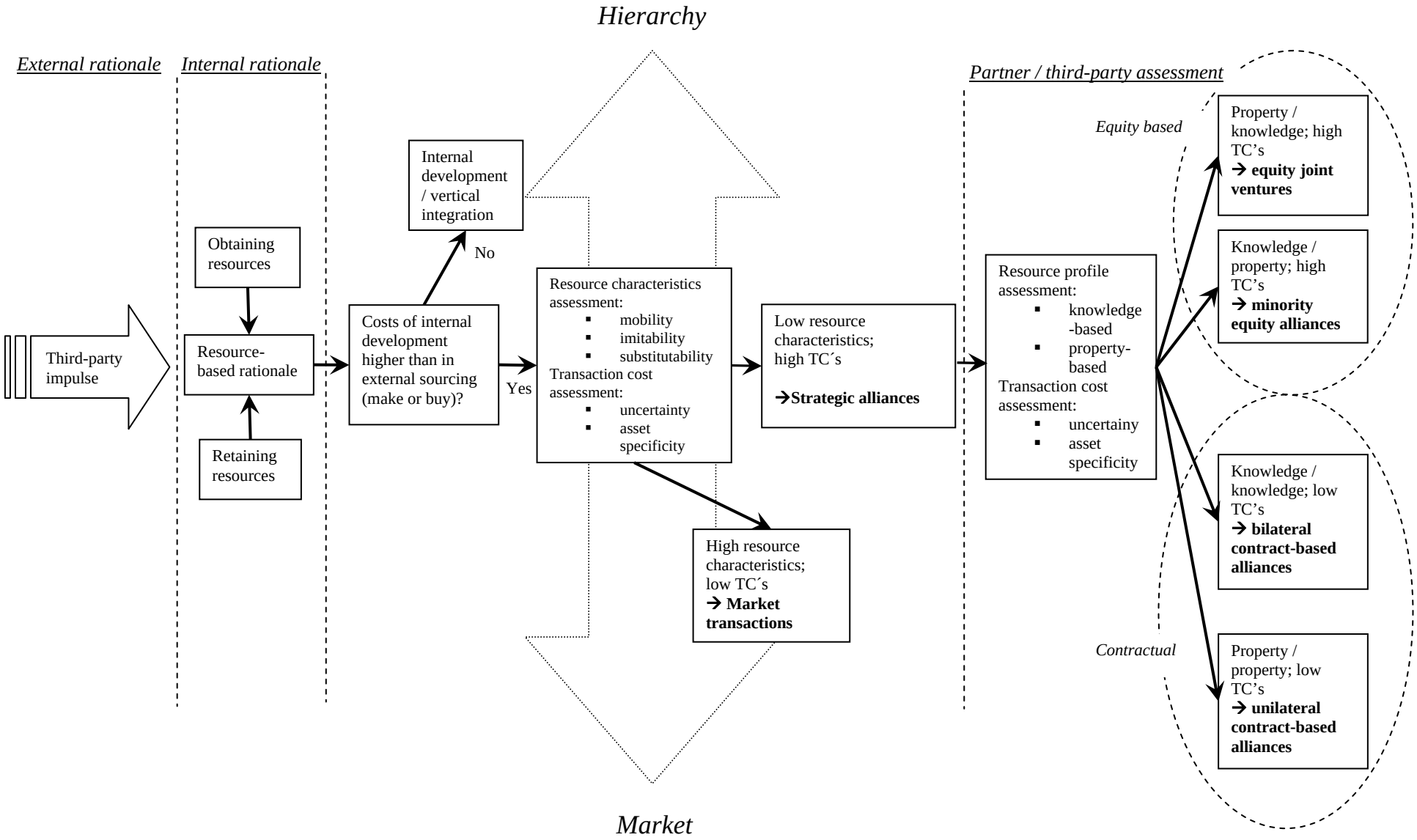

Figure 7 **Process model on governance form decision-making**

The presented framework will be utilized in the following case studies in order to demonstrate its relevance. Additionally we utilize it in the context of potential relationship redevelopment target, in order to provide insight for the decision makers involved.

3.4 Gasum Oyj

The information and considerations to follow are based on public company information and the interview of Gasum Chief Executive Officer and Chairman of the Board, Mr. Antero Jännes (28.9.2004).

Gasum Oyj ranks the 71st largest company in Finland, measured by turnover (653 MEUR in 2003). The company was established in 1994 when Neste Oyj separated its natural gas operations from the parent corporation, creating an independent natural gas company. Neste Oyj remained principal shareholder in the new company and the remaining 25%-stake was sold to the Russian natural gas provider, Gazprom. Along with the improved predictability of gas deliveries, the Gazprom's stake in the new company secured Russia's strategic interests in the Finnish natural gas markets. Apart from Gazprom, the principal owners of Gasum currently include Fortum (25%), Finnish State (24%) and Ruhrgas (20%). The remaining 6%-stake is divided between three Finnish forest companies, thus granting the majority ownership for the domestic entities. Gasum management team consists entirely of Finnish nationals, the principal owners being represented in the Board of Directors, including two representatives from Gazprom and one from Ruhrgas. The financial indicators of Gasum are provided in the following Table 12.

Table 12 Key financials of Gasum Oyj in 2003

Gasum Oyj	
Sector	Energy
Registered office	Espoo
Turnover (MEUR)	653
Operating profit (MEUR)	66
Return on equity	16
Gearing %	16
Equity ratio	61
Gross investments (MEUR)	8
Number of personnel	200
TE grading	9,4

Source: Talouselämä 21/2004.

Gasum's operations cover importing, marketing and selling of natural gas in Finland. The company is the only importer of natural gas to Finland controlling the country's

1000 km-gas pipeline network. The Finnish pipeline network is currently connected only to that of Russia, thus being entirely dependent on her gas supplies. Geographical factors provide the trade partners with mutual advantages – the prices for natural gas are lower in Finland than in other pars of Europe, but the profit margins for the supplier are still higher than on any other market, mainly due to low delivery costs.

The natural gas purchases are based on 20-year supply contracts with the Russian Gazprom. Since the supplier is the holder of world's largest natural gas reserves, the availability of gas remains granted should the Finnish consumption increase in the future. Along with constant development of Western-Siberian gas deposits, Gazprom has further showed interest in development of the gas pipeline projects in Northern Europe and Scandinavia. If realised, Finland is likely to have a key position in these developments due to its strategic location and existing pipeline connections to Russia.

Currently, the share of natural gas in total energy consumption in the EU area is a quarter. According to various estimations, the consumption of natural gas will considerably increase in the future, further giving rise to gas imports from Russia. Finland ranks among the largest importers of Russian natural gas in the EU, together with Germany, Italy and France. Along with the EU enlargement, the role of the new member states will considerably increase in the planned Trans European Network – projects, including the elaborated gas pipeline under the Baltic Sea to the German coast. Together with the Baltic gas companies, Gasum is currently elaborating on the possibilities to utilise the Latvian natural gas reserves.

Since the current study concentrates on Russian ownership in Finnish companies and particularly, the organisational governance in their relationships, the Gazprom's involvement in the organisational structure of Gasum will be discussed in following. First, a short overview of the formulation of the current ownership structure is provided, followed with a brief conceptual analysis on the organisation of strategic co-operation.

The sole supplier of natural gas to Finland, Gazprom, holds a 25%-equity share in Gasum, sharing the position of the largest owner in the company together with the Finnish government-owned Fortum Oyj. Development of the current ownership structure can ultimately be seen to have resulted from uncertainties about the gas deliveries after the collapse of Soviet Union and dismissal of former industrial structures in Russia. After the evaluation process initiated by the Finnish authorities and Neste Oyj (the then national oil and gas corporation), in 1992 Finland was officially declared as a strategic trading partner for Russian natural gas and the export quotas were set to be increased accordingly. Two modes of co-operation were discussed, including the trading house-type arrangement suggested by the Russian side, and the Finnish proposal for the Russian equity involvement in the prospective listed gas trading company. In Finland, incorporation of the gas importing and marketing activities was seen as a part of inevitable development of the energy sector, and integrating the

exclusive natural gas supplier in the new corporate structure was considered a viable option. After the complicated negotiation process, the solution was found in 25% equity involvement of Gazprom in the newly-formed Gasum. This strategic option to involve the Russian company in the new corporate structure was preferred to avoid the potentially dubious structure of the planned trading house system. In Finland, the ownership arrangement was viewed to both considerably increase the predictability of Russian gas supplies and to guarantee the Russian strategic interests in Finnish natural gas market and its development. The current ownership structure was created in 1998, when Gasum was separated from the Fortum energy corporation. The Fortum ownership in Gasum was reduced to 25% from its former 75%-stake, and the remaining share in the company was divided between the Finnish State, Ruhrgas and the three Finnish forest corporations (Gasum 2004; Parpola & Åberg 2004).

Conceptually derived (see Figure 7 above), the political uncertainties and resulting concerns on energy supply security in Finland created an external *third-party impulse* for negotiations with the Russian side on the corporate level. The underlying need for organisational restructuring of Finnish gas sector stemmed from the necessity of *obtaining resources* Neste Oyj did not possess or was unable to produce internally. This, understandably, triggers the need for seeking the resources through the Russian supplier. The specific nature of the natural gas as a resource suggests it cannot be *imitated, substituted, or* exclusively *moved* from one location to another (in a sense that the resource would subsequently be available for continuous use). Coupling this resource-based consideration with the existing *uncertainty* related to attending the resource through mere market-based transactions, the hybrid consideration model suggests attending the resources through *strategic alliance* formation with the resource provider. The proposed alliance structure included the *knowledge-based resources* (marketing skills and technological know-how) to be provided by the Finnish side and the *property-based resources* (natural gas & pipeline system) to be contributed by the Russians. A conceptual assessment on this resource combination of the two partners, again accompanied with relative *contractual uncertainties* and *high degree of asset specificity* (e.g. the natural gas infrastructure assets), suggests the companies to conclude on *minority equity alliance* -structure. Based on the above reasoning, the *network control* (control over the gas supplies) and the *balance in being able to influence other actors in the network and being influenced by others* (Gazprom's role in management of Gasum's operations), are key *strategizing issues* for Gasum.

The presented conceptual approach to the alliance formation between Russian Gazprom and Finnish Gasum suggests a certain degree of legitimation for the hybrid model of organisational governance in industrial relationships developed by the authors. In Chapter 5.3, we elaborate on the potential involvement of Russian oil companies in the Finnish oil sector and the new Fortum Oil Company. Based on the economic logic

presented above, policy suggestions are made for the ownership and co-operation structures of the new company.

3.5 Fortum Oil

3.5.1 Operational Overview

Fortum Oyj is the leading Finnish energy corporation. Under the present structure, Fortum's operations cover the generation, distribution and the sale of electricity and heat, the production, refining and marketing of oil, and the operation and maintenance of power plants as well as energy-related services. The corporation holds the leading position on the Nordic markets in electricity distribution, power generation and refining of clean traffic fuels (Fortum 2004a).

In April 2005, the oil segment will be separated from the Fortum Corporation and listed at the Helsinki Stock Exchange. The separation will be implemented through a distribution of Fortum Oil shares as a dividend to the Fortum Corporation's shareholders and a marketed offering of the remaining 15% of the shares to investors (Fortum 2004b). As a result of shares distribution, the Finnish State will become a direct majority shareholder in Fortum oil, in line with the Parliamentary decision adopted in 2003. The distribution of shares as a dividend is facilitated by notably strong performance of the corporation's oil segment in 2003-2004. During the last 12 months, the international oil refining margin has remained record-high and thus ensured the high profitability of Fortum's oil refining operations. In addition, the Fortum's capability of refining the comparably cost-efficient but high-sulphur Urals crude to produce clean traffic fuels provides the company with the refining margins above the industry average.

The Fortum Corporation's oil operations are divided into the s*egments of oil refining, oil retail,* and *the shipping and other oil.* During the first 9 months of 2004, the combined net sales of the oil operations totalled to 6 590 MEUR. The operating profit of oil refining sector nearly 100% doubled compared to the corresponding period in 2003 (see Table 13).

Table 13 Key figures of Fortum Corporation's oil segment, *Jan-Sep 2004*

	Oil Refining	**Oil Retail**	**Shipping and Other Oil**
Net sales, *MEUR*	4 579	1 763	248
Operating profit, *MEUR*	411	41	83
Net assets, *MEUR*	1 199	328	184
Return on net assets, *%*	49.6	18.0	69.5

Source: Fortum 2004c.

According to the company, the new organisational structure provides Fortum Oil full independence and capitalisation to implement its own strategy, including the high-profile upgrade of its main production outlet, Porvoo refinery. The EUR 500 million-investment will increase the refinery's capacity for sulphur-free diesel production thus enhancing the competitiveness of Fortum products on the EU market.

In Oil Retailing sector, Fortum controls an extensive network of 885 retail outlets in Finland and 169 in the Baltic Rim countries. The strategic objectives of the company include increasing the petroleum sales in these countries to the level comparable to that in Finland by the year 2006.

The Shipping sector operates a tanker fleet for crude and oil product transports. From the total volumes carried by the Fortum fleet, approximately 50% are for the third-party customers. The total capacity amounts to 1 million dw-tonnes[4]. The other Oil sector includes operating a joint oil field in Russia together with Lukoil. The average oil production of the SeverTEK joint venture totalled some 26 400 bpd[5], of which Fortum's share was 50%. The SeverTEK venture implicates the change in Fortum's strategic focus. In late 2002, the company abandoned its oil production activities in Norway and entered into joint venture in Russia. Although the SeverTEK currently accounts only for some 5% of the crude processed in Fortum's refinery, the vast majority of the crude imported originates from Russia.

3.5.2 Some Implications on the Ownership Structure of Fortum Oil

The prospects of separating the oil operations from the parent company understandably raised discussions on potential involvement of strategic investors in the new company. The initial speculations included these on the interest of both Western and Russian oil companies in the new business unit, providing several strategic advantages for a large, vertically integrated oil company. Among others, the strategic location of Porvoo refinery on the Finnish Gulf, complemented with its ability to handle the lower-quality but cost-efficient Russian crude at high profit margins, should lie especially in the interests of several Russian oil majors. Russia currently supplies almost ¾ of crude oil and feedstock imported by Fortum, making it a viable partner in economic sense. The extension of the Russian Baltic Pipeline System (BPS), connecting the West-Siberian oil fields to the export outlets on the Baltic Sea, to 1 Mbpd[6] in June 2004, further emphasises the role of the Gulf of Finland in Russian oil exports.

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[4] Dead-weight tonnes
[5] Barrels per day
[6] Million barrels per day. The BPS system will further be extended to handle 1,24 Mbpd by the end of 2004.

Although the initial ownership structure of Fortum Oil has been declared with Finnish State as a majority owner, the authors see the discussion on the future of the new oil company worth conceptual and empirical analysis. Implied by the facts stated above, this view is legitimated by both the high interest towards the new business unit in the East as well as the strategic and politically sensitive nature of the issue in Finland. In following, we thus elaborate on possible future involvement of a strategic investor in the new Fortum Oil company. The analysis first provides some implications on Russian strategic ownership in Finnish oil sector, as viewed by the representative of Finnish Ministry of Industry and Trade. Subsequently, a conceptual argumentation is provided on the organisational governance in industrial relationships with a view on the case Fortum Oil. Additional policy considerations are eventually made. A brief strategic overview on the Russian oil majors follows, regarding their asset portfolios, to implicate the strategic fit of Fortum Oil in them.

As for the Finnish side, the attitudes towards the Russian involvement vary. The political considerations often seem to overweight the economic rationality with the questions raised on supply security and underlying political motivations of the Russian companies. Cautious attitudes towards the Russian involvement have seemingly prevailed also in the Finnish Parliament responsible for deciding on the ownership structure of the state-owned companies. On the other hand, the expert opinions on the matter vary. Based on the interview conducted in May 2004 with the Director in the Finnish Ministry of Industry and Trade, Markku Tapio, some implications on the attitudes in the Ministry towards Russian investments are given in following.

The foreign direct investments are seen to have a strategic value for the development of domestic industries. Particularly in the case of state-owned companies, the occasional structural arrangements are possible for attracting the desired foreign investors. In the Ministry's view, the Russian investments are rarely considered detrimental as compared to the Western ones. Although the initial involvement of a strategic investor in Fortum Oil was not considered, the possibility for later arrangements is not ruled out should the foreign investors indicate their strategic interests. The Parliamentary decision on retaining the majority ownership in Fortum Oil in hands of the Finnish State indicates the strategic importance of the oil sector also for the Finnish decision-makers. The reasoning behind the Parliamentary decision to secure the state majority ownership in the oil company largely relies on the issue of oil supply security that is believed to be better secured through the state control over the company. On the other hand, the Ministry's view does not indicate the Russian supplies to cause uncertainty on current deliveries, given the reliability of the supply contracts between the Finnish and Russian partners. Involvement of a minority strategic investor is seen to enhance the development possibilities of Fortum Oil through the investor's network and potential know-how. The decision-making concerning the minority shareholdings is a corporate

function and not that of the Finnish state as a majority shareholder. The Yukos probe is, however, seen to affect the considerations on Russian involvement, causing relative unrest among the decision-making bodies. The increased operational and political transparency of Russian companies is seen to have a considerable positive impact on co-operation possibilities. Hence, whereas the interview within the Ministry indicated generally positive attitude towards the Russian corporations as strategic investors in Finnish oil sector, a certain degree of cautiousness is unsurprisingly present.

Recognising the strong political dimension of the subject under study, the objectives of the current study lie in providing a theoretically based economic analysis on the organisation of industrial relationships in Finnish oil sector, to support the policy discussions. Thus, in following we elaborate on the organisational governance form of Fortum Oil using the theoretical approach presented in the previous Chapter.

The considerations on the industrial organisation of the Finnish oil sector are inevitably based on the need for importing the resources the country (or the Finnish companies in that matter) does not possess. Given the geographical proximity and existing supply links to the vast oil deposits in Russia, the economically most viable option seems to be the imports of crude from the Russian sources. The current reality strongly suggests this argumentation, given the increasing importance of Russia as a crude oil supplier to Finland. The Russian share in Finnish crude imports currently stands around 80%, whereas the imports from other countries (Denmark, Norway, Kazakhstan) have decreased notably (see Table 14).

Table 14 Crude Oil Imports in Finland by Countries of Origin, *MEUR*

	2002	**2003**	**2004 (I-II)**	**Share of total 2004 (I-II),** *%*
Russia	1195	1412	279	80.2
Denmark	520	438	32	9.2
Norway	366	223	17	4.9
Kazakhstan	131	121	19	5.5

National Board of Customs, Finland 2004.

3.5.3 Conceptual approach to organisational governance of Fortum Oil

Considering the implications discussed above and applying the conceptual logic (see Figure 7) to assessment of potential Russian ownership in Fortum Oil, the following approach is developed.

The *Third party impulse* for restructuring the oil company is derived from the tightening EU regulations concerning the quality of low-sulphur fuel. The regulative pressures understandably create demand for Fortum Oil products, thus, making it economically viable for developing its refining process and increasing the capacity. This

internal rationale for developing the refining operations requires the access to cost-efficient raw material and the Russian crude in particular, since Fortum derives its competitive advantage from the ability of refining the cheaper Russian oil on higher profit margins. Hence, the *resource-based rationale* here is twofold – on one hand the capital is needed for upgrading the refining facilities, on the other, the stable deliveries of Russian oil must be secured.

Since the required resources cannot be developed internally, the resource characteristics and the transaction costs related to their acquisition are further assessed. Here, the factors of *immobility*, *inimitability* and *non-substitutability* become materialised due to the specific nature of Russian crude as a source of competitive advantage for Fortum. Although the Russian deliveries can be partially substituted by imports from other countries, the higher prices would diminish the profitability of the refining operations. Assessment on the contractual uncertainty and *asset specificity* suggests the high specificity of Fortum refining assets, designed primarily to process the Russian crude. The geographical location of the refinery on the main Russian export route on the Finnish Gulf further suggests the existence of strong *locational asset specificity*. Regarding the aspect of *contractual uncertainty*, the expert interviews carried out suggest the support for the assumption of increasing predictability of supplies together with the supplier's increasing strategic involvement in the target company. Essentially we are concerned about *incentive alignment.* The market-based contractual agreements are thus not assumed to provide comparable supply predictability.

As the previous logic leads us to proceed on the conceptual path of strategic alliance formation, the *partner assessment* indicates the last phase in designing the alliance governance structure. In the current stage, we argue the resource profile considerations to lead to knowledge-/ property-based combination of assets. Although Fortum can be claimed to control an extensive set of property-based assets (refinery, oil infrastructure, tanker fleet, retail stations), these resources ultimately follow the criteria of knowledge-based assets due to the underlying need of know-how of technological and business processes in operating them. Fortum's operations are essentially based on the advanced refining processes. In comparison, the Russian company essentially contributes the property-based assets to the alliance (crude oil).

From the economic viewpoint, our conceptual analysis thus suggests minority equity alliance between the Fortum Oil Company and a Russian strategic investor to be the optimal form of organizing the industrial relationship. The Russian minority ownership would likely increase the strategic interests in supplying Fortum Oil, enhancing the predictability of oil deliveries and adding to the supply security. Further, provided the acquirer would be a large, internationally established corporation, the development of Fortum business unit could be brought to a new level from being mere regional player

as it currently is. The investor’s economies of scale are likely to contribute Fortum by providing the possibilities to expand and take better use of the existing retail chain in the Baltics and Russia, both defined as strategic market areas for the company. Furthermore, utilising the Fortum’s advanced technological solutions should raise interest in several refining facilities in Europe, accessible through a large strategic partner.

The results provided are not intended to be comprehensive in nature, given the strategic complexity and political sensitivity of the issue, but to serve as a building block in future policy discussions on the ownership structure of Fortum Oil.

4 SUMMARY AND DISCUSSION

The economical ties between Finland and Russia are constantly gaining on relevance. As of mid-2004, there were nearly 2000 companies registered in Finland with Russian managerial or governance involvement. Given the increasing trade dependency between the two countries, the Finnish companies and decision-makers are driven towards closer interaction with their Russian counterparts. However, one should keep in mind the very nature of the trade dependency, with Russia most likely becoming the Finland's largest trading partner in near future, whereas the Finnish share in Russian trade remains notably modest. In case of such an unbalanced trade relationship, it is thus not the numerical indicators of co-operation that should be paid most attention to, but the areas where mutual strategic interests could be found.

The current report concentrates on the Russian companies' activities in the Finnish energy sector. Finnish dependency on Russian energy exports has nothing but decreased during the past years. Russia is practically a dominant primary energy supplier to Finland, supplying currently some 80% of Finnish oil imports and all the natural gas imported to Finland. Along with the recent expansion of the Russian electrical energy giant, RAO UES, even larger share of electricity consumed in Finland is originated from Russia. The current share of Russian electricity in the Finnish total electricity supply stands around 13%, which already exceeds the 10% limit for one external supply source set by the Finnish Ministry of Trade and Industry.

The above figures, thus, indicate increasingly strong dependency in Finland on the Russian energy supplies. Adding the strategic dimension of the energy supplies, it can be stated that Finland is inevitably tied to Russian energy policy. In a global comparison, the situation is not unusual for a small country neighboring one of the largest energy resource accumulations in the world. However, this dependency highlights the importance of creation of mutual strategic incentives for co-operation, not only for the importer, but also for the supplier.

In several areas, Finland is currently in a position to provide strategic incentives for Russian energy suppliers. The Fortum oil refinery in Porvoo, on the Gulf of Finland is to be updated to be the most competitive facilities in the world, capable of running incomparably high refining margins. Being currently the only facility in Europe capable of producing high-quality diesel fuel in accordance with tightening EU standards from the high-sulphur Russian crude, it should be in the interests of several Russian vertically-integrated oil companies. Economic wise, the Russian ownership in Fortum Oil should add to the predictability of supplies and more transparent co-operation between the countries. Further increase in Fortum's operational efficiency could be provided by the debated oil pipeline from the Russian port of Primorsk to Porvoo, a project that has been discussed on various forums since the late 1990's. Although in the

interests of several Russian companies, without a strategic ownership imperative the project will be likely to remain too “risky” given the high construction costs.

On the natural gas and electricity markets, Finland’s strategic position could further provide the Russian suppliers with considerable strategic incentives. According to RAO UES, the Finnish markets have provided valuable experience concerning the efficient operation of liberalized electricity markets. In addition, Finland is likely to serve as a staging ground for the operational expansion to the other Scandinavian countries. The further developing of these strategic relationships should lie in the interests of both sides. Similarly, the Finnish natural gas markets may prove of strategic importance in future expansion of Russian gas supply network, either southwards to the Baltics or westwards to Scandinavia.

The above considerations indicate the potential for mutual interests in the strategic sectors of economy. Recognizing the politically sensitive nature of most of the issues, this report, nevertheless, suggests the increasing attention to be paid on economic rationality in decision-making. The strategic dependency of Finland on the Russian energy supplies raises the need to provide mutual interests for Russia if sustainable co-operation is to be built. Committing the Russian companies to Finnish economy trough strategic partnerships and investment opportunities would benefit not only the Russian companies’ ambitions abroad but also the Finnish counterparts inevitably dependent from the Russian supplies.

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