Russia slowly enters the pathway towards a "green economy"

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The European Union attempts to be carbon neutral in 2050. In the meantime, financing will depend on an ever-larger extent on a company's performance in terms of ESG-performance. For businesses in Russia, this is yet a challenge that must be turned into an opportunity by setting the course towards a future energy with hydrogen and zero-emission projects.

Let us be honest: in Russia and other emerging markets, most climate change action has long been dismissed quietly as a philanthropic topic for saturated societies in the West. Although Russia politically supports the Paris Climate Protection Agreement, corporates have so far assumed that Russian gas – cheap as it is produced – will always find its customers anyway. The trend towards renewable energy has been underestimated systematically.

This is now about to change. Climate change is more and more perceived as a factor of financial risks: oil spills such as in the case of Norilsk Nickel show the Russian government's readiness to prosecute companies for environmental hazards instead of imposing symbolic fines. Environmental catastrophes can end up in losing, strategic partners, markets, customers. Large corporates are now forced by law to publish non-commercial reports about environment, social, and governance (ESG) performance, which go beyond the ancient threshold that planting trees is enough commitment to the ecology. Most importantly, the financial market is shifting capital supply globally away from conventional investments toward "green" and ESG-compliant products. This trend is set to become the main driver for this transition.

The importance of all means of "Green Financing" is gaining pace dramatically. Among the ESG-related financial products, the "Green Bonds" reached a market volume of EUR 250 billion in 2019, but this amount is expected to quadruple at least in 2020. Large public investors such as European Investment Bank (EIB) or private fund managers (Blackrock) declared to shut down investments in companies related to carbon emissions. Other fund managers are entirely looking for "clean" opportunities such as energy companies with a focus on renewables, retail chains providing fair working conditions, food processors with a sustainable sourcing approach. Notably not on the paper but proven by facts and figures.

If we anticipate the trends on western financial markets, we can easily assume: companies lacking ESG performance will face increasingly difficulties to receive at least cheap financing from global financial markets as investors are more and more shifting equity, debt or other means of investments towards more attractive directions. Among the ESG concept, the subcategory "environment" will probably be the most relevant one as the pressure of politics, society and competitors grows to decrease GHG emissions and cope with increasingly sophisticated targets to mitigate climate change.

The most obvious victim could be the oil and gas industry. This may cause large difficulties for Russia as still more than 40 percent of the gross domestic product (GDP) are linked with oil and gas producers.

In a worst-case scenario this could mean that an oil and gas producer will be cut off from international corporate financing soon, begging in one queue weapon manufacturers and tobacco companies for investors. Most of the latter are forced by their own investment frameworks to invest only in stocks or obligations of ESG-compliant companies. Even equity partners enter projects only on large discounts. Consequently, the "fossils" face increasing difficulties to raise cheap capital on financial markets. They will increasingly rely on governments support as shrinking profits do not even allow financing even the most necessary maintenance investments in oil and gas fields.

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Certainly, it is too early to bury the "traditional" hydrocarbons – oil and gas. Demand for these energy resources will remain for decades to come. But the market growth already stalled this year, which is only to some extent due to the COVID-19 crisis. Instead, competition in the energy market – primarily with renewables – will increase exponentially, while demand for carbon will gradually decline. A horrific scenario for the oil and gas industry as abovementioned might come true not in the 2030s but in the 2040s. And it can be still avoided if oil and gas companies take a clear stance on GHG emission, innovation, and a setup of value-chains for alternative fuels and sources for electricity.

Businesses in Russia must accept this challenge and turn the latter into an opportunity: oil and gas companies are requested by strategic partners and financiers to take a clear stance on ESG, so why not preparing the companies strategically for a time beyond fossil fuels, accompanied with investments.

Italy's Enel did this by installing a wind-park in Murmansk region. Lukoil uses solar power to cover the internal electricity demand for refineries in southern Russia. Severstal made huge efforts to decrease energy consumption in their steel plants. However, the market demands even more disruptive strategies and concrete investments, which show a company is heading towards net-zero.

It would be strategically appropriate even for conventional Russian oil and gas companies to offer cleaner alternatives: the production of hydrogen based on the abundance of natural gas for industrial purposes. Several chemical companies and refineries process gray hydrogen from methane, releasing CO_2. The separation of carbon or the storage of CO_2 are technically possible but would have yet to be rolled out in series.

Corporates can show the financial market to move despite difficulties such as sanctions and political risks in a trajectory towards sustainable development. This might prove a company's strength in the perception of investors, buyers, and strategic partners. Consequently, a company with positive ESG performance can shelter itself to some extent against maintaining political risks and increase their potential for competitive corporate financing on global capital markets.

Apart from the energy sector, Russian Railways (RZD) recently proved that a state-owned Russian corporation can despite sanctions successfully attract capital from European financial markets by having a green framework for a bond in place: their green bond with a maturity of eight years has been placed with a final price of 2,2 percent last year in Europe, raising a volume of more than EUR 500 million for modernization projects. Since RZD is planning to switch diesel-driven locomotives to hydrogen in the next year, the surprisingly effective railway company will for sure find other stories to issue "green" products on the international financial markets.

In Russia there is a brisk trade in "green bonds". Since the Moscow Exchange began listing in August 2019, nine bonds with a volume of more than RUB 70 billion have been issued. This is yet a small amount, but taking into account that the green bond framework has not yet been finally authorized between several ministries, the Central Bank of Russia, and Vneshekonombank as the author or the Russian "taxonomy", these activities should be seen as a good start. The first Vice-President of Sberbank, Aleksander Vedyachin, expects a market volume of three trillion roubles all for "green financing" by 2023.