

Business system in Kazakhstan

-based on an Astana survey in March 2010-

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Abstract

Kazakhstan is one of the five Central Asian countries which had affiliated to the Soviet Union. After the collapse of the Soviet Union, Kazakhstan has socio-economically developed in its own way. Kazakhstan is interesting to us not only because it is an Asian country, but also it has unique relationships with us, especially China, South Korea, Russia and Japan.

In this paper we investigate current business system in Kazakhstan mainly based on the author's field study results.

We can summarize the characteristics of Kazakhstan's business system as follows.

(1) Convention of organizational architecture. As Kazakhstan companies are known to show comparatively high power distance index (House and others [2004]), we can suppose that its company organization generally works as a functional hierarchy. It is a legacy of the Soviet era. (2) Corporate governance. While EBRD statistics show that the private sector covering GDP is 70% (2008), the state controls many prominent corporations in actuality. (3) Financial institutions. A comparatively stable banking system is formed, while a stock exchange organization is undeveloped. Therefore indirect financing prevails. (4) Labor and employment institutions. Although there are labor unions, they are not very influential (a bureaucrat the author interviewed did not know about the presence of labor unions). The Government is targeting the training of a high quality labor force through the improvement of education system and a study abroad system. (5) Product market/ industrial institutions. Kazakhstan is dependent on foreign investment for their production, and relies on exports for their product market. (6) Supply relationships. Supply relationships are undeveloped, because the manufacturing sector is weak. (7) Property rights rules and enforcement. Collusion of bureaucrat, politician and big business is remarkable, as is assumed from low corruption perceptions index (ranked 120th globally). (8) Social embeddedness/ norms/ values. There is a tendency to respect bureaucrats and look down on private people, but in recent years, there is also growing entrepreneurship as seen in the rise of small businesses. (9) State. Kazakhstan state has the attributes of a developmental dictatorship. While the President himself try to lead the industrial development, EIU Democracy Index (2008) ranks Kazakhstan 127th of 167 countries and put it among "authoritarian" countries".

1. INTRODUCTION

Kazakhstan is one of the five Central Asian countries which had affiliated to the Soviet Union. After the collapse of the Soviet Union, Kazakhstan has socio-economically developed in its own way. Kazakhstan is interesting to us not only because it is an Asian country, but also it has unique

relationships with us, especially China, South Korea, Russia and Japan. Russia had continuously made a powerful influence on Kazakhstan through the Russian Empire and the Soviet Union, and still now have a strong linkage with Russia in cultural, political, and economic meanings. Ethnically Russian people account for 30% of the population of Kazakhstan (1999) and Kazakhstan's official communication language is Russian. China, which also shares border with Kazakhstan, is one of its most important economic partners. China takes the 3rd place in terms of export and the 2nd place in terms of import. China is interested in the rich mineral resources in Kazakhstan. Although South Korea is quite far from Kazakhstan, it has also special links with Kazakhstan, because not a few Korean people living in the far east Russia before the 2nd World War were deported to Central Asian regions including Kazakhstan by the Soviet government. Korean people account for 1.5% (103 thousand people) of the population of Kazakhstan (1999). Japan is trying to develop economic relationship with Kazakhstan in the way that Japan provides Kazakhstan with technology and know-how, and Kazakhstan provides Japan with mineral resources, especially uranium, rare earth, etc.

In this paper we will investigate current business system in Kazakhstan. Business system here refers to the way of existence of companies that have incorporated core activities, targets, organization and interaction with environment as its subsystems. The author visited Astana, the capital of Kazakhstan from March 15-19, 2010, conducted a field research and present here my research results.

It is important to model business systems in order to define their features. Although the existence of different business systems with unique features based on nations and societies is widely recognized, there are not many comprehensive models proposed to compare them.

Models have traditionally been based on a cultural approach. This has primarily been an approach by sociologists that is of great interest and appealing, but it focused interest on the interrelationship between business system and culture.

Thus models based on an institutionalist approach have appeared from the 1990's. This is mainly an economist based approach where the entire national and social economic system is the focus of interest, but companies are emphasized as the major agents of the economic system. Masahiko Aoki (2001) advocated quite comprehensive "Models of institutional linkages". Simply put, he identified 9 "domains" which define the features of business systems: convention of organizational architecture, corporate governance, financial institutions, labor and employment institutions, product market/ industrial institutions, supply relationships, property rights rules and enforcement, social embeddedness/ norms/ values, and state. Through this approach, he proposed the classical economics theory models (W, HM), the traditional industrialized nation models (A, D, J) and the post ITC revolution models (SV, GL).

This paper is based primarily on the comprehensive Aoki framework, and may employ other approaches as needed.

2. Large Corporations

Almaty had been the capital of Kazakhstan until 1997 when Astana became the new capital. The government gradually shifted there and the population of Astana grew from 327,000 in 1999 to 639,000 in 2009. Government buildings and housing for the influx of people led to the construction of a new downtown area developed across the old downtown area and a river. There are many new, magnificent buildings, one of them being the main building of KazMunaigaz, a

state-owned corporation.

First, let's take a closer look at the situation in large corporations such as KazMunaigaz.

The first top 100 company sales ranking of corporations in Kazakhstan were announced in November 2009. KazMunaigaz was number 1 in the ranking. Such prominent corporations as Karachaganak Petroleum Operating (oil and gas; British, Italian, American and Russian consortium), ArcelorMittal Temirtau (iron and steel; Luxemburg interest), Bogatyr' Komir (coal; US interest, but ownership switched to the Kazakh and Russian consortium in 2009), and Kaztsinka (lead, Swiss interest) are not included in the ranking because sufficient data of them are not open to public. Nevertheless the total sales of these 100 companies covers 72.6% of Kazakhstan's GDP.

The industry breakdown is 51% oil and gas, 14% mining and metallurgy, 14% banking, 7% transport, and 14% others. This reflects that the oil and gas industry as well as mining and metallurgy industry are core industries in Kazakhstan. The GDP structure reveals that 30.5% comes from industry, 56.8% of industrial production is dependent on the mining industry and 15.2% depends on the metallurgy industry.

There is a high concentration of economic power in the top 10 companies, with their total sales reaching 51.9% of the GDP (Table 1). The industry breakdown here also shows that the oil and gas production, and mining and metallurgy industries are predominant, and banking and transport follow.

Top ranked NK KazMunaigaz is an oil and gas concern, a massive corporation with over \$21.0 billion in sales. NK (National Company) means a 100% state owned company. It has 10 exploration and exploitation, 7 transport and other affiliates. It is a large shareholder in different big companies like Tengizshevroil (2nd place), Mangistaumunaigaz (5th place) and PetroKazakhstan (7th place), and we see that Kazakhstan's oil and gas industries are controlled by the government through KazMunaigaz. US oil giants, Chinese national oil and gas companies (CNPC) and others have a strong presence, and we can say that foreign investment plays an important role. Although the government accounts for a considerable ownership percentage for mining and metallurgy industry companies as well, private ownership also appears as major shareholders.

The government established JSC "National welfare fund, *Samruk kazyna*, " as the management organization for state-owned stocks. This corporation has 404 companies under its umbrella, with 49 major companies therein. It includes 1st, 6th, 8th and 10th place companies on the list of the top 10 ranked by sales. The goal of *Samruk kazyna* is to manage companies to maximize the long term value of affiliated businesses and improve their global market competitiveness. The prime minister is the Chairman of *Samruk kazyna*.

As shown here, major corporations in Kazakhstan are concentrated in the oil and gas as well as the mining and metallurgy industries, and the government controls them through ownership stakes. There is also a strong foreign investment presence. But there are almost no powerful manufacturing companies.

3. The Program for Development and Promotion of Industrial Innovation & Ministerial Reorganization

The global financial crisis of 2008 was also serious for Kazakhstan as predicted easily from the industrial breakdown of large companies as described above. GDP growth which approached 10% from 2000 fell rapidly to 3.2% in 2008 and 1.2% in 2009.

The move away from a resource dependent economy, diversification of the economic structure

and the shift to a tertiary industry centered economy were already cited as goals in the document titled “2003-2015 Development Strategies of Industry and Innovation” approved by Presidential decree in 2003, but the need to promote this strategy was further emphasized by the financial crisis.

Around the time I was conducting a research activity in Astana, a new program was announced and ministerial reorganization followed. Probably that is why bureaucrats of economic related government agencies seemed to be very busy and sometimes in disarray.

The new program was titled “2010-2014 State Program for Development and Promotion of Industry and Innovation” which was resolved by the government in February 2010 and affirmed by Presidential decree on March 19. A bureaucrat stated “this is a 5-year plan just like we had under the Soviet system”. The goal of this plan is said to be “continuing the diversification of economic development in a long term, improving competitiveness and achieving 150% of the 2008 GDP in 2015”. The main measures for achieving it are considered to be: (1) forming an economic framework withstanding economic shocks from overseas and based on the national and regional markets (Kazakhstan, Russia, Belarus tax union), (2) developing traditional export sectors and diversifying products and technological chain and (3) developing innovation industries. This means, specifically, to develop the agriculture and agricultural product processing, construction and construction material industry, oil and oil chemicals, chemicals and pharmaceuticals, metallurgy and materials, power generation, transport and communications as well as the space industry, tourism and machine manufacturing.

4. Accepting Foreign Direct Investment

Foreign investment was promoted actively by the Kazakhstan government in the economic turmoil that followed the collapse of the Soviet Union. Most of this was for resource related industries. An industry sector breakdown of foreign direct investment as of June 2009 shows that 50.4% went to geological exploration and 23.9% went to mining. Most of the investment came from the Netherlands at 28.9% and the United States at 19.5%. However, there are many examples of investment by Russian companies through offshore centers. Companies with foreign participation working in Kazakhstan include 2355 Russian, 1376 Turkish, 607 American, 547 Chinese and 546 German investments.

The author interviewed A. Dosanov, Vice Chairman of the Investment Committee of the Ministry of Industry and New Technology and heard about the policies, situation and goals of accepting foreign direct investment. Based on what Mr. Dosanov said, the following might be noteworthy considering the features of foreign direct investment in Kazakhstan from the viewpoint of its impact on the business system.

Protection of rights of foreign investors is regulated by law. “The Law on Investment” (2003) stipulates protection of investor's rights, state support for investment and dispute resolution procedures with investor's participation, which are equally applicable to both domestic and foreign investors.

Measures for preferential treatment of investment are established. Investors are provided preferential treatment based on agreements with the Investment Committee (customs tax exemptions, state support in kind etc).

The following 6 Special Economic Zones were established to be provided tax exemption for business, property and foreign trade. These are Aktau Port (transport service on the Caspian Sea coast harbors), Astana (construction and construction material production), IT Park (Almaty),

Ontystik (textile industry in southern Kazakhstan), Petrochemical Techno Park (Atyrau on the north coast of the Caspian Sea) and Burabai (tourism cluster in northern Kazakhstan).

Resource nationalism policies have been implemented in recent years on investment in underground resources. The 2007 revisions to the “Law on Underground Resources” (1996) (1) allow the government to revise contracts already signed, (2) allow the state-owned corporation, KazMunaigaz, to get 51% ownership rights in all new development and production contracts and to obtain development rights without an open bidding process, and (3) provide the government with preemption rights when strategic resources are put on domestic or international markets.

Local content regulations have been strengthened. On March 2, 2009, Prime Minister Massimov stated that domestic products must be procured by foreign oil companies, and local content provisions must be added to all contracts with foreign companies.

Council of Foreign Investors was established for the sake of direct talks between foreign investors active in Kazakhstan and the Kazakhstan President and government. The council gathers twice a year, with the President as the chairman and the Investment Committee as the secretariat. The members consist of managers from international financial organizations and foreign companies working in Kazakhstan.

In short, the Kazakhstan state is taking the initiative in accepting foreign direct investments in order that it should be oriented to preferable spheres, related to the national interest and not damage domestic companies.

5. Special Economic Zones and Social Business Corporation

The author had several opportunities to make an interview with a bureaucrat from the Department of Regional Industry Policy of the Ministry of Commerce & Industry. The major task of this department is to establish policies for the organization and administration of Special Economic Zones and the Social Business Corporations (SPK).

We have given an overview of the Special Economic Zones above.

SPKs are regional development organizations that manage state property of each region in Kazakhstan which include vacant land and undeveloped underground resources. A SPK is a 100% state-owned JSC that plays a role of promoter of regional development program. When companies participate in SPK projects, they can gain access to resources, properties, machinery and foreign markets among others. There is a SPK in each of Kazakhstan’s 7 regions.

Therefore, the Department of Regional Industry Policy of the Ministry of Commerce & Industry is engaged in regional development in a way of top-down, using the leverages of Special Economic Zones and Social Business Corporations.

6. Financial System

Many major banks in Kazakhstan fell into crisis due to the impact of the global financial crisis, and received government bailout. However, as Kazakhstan’s financial system has excelled in establishing payment discipline and business transparency, it is regarded as the best developed among those of CIS countries.

The author conducted an interview with Manager A in a midrange bank, and was given guidance on Kazakhstan’s financial system from the perspective of corporate financing. The following are the major points as described by Mr. A. (1) Kazakhstan’s banking system is developing and stable.

It is regarded as the best in Central Asia, and the people trust the banks. The share of banking transaction in GDP is a fairly strong 60.6% (2005). (2) It is against the background that Financial laws and regulations have been much developed. The deposit insurance system was partially introduced in 1999, and was strengthened in 2004. Though one bank actually collapsed in 2004 and another in 2007, deposits were protected. In 2003 bank asset evaluation system and standards for reserves for bad loans were made stricter, and banks were mandated to adopt an international accounting standard (IAS, IFRS). There are regulations on equity capital ratio as well. There works a credit information center where information on people receiving bank credit is concentrated. (3) Problems occurred due to the global financial crisis, because there were many high risk finance operations among overseas investing or borrowing in 2000-2005. The situation is stable again. (4) Interpersonal relationships are important for the business climate in Kazakhstan. Personal relationships matter when companies choose their banks. While Western business people conduct important negotiations in their offices, Kazakh people do those during dinner or hunting expeditions. (5) Indirect financing is the mainstay, as direct financing is undeveloped. The stock exchange system is not mature. The number of companies listed on the Kazakhstan Stock Exchange (KASE) is no more than 73 (2010), and more than 50% of stocks really traded are in the raw material sector, more than 20% in the energy sector and less than 20% in the financial sector.

7. *Bolashak* Program (Human Resource Training)

Kazakh bureaucrats and company managers often take pride in the *Bolashak* Program. *Bolashak* means "hope" in Kazakh, and the *Bolashak* Program is a government scholarship system for Kazakhstan's best and brightest, Kazakhstan's future, to study overseas. Mr. Dosanov, Vice Chairman of the Investment Committee who the author interviewed, cited superior human resources as one of the most appealing parts of Kazakhstan as an investment destination, and also cited the *Bolashak* Program as one of the systems that make it so. When the author asked the midrange bank manager "Weren't there any problems with human resource procurement given that Kazakhstan established commercial banks only after the breakup of the Soviet Union?", he answered "Not at all...Because we could get personnel through the *Bolashak* Program." The director of the Japan Center in Almaty also commented when the author visited its office in 2006 that the *Bolashak* Program was highly regarded.

Through the *Bolashak* Program, 785 people studied in 13 foreign countries from 1994-2004. The number of students on scholarship grew to around 1000 each year thereafter, and the total number of scholarship students from 2005-2009 is 5165. Most of them have headed to the UK, USA, Russia, Germany, Canada, Malaysia and China for overseas studies.

8. Small Business Policy and Women Entrepreneurs

The author met with 3 women entrepreneurs during this survey, and they filled out a questionnaire. All 3 are engaged in small business.

Before examining their cases, let us make an overview of small business in Kazakhstan.

Small business accounts for 25.3% of all the employees and 15.0% of total GDP. These numbers show that small business sector in Kazakhstan makes up a smaller percentage compared to many transition economies including Russia, to say nothing of other developed countries.

The Kazakhstan government has implemented a small business support and development program

6 times since 1991. Financing businesses and removing bureaucratic red tape have been believed to be the priorities. But, there still exist problems with laws and regulations, a lack of knowledge and information for small business people, as well as difficult access to capital.

JSC "Fund for Small Business Development" was established in 1997 for the state to support small business development. The JSC was reorganized into the JSC "Fund for Business Development *Damu*" in 2007. *Damu* is an affiliate of the state-owned holding company *Samruk kazyna* described earlier.

The midrange bank mentioned in Section 5 is mainly engaged in financing small businesses, and have become one of the mediator banks through which *Damu* provides small businesses with financial resources.

The 3 women entrepreneurs the author met in Astana were all comparatively young (in their 30's), engaged in the service industry, started their businesses after moving to Astana when it became the capital, developed their businesses successfully, are quite satisfied with their activities materially and psychologically. In these meanings they are considered to be typical examples of small entrepreneurs in Astana. As described above, in Astana, where the population has exploded since it became the capital, there is an increasing number of government bureaucrats, and the government encouraged younger people to move there through housing policies, so Astana has obviously huge service demand and many younger people eager to launch their own business to satisfy this demand. Recently on the background of rapid macro-economic development, Astana is extending more and more as a market.

What sets these three examples apart is that the entrepreneurs are married women with high level education.

We should also pay attention to the following points. Two of the women entrepreneurs stepped down as bureaucrats and launched their businesses to cope with both working and taking care of their children. They regard highly the government's small business policies. They feel that there are risk avoidance tendency, individualism and less of a gender gap in Kazakhstan's business culture. Here we can recognize some characteristics of a post-modern business society.

While we cannot assert something with only this small sample, it does indicate that there are some achievements in small business policies, and some characteristics of a post-modern business society.

9. Conclusions

The author enumerated some results of her field work survey above. When we examine these results considering some information from the literature on business system in Kazakhstan, features of Kazakhstan's business system seem to be revealed. Let us try to summarize them in line with the Aoki's framework.

References

- 1) Convention of organizational architecture. As Kazakhstan companies are known to show comparatively high power distance index (House and others [2004]), we can suppose that its company organization generally works as a functional hierarchy. It is a legacy of the Soviet era.
- 2) Corporate governance. While EBRD statistics show that the private sector covering GDP is 70% (2008), the state controls many prominent corporations in actuality.
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organization is undeveloped. Therefore indirect financing prevails.

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6) Supply relationships. Supply relationships are undeveloped, because the manufacturing sector is weak.

7) Property rights rules and enforcement. Collusion of bureaucrat, politician and big business is remarkable, as is assumed from low corruption perceptions index (ranked 120th globally).

8) Social embeddedness/ norms/ values. There is a tendency to respect bureaucrats and look down on private people, but in recent years, there is also growing entrepreneurship as seen in the rise of small businesses.

9) State. Kazakhstan state has the attributes of a developmental dictatorship. While the President himself try to lead the industrial development, EIU Democracy Index (2008) ranks Kazakhstan 127th of 167 countries and put it among "authoritarian" countries".

Thus, we should say that Kazakhstan's business system is fraught with serious problems, especially considering that its core parts are controlled by the state with corruption. Yet, at the same time, national education system and small business policies have shown a certain effect, raising some hopes for future development. We can also argue that Kazakhstan business system has some common features with Russian one, due to not only their legacy of the Soviet system but also their resource-dependent industrial structure.

Table 1 Top 10 companies in Kazakhstan (2008)

Rank	Comapany Name ⁽¹⁾	Industry	Sales in 2008		Ownership
			(mil. tenge)	(mil. US\$)	
1	AO NK KazMunaiGaz	Oil & Gas	2 537 391	21 007	Government
2	TOO Tengizshevroil	Oil & Gas	1 730 809	14 329	Chevron – 50%、KazMunaiGaz – 20%、ExxonMobil – 25%
3	ENRC	Mining & Metallurgy	824 155	6 823	Kazakhmys – 26.00%、Mr. Chodiev – 14.59%、Mr. Ibragimov – 14.59%、Mr. Machkevitch – 14.59%、政府 – 11.65%
4	Korporatsiya Kazakhmys Plc	Mining & Metallurgy	622 193	5 151	Mr. Kim – 38.9%、Government – 15.0%、Mr. Novachuk – 5.5%
5	AO Mangistaumunaigaz	Oil & Gas	488 396	4 043	Central Asia Petroleum Ltd (UK). Obtained by KazMunaiGaz and CNPC(China) in April 2009。
6	AO NK Kazakhstan temir zholy	Transport(railroad)	483 763	4 005	Government
7	AO PetroKazakhstan	Oil & Gas	459 263	3 802	CNPC(China) – 67%、KazMunaiGaz – 33%
8	AO BTA Bank	Bank	426 801	3 533	Government – 75.1%
9	AO SNPS-Aktobemunaigaz	Oil & Gas	417 597	3 457	CNPC(China)
10	AO Kazkommertsbank	Bank	380 799	3 153	Central Asian Investment Company (Mr. Subkhanberdin) – 23.72%、Alnair Capital Holding (Sheikh Tahnun bin Zaid Al Nahayan, Abu Dhabi) – 28.565%、Government – 21.26%

(1)AO means JSC, TOO – LLC.