Survival and Growth in Kazakstan

Case Studies of Industrial Enterprises

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1 Introduction

With the collapse of the Soviet empire in 1991 and the concurrent collapse of the traditional supply and distribution channels across the former Soviet Union (FSU), the major challenge seen to be confronting the transition economies in the early transitionary period was the need to establish a stable macro-economic environment and to liberalise trade and prices. This, it was assumed, would set the framework within which economic activity could proceed at a favourable rate and enterprises would respond (in some mysterious way, automatically) to the changes. While considerable progress has been made in macro-economic stabilisation and liberalisation, this has been accompanied by growing rates of unemployment, social distress and political upheaval as well as a sharp decline in output.

Efforts to promote restructuring and growth of the productive sector need to be underpinned by a sound understanding of the situation at the enterprise level. This article aims to contribute to this understanding through the use of a case-study approach. Two cases are considered: the first is an industrial enterprise set up in the Soviet era and recently privatised ('inherited firm' hereafter); the second is a new firm set up at the outset of the transition era ('new firm' hereafter). The case studies indicate that while some of the market-adjustment problems encountered by industrial enterprises in transition economies are similar to those encountered by enterprises in developing and indeed in developed countries, enterprises in a transition economy like Kazakstan are concurrently struggling with the legacy of central planning and as such face a distinct set of challenges requiring a distinct set of policies.

The article begins by setting out the main elements of the external environment relevant to industrial enterprises in Kazakstan. This is followed by a description of the two firms. The final section takes stock of the lessons to be learned from these case studies and their implications for future research

[1] Special thanks are due to Raphie Kaplinsky, whose unflagging enthusiasm for industrial restructuring, especially at minus 34°C with wind-chill, will remain a continuous source of inspiration. All errors and misinterpretations are the authors' own.

on, and policy for enterprise restructuring and development in transition economies like Kazakstan.

2 The context for enterprise development and restructuring

Since gaining its independence in 1991, Kazakstan has embarked on far-reaching economic reforms. The initial transition years were dominated by efforts to manage the negative repercussions of the collapse of the socialist system. In this context, the focus was on privatisation of assets, liberalisation of markets and the creation of a stable macro-economic environment. After an initial period of high macro-economic instability, a number of critical areas of macro-economic management and market liberalisation were addressed successfully: inflation was reduced from just under 2,000 per cent in 1994 to approximately 25 per cent in 1997; following the introduction of the national currency in 1993, a relatively stable exchange rate was obtained; almost all prices were liberalised by the end of 1994; and a liberal trade regime was introduced (EBRD 1997: 179).

The costs of this adjustment have, however, been high. In addition to growing rates of unemployment, social distress, income disparities and political upheavals, the economy experienced sharp falls in output. As shown in Table 1, until recently, this decline was more pronounced in Kazakstan than in most other transition economies. In recent years, the economic situation has improved and Kazakstan has experienced economic growth, albeit modest.

However, a number of problems beset the external environment of enterprises in Kazakstan:

- In the evolving agenda the underlying attempts to reform the enterprise sector have almost exclusively been seen in terms of financial rehabilitation. Enduring growth in productivity and output can, however, only be attained if these are accompanied by changes in strategic focus, organisation and production methods.
- If enterprises are to break their reliance on government and to secure finance for restructuring or new business ventures, open access to sound financial and capital markets is needed. The financial sector in Kazakstan is marked by high fluctuations. In the middle of 1993 there were 210 banks in Kazakstan; by 1997 this number had reduced to less than 100. The volatility of the banking system, coupled with high real interest rates of some 30 per cent and undercapitalisation of banks, makes it virtually impossible for enterprises to borrow capital economically (EBRD 1997: 179).
- As an extensive study of Kazakstani inherited and new enterprises showed, there is a need for assistance in facilitating enterprise restructuring. While Kazakstan continues to enjoy a high educational base (over 90 per cent of the population are literate and have completed secondary school education), there is a severe lack of skills and experiences required for domestically based enterprise restructuring and development (Tacis 1996).
- The legal and institutional infrastructure required for growth of a market-driven enterprise sector is weak. Notably bankruptcy laws and competition policies remain underdeveloped or are altogether absent, leading to

Table 1: Growth in real GDP in Eastern Europe, the Baltics and the CIS (per cent)

	1991	1992	1993	1994	1995	1996 estimate	1997 projection
Eastern Europe and Baltic States	-10.6	-4.2	0.4	3.7	5.3	4.1	3.1
CIS	-5.8	-14.3	-9.3	-13.5	-4.9	-4.6	0.8
Kazakstan	-13.0	-12.9	-10.4	-17.8	-8.9	1.1	2.0

Source: EBRD 1997: 115

Table 2: Industrial production of selected sectors in Kazakstan

Sector	Percentage change over previous year 1991	1992	1993	Cumulative percentage change 1991–93
Clothing	15.5	-22.0	-80.2	-82.2
Light industry	2.5	-21.0	-70.2	-75.9
All industry	-0.9	-13.8	-27.4	38.0

Source: World Bank 1995: 262

problems such as unprofitable businesses continuing to operate and strong enterprises imposing entry and exit restrictions in key sectors.

- Corruption at all levels of business is a severe problem. The EBRD estimates Kazakstan to be one of the most corrupt countries in the FSU (EBRD 1997).

3 The case studies

Having sketched out the background against which enterprises operate in Kazakstan, the article now turns to examining two industrial enterprises in Kazakstan. The first is an inherited firm which is struggling with survival and the second is a new enterprise which has experienced considerable success[2]. The two cases are first examined separately before they are compared and contrasted. Lessons to be drawn from these case studies are examined in the concluding part of the paper.

Survival of the fittest: case study of an enterprise's restructuring efforts

The first enterprise in question is a clothing producer established in the 1960s[3]. It was established as one of three clothing producers in Kazakstan exploiting cotton produced as a result of the cotton mono-culture policy in Central Asia. During the Soviet era, the enterprise held a more than 50 per cent share of the market in Kazakstan. It had an extensive distribution network, comprising some 50 wholesalers throughout Kazakstan and neighbouring republics. The company developed a well recognised and strong brand name during Soviet times. It employed some 2,000 people.

Since the onset of transition, this enterprise has been confronted with many of the problems typical of a Soviet enterprise. As shown in Table 2, the clothing sector experienced a severe fall in output, falling by more than 80 per cent from 1990 to 1993.

The economic downturn, combined with the opening of trade (resulting in c heap imports flooding the markets, mainly from Turkey, China and Thailand), had an immediate impact on the clothing enterprise in question. The enterprise experienced a sharp decline in sales. Since 1993, the company has been at a near standstill, producing at a maximum of 10 per cent of its capacity.

Following this decline, the enterprise followed a path common to inherited industrial enterprises in less developed transition economies: inertia was coupled with efforts to maintain production through barter trade. The enterprise managers' main aim was to maintain the *status quo*, in particular with regard to its employees. While this is a problem in many other countries and economic systems, this is particularly strong in former socialist economies where full employment was a fact of life for over 70 years and where a social wage, which included access to housing, energy, schooling and medical care, was linked directly to employment. Managers also inherited the Soviet culture of measuring an enterprise's status (and that of its managers) by the number of workers and the volume of output, not the value of output or profit.

Thus, when the enterprise was privatised in 1993

[2] Both are located in the south of Kazakstan and within close proximity of large commercial centres. They are also within close proximity of the border of populous Uzbekistan.

[3] This enterprise was visited by T. Azad at the end of 1995 in the framework of a countrywide cross-sectoral analysis of Kazakstani enterprises (EES 1996).

and 95 per cent of the shares were transferred to the employees and management of the enterprise, little actual change was introduced. The managers' lack of experience with market-oriented business practices as well as their historic links to the enterprise and in particular its employees meant that emotional ties precluded reorganisation for more efficient and productive (labour) resource allocation. This is exemplified by the fact that despite the decline in sales, the company still had some 1,900 people on its payroll at the end of 1995. It should be noted that in the context of Kazakstan, this does not mean that people on the payroll were working at or being paid by the enterprise. When the company was visited in December 1995, none of its employees had been paid since August and most employees were working elsewhere, mostly selling products on the market. Nonetheless, the employees, as in many inherited enterprises, stayed on the company's payroll to have access to the social wage and because of the social stigma attached to being unemployed.

The enterprise continued its existence on the basis of minimal production, designated for barter trade. By the end of 1995, some 75 per cent of all transactions were on a barter trade basis[4]. For example, at the time the enterprise was visited, it purchased cotton, the main input, from neighbouring Uzbekistan. However, as it could not afford the transport costs, it entered into a barter arrangement with the national railway company whereby uniforms were produced for the railway company in return for the cotton being transported to the enterprise by rail. This barter trade enabled the company to continue producing, thereby avoiding closure.

Despite the dire situation at the enterprise at the end of 1995, it can be considered potentially viable, though it currently lacks a credible strategy and needs to make major changes. The enterprise's technical know-how to produce good-quality clothing as well as a strong local brand name would be valuable assets when allied to an appropriate strategy, notably setting up reliable distribution channels, upgrading retail marketing and updating designs. While an injection of capital will be necessary for the implementation of the strategy, such a capital injection must be complemented by a focus on management and organisational methods. The risk of the investment being utilised to cover operating losses, or for inappropriate purchases of equipment, would need to be averted by underpinning the restructuring efforts with a strong strategic focus. There is a tendency for inherited enterprises in the FSU to attribute all problems to outdated technology, thus viewing all solutions in terms of technology.

A successful enterprise-level effort

The article now turns to the second case study which is a new enterprise founded in 1990 as a private family-run business. At the outset, the enterprise produced one beauty-care product on the family's private premises. By early 1997, the company was producing four types of beauty-care products and the initial number of five employees, all family members, had increased to about 450.

Since the outset, most of the inputs required for the production, packaging and labelling were sourced from well known, mainly European, suppliers. Most inputs have been and are continued to be sourced from abroad because local suppliers either do not exist or do not meet the company's quality and delivery requirements.

The enterprise operates in a sector which is dominated by global brands of multinational corporations (MNCs) and by Russian brands. There are virtually no other local brands. Thus, the company's competition is mainly against global brands. In 1997, the company held 6 to 10 per cent of the domestic market.

As shown in Table 3, from 1991 to 1993 the company enjoyed a steep increase in sales because of: (a) the company's price competitiveness: its

[4] Barter trade, typically bilateral, has become a prevalent method of exchange in industry in many transition economies. Once started, barter trading becomes a vicious circle, leading to debts, taxes and wages settled with payment-in-kind or through mutual write-offs. Therefore, enterprises become more dependent on each other due to their simultaneous supplier-customer relations. It is notable that barter trade was prohibited in Kazakstan in 1995. However, it is still common practice, especially for inherited enterprises. For more on causes of barter trade and policies to promote non-barter sales in transition economies, see Marin and Schnitzer (1995).

Table 3: Changes in company's average annual sales volumes (per cent change over previous year)

	1992	1993	1994	1995	1996 (approx.)	1997 (approx.)
Sales volume (% change)	140	39	-40	9	0.6	74

products were sold for two to three times less than global brands; (b) access to Central Asian import markets, which were still closed to outside trade and thus local enterprises could benefit from the protectionism; and (c) good contacts with the administration. However, the situation changed in 1994 when the company experienced a 40 per cent fall in sales. This was caused by the loss of one of its key markets (neighbouring Uzbekistan, which liberalised imports in that year) and by trade liberalisation in Kazakstan, which increased the inflow of competing foreign goods.

In response to this dramatic decline in sales, the company started a competitiveness strategy which the authors believe constitutes the key to its success today. This strategy was constituted by: (a) devising and implementing a restructuring plan using external finance; (b) retraining the staff; and (c) undertaking market research and consequently responding to market signals.

With the onset of the enterprise's crisis, two external consultants, retired Western executives working as volunteers for an aid programme, were drawn in by the company's management. While the use of outside experts is a common practice in European and American enterprises, it is a new approach to problem solving at the enterprise level in economies in transition, thus reflecting the management's forward thinking.

Research by the first consultant revealed that a key reason for the decline was the significantly poorer design and packaging of the products in comparison to its competitors. In response to this needs identification, the consultant and the enterprise's management submitted a restructuring plan and secured a loan from an international lending agency. In view of the limited sources and supply of project finance in Kazakstan, it can safely be assumed that close contact with the administration was influential in securing this loan. The loan was used for the purchase of packaging and labelling equipment and a greenfield site. In 1996, the company constructed its new production, storage and administration facilities and bought packaging equipment from Europe. Following research into international packaging standards and designs, the company used its new packaging facilities for the first time in November 1996. The new packaging had an immediate impact on the company's sales.

A second consultant, a marketing professional specialising in beauty care, was drawn in to upgrade the company's strategic marketing and management skills. The consultant carried out practical on-the-job training on strategic management, market research and marketing.

The third aspect of the competitiveness strategy lay in efforts to understand the needs and wants of the consumers through market research. In response to this research, efforts were undertaken to develop new products, through in-house research and development, to meet customers' changing expectations and to diversify the product range. New products, targeting different segments of the market and reflecting consumers' demands for more naturally-based ingredients, were successfully introduced.

This three-pronged restructuring strategy had an immediate impact on the enterprise's growth. In the first three months of 1997, the company's sales increased by 32 per cent versus the previous year. In addition, its market share increased by almost 30 per cent. The enterprise planned to maintain this level of growth by expanding within the Central Asia region and other neighbouring countries, notably Russia.

In conclusion, this firm can be considered a success as a result of its ability to respond to the changing market conditions, that is fluctuations in the market size and competitive pressure, changing consumer demands, and the need for appropriately skilled management. These strategies were all implemented in connection with the capital injection.

While this capital injection was vital to the company's growth, the company's strategic use of it was of equal or greater importance.

4 Determinants of differences: comparing apples and oranges?

Having examined the two cases separately, the article turns to drawing out the determinants of the differences between these two companies. However, prior to outlining the factors determining the differences between the two producers, the comparability of the two companies needs to be analysed. Both enterprises produce consumer goods; one is satisfying basic needs (low-cost clothing) while the other (beauty care) is aiming to satisfy consumer desires beyond basic needs.

With respect to their labour markets, neither company faces organised trade unions and both have access to the skills required for the production processes. However, the skills required in the production of beauty care are significantly less than those required by clothing production. It is not believed that the differences in availability of skills for the two companies had a significant effect on their differences in performance.

A serious difference between the two companies lies in their approach to both supplies and sales. Both enterprises faced difficulties in sourcing their inputs: the clothing producer because of a collapse of the Soviet supply chain and the beauty-care producer because of the volatile trade structure. The beauty-care producer purchased all raw materials from Europe, while the clothing producer sourced all inputs locally and from neighbouring Uzbekistan, on barter terms. Its output was also sold through barter, which requires more complex arrangements. The company's sales were in the FSU, and these channels have largely become redundant. However, the new enterprise was able to develop viable marketing channels, although it paid high prices for the imported inputs. Thus both faced distinct sets of difficulties which cannot be easily measured against each other.

Two factors in particular had a significant impact on the comparative success of the new enterprise over the old enterprise. Firstly, the clothing producer's inertia and reactive business approach is a reflection of the vigorous repression of entrepreneurship under Soviet rule. In contrast, the management of the new enterprise was not weighed down by the burden of an inherited anti-entrepreneurial spirit. Secondly, the beauty-care producer was well enough connected to be able to import raw materials when Kazakstan still had a closed economy, giving it a competitive edge over other local producers. Its exploitation of opportunities offered in this way would, in some cultures, be considered entrepreneurial.

5 Conclusions

The external environment for enterprises in Kazakstan has improved since the early 1990s and enterprises can now develop against a backdrop of relative macro-economic stability. However, the framework for market-oriented enterprise development and restructuring, in particular the legal, institutional and financial infrastructure, remains weak. In the present article two cases of enterprise restructuring in Kazakstan were analysed in pursuit of highlighting some of the conditions determining the ability of enterprises in a transition economy like Kazakstan to respond to the transition and to develop.

Two enterprises were examined. The first is characteristic of inherited enterprises. It faced immense difficulties in coping with the legacy of the past, in particular the management's lack of skills and experience with the market economy. Although the enterprise managed to survive, the sustainability of this approach is questionable and the need for a change of strategy is evident. The new enterprise can be considered representative of the (few) successful enterprises in Kazakstan. Its success was largely based on getting many of the basic elements of business right and benefiting from privileges through which it could protect itself.

The two case studies raise a number of interesting questions for future policy and research. At the moment, enterprises seeking finance are, on the whole, unable to borrow economically at local banks and must therefore resort to foreign sources of financing which are sparse and generally finance larger projects. There is, therefore, a need for low-cost financing for enterprises wishing to restructure and devising a strategy to that end. However, this needs to be coupled with assistance to entrepreneurs in developing and implementing a strategic plan for the enterprise. There could be a role for government to promote the development of advisors in enterprise restructuring and development.

With respect to future research, further case-study research needs to be undertaken, in view of the lack of reliable data from Kazakstan and the limited understanding of the situation within enterprises. Case-study analysis is a useful and necessary way of highlighting similarities and differences. Such research would provide important and substantive background information for comparative analyses on the basis of which government policy and policy advice to Kazakstan and the region can be devised.

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