The Risks of Doing Business in Central Asia

The Central Asian Republics – Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan – have gained considerable attention among western companies for their strategic location, natural resources, and potential for growth. But people interested in doing business or opening operations in this area need to understand that the barriers to entry are high and the risks are pronounced. This is not to say that business should avoid the region; if the risks are high, so too are the rewards. However, investors should do a careful assessment before entering these markets, and should look for a suitable partner to guide them through the minefields of operational, market, reputational and asset impairment risks that await the unwary.

Operational Risks are perhaps the easiest to understand, for they are familiar to anyone who has done business in emerging markets. A partial listing of such risks includes:

- *Geographic constraints.* Kazakhstan, for example, is the ninth largest country in the world, measured by area. Distances among the major cities and capitals of the five Central Asian republics are daunting, and terrain ranges from vast mountain ranges to barren deserts. This can make transportation and communication very difficult.

- *Infrastructure limitations.* Road networks are often under-developed, power generation and power distribution problematic in some areas, and water is scarce in some regions, abundant in others, but potentially unhealthful everywhere. Security is uneven, and pilferage from warehouses is a common problem. Transportation, storage and distribution of goods – particularly perishable goods – can therefore be impaired.

- *Cultural and ethnic issues.* Residents of all five republics include ethnic Russians. Given Russia's colonial history in the region, this has occasionally caused significant strife as ethnic Kazakhs, Uzbeks and others have directed their frustration over social and economic issues against Russians living in the region. Just as important, there are ethnic, national and tribal resentments among and between many of the non-Russian people in the region. Tajiks and Uzbeks, for example, are famously hostile to each other. Finally, while Russian served as the common language among those who grew up under the Soviet Union, it is losing its preferred status in many areas, making communication difficult. These issues can complicate everything from marketing to workforce management.

- *Vendor quality and reliability.* Simply put, a very high percentage of vendors do not meet common standards for quality and reliability. Products and services suffer wide variance from unit to unit, person to person, and time to time, and concepts like statistical process controls or quality assurance are alien to many of the local national firms in the region. Clearly, there are many local national firms with high standards and a good reputation. But it is important to screen local firms for quality and to maintain an updated vendor database.

- *Employee qualifications, credentials and training.* The old Soviet educational system was very good, and literacy rates and overall educational levels are quite high throughout the Former Soviet Union. But there are still major issues in screening and managing job candidates. For one thing, academic credentials do not always translate to western expectations. For example, many people who attended a five-year undergraduate program are prone to claim a Master's degree when they hold merely a Baccalaureate. In addition, much technical education is so narrowly focused that people find it difficult to adapt to new requirements. Finally, while younger residents have a global focus and are highly ambitious, many people were so inculcated with Soviet values that they have a "9 to 5 mentality", viewing work only as an unpleasant necessity that entitles them to a salary. If it is important to screen vendors, it is equally important to screen employees.

Market Risks are pronounced, and include:

- *Quality standards.* ISO and similar standards are not widespread, and product substitution is common. At best, the Russian Gosudarstvennyy Standart (GOST) standards can serve as a surrogate for more familiar western and international metrics, but the safest course is ultimately to rely on physical inspection before, during and after products are fabricated.

- *Local competition and product substitution:* Pricing points are often flexible in Central Asia, and many vendors and customers are willing to engage in product substitution in order to win business. Competition is magnified by an additional factor: the commonplace assumption that money means nothing to a western company, resulting in an "America premium" for the purchase of local-origin goods and services. Finally, many employers deliberately refrain from withholding the mandatory income and social security taxes, opting instead to pay their employees under the table in order to gain an edge in pricing.

- *Corruption.* Transparency International's most recent corruption index ranked 182 countries from least to most corrupt. Kazakhstan was ranked at 120 with a score of 2.7 out of a possible 10 points. Tajikistan came in at 152 (2.3 points), Kyrgyzstan at 164 (2.1), and Turkmenistan and Uzbekistan tied near the bottom of the list at 177 (1.6 points). Corruption is a fact of life in Central Asia, and it must be addressed by any western company seeking to do business in the region.

In the internet era, **Reputational or Franchise Risks** have become an important consideration for corporate governance decisions. The fact is that all five Central Asian republics, to some degree or another, fail to meet common western standards of liberty and human rights. An extreme example is the "Andijan Massacre" of 2005, when security forces in Uzbekistan opened fire on a crowd of protesters in the city of Andijan, killing several hundred. The U.S. government protested this incident, resulting in a downturn in U.S.-Uzbek relations that continues to this day. Doing business in Central Asia therefore carries with it the risk that a firm's corporate image can be damaged by association. One way to minimize this risk and mitigate its impact is to operate through a trusted agent who can act as a liability shield.

Finally, **Asset Impairment Risks** are severe, and include:

- *Access to banking, finance, and credit.* At the minimum, companies need to register in each country where they plan to do business. Without registration, it is not legally possible to open a bank account, hire local employees, or sign contracts. But registration is often difficult and time-consuming (it is nearly impossible in Uzbekistan because of poor relations with the U.S.), and it is only the first step toward gaining access to local finance. In addition, currency fluctuations, sovereign credit risk and related issues and can play havoc with income streams derived from Central Asian operations. Finally, business outside major metropolitan areas is often conducted on a cash-only basis. Many firms, therefore, choose to work through a western company already registered and with access to both cash and a line of credit.

- *Contractual, tort and liability issues.* The legal systems throughout Central Asia are code-based rather than common law-based, and westerners are often surprised to find themselves held liable for actions that would be considered harmless elsewhere. In addition, judicial procedures are often both opaque and time-consuming. Cases, particularly those involving intellectual property rights and similar issues, are heavily backlogged, and the legal process can be corrupted.

- *Political, bureaucratic and regulatory risk.* Obtaining something as simple as a construction permit can necessitate dealing with multiple government agencies. Delays are inevitable, and often caused by nothing more than turf wars among overlapping bureaucracies. In addition, regulations are often excessive and administered in a ham-handed way. Finally, there is a continuous risk that a change in the international or local political climate can cause significant changes in the business environment, ranging from taxation to confiscation to outright expulsion from the country. In short, it is helpful to deal with a western company that has the training and background to navigate successfully through the corridors of government.

- *Physical impairment.* Plant, equipment and personnel can be exposed to physical risk in Central Asia. Street crime and extortion are potential risks, particularly in outlying areas. Of greater concern, however, is the constant potential for terrorism, sabotage, and civil and international conflict. The Central Asia republics abut Pakistan, Afghanistan, both highly unstable, and western China, where Uighur separatists have increasingly fallen under the sway of pan-Islamic movements. Finally, natural disaster is always a possibility, particularly in such earthquake-prone cities as Almaty, Kazakhstan. To manage such risks, it is helpful to turn to a locally-based teammate with the knowledge, experience and infrastructure to provide risk analysis, contingency planning and disaster response.

The Role of TMC

Technology Management Company (TMC) has been registered and operating in Central Asia for more than a decade. We are experts in global supply chain management (including local procurement, warehousing, transportation and distribution) as well as government relations, risk analysis, project management and local staffing. We have locally-staffed offices in four Central Asian republics and have operated in all five. We are one of only a small number of U.S. companies not expelled from Uzbekistan following the Andijan Massacre.

We also have offices in Afghanistan and the Caucasus countries, so we cover the entire sourcing and distribution system that feeds the Silk Road and the Northern Distribution Network. We are recognized as subject matter experts in labor, health and safety codes by the U.S. government and the European Bank for Reconstruction and Development.

We can assist with identifying, measuring and managing operational, market, reputational and asset impairment risks. As one example, we have the procedures and knowledge to meet western quality standards while procuring goods and services locally, providing our clients with both a significant cost advantage and the benefit of maintaining good relations locally.

Our employees conduct market research to screen and qualify local sources of product from both well established and emerging companies. After a vendor has passed initial screening, we conduct a face to face meeting with the vendor's management team on their premises. This allows them to display their manufacturing capabilities and to discuss their products. During these visits, we compare their products to the U.S standard specifications and others, such as the GOSTANDART in use within the former Soviet Union. If discussions remain positive, we use a TMC Quotation Checklist to address the remaining items of interest, such as price, production schedule, packaging and labeling, validity period of quote, insurance and Certificates of Origin.
If this screening process establishes the vendor as a best value, we notify them of our intent to award a contract and we conduct discussions over contract structure and legal compliance. TMC ensures that, in addition to U.S. legal requirements, all local laws and regulations are also observed in the contract.