

Transition Economy and its Implications on the Kyrgyz Business Environment: Analysis and Recommendations

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ABSTRACT

Since declaring its independence from the Soviet Union in 1991, Kyrgyzstan has undergone a substantial transition period marked by major reforms in the cultural, socio-political, legal, and economic environment. These developments have turned Kyrgyzstan into one of the most advanced investment destinations in Central Asia. Yet, Kyrgyzstan has not been able to receive the high levels of foreign direct investment other transition economies have attracted. In reality, numerous promising business areas exist in the country along with risks. This paper examines the opportunities and challenges awaiting multinational firms in Kyrgyzstan and recommends proactive strategies that will help them succeed in this transition market.

Keywords: Transition Economy, Business Environment, Foreign Direct Investment, Multinational Firms, Kyrgyzstan

INTRODUCTION

Following the collapse of the Soviet Union in 1991, Kyrgyzstan entered a significant economic transition period which has been defined by progressive restructuring efforts and supporting reform programs in the economic environment. Yet, to achieve a sustainable level of economic development, Kyrgyzstan desperately needs financial assistance from multinational firms. With the aid from foreign businesses, Kyrgyzstan intends to import the latest technology, products, and management know-how to modernize the country's industrial foundation. Foreign direct investment will also have positive political and social implications and is the key to a speedier economic transition in the country. The Kyrgyz government has taken various initiatives to improve the country's business landscape in an effort to make Kyrgyzstan one of the most attractive markets in Central Asia for foreign investors.

Kyrgyzstan possesses a tremendous economic growth potential which is expected to increase even more in the future as the country continues its transition to a market economy. Despite this potential, Kyrgyzstan has not received as much attention from the multinational companies as some other transition countries have. This is mainly caused by the country's adverse geographical environment which has historically isolated Kyrgyzstan from the world markets. In reality, as a newly emerging transition economy, there are numerous untapped business opportunities in the country along with many risks and challenges. Thus, the purpose of this paper is to present the opportunities and challenges awaiting multinational firms in Kyrgyzstan and to recommend proactive strategies that will assist them to succeed in this attractive transition market.

ENVIRONMENTAL ANALYSIS OF KYRGYZSTAN

Given that most foreign companies have no business experience in Kyrgyzstan, a detailed assessment of Kyrgyzstan's business environment is required to help those companies establish their presence in this country. Through such an analysis, multinational companies can avoid costly mistakes and maximize their future returns in this highly unfamiliar market. To provide a thorough understanding, several factors are to be studied, including the geographical, cultural, socio-political, legal, and economic environment in the country. This environmental review will guide multinational companies that would like to capitalize on the various business opportunities in Kyrgyzstan.

Geographical Environment

Situated in northeast Central Asia, Kyrgyzstan is a country with remarkable natural beauty. It is bordered on the north by Kazakhstan, on the south by Tajikistan, on the west by Uzbekistan, and on the east by China. The capital and largest city of the country is Bishkek which is located in the north, close to the Kazakhstan border. Osh, the second largest city, is in the south, near the Uzbekistan border. The country has a small population of slightly more than 5 million people. The population reflects a mosaic of different ethnic groups including Kyrgyz, Russians, Uzbeks, Ukrainians, Germans, and many other nationalities.

Over 90% of the country is mountainous and three-quarters of it is under permanent snow and glaciers (Oleynik, Alexander, & Cherepanya, 2004). The peaks of the Tien Shan mountain range, with associated valleys, basins, and lakes, stretch over the entire territory from the east to the west. Although Kyrgyzstan possesses limited natural resources due to its small size, it hosts the world's largest natural growth walnut forest as well as significant supplies of high-quality water and rare-earth metals (Stewart & Weldon, 2002). Kyrgyzstan's geo-political position determined its destiny throughout the history and is the key to the country's culture, politics, and economy.

Cultural Environment

The mighty mountains of Kyrgyzstan divide the country into north and south, making it extremely difficult if not impossible to travel between these regions. The Russian population lives around Bishkek; whereas the Uzbek population is concentrated around Osh. This geographical and ethnic separation resulted in two strikingly different cultures in the country. Although the Kyrgyz are the majority in both regions, northern Kyrgyz are inclined towards Kazakhs and southern Kyrgyz tend to identify themselves closely with Uzbeks (Oleynik et al., 2004).

Kyrgyzstan's ethnic and cultural diversity has caused several conflicts, especially around the southwestern Fergana Valley which is considered a natural extension of Uzbekistan (Stewart & Weldon, 2002). Fergana Valley, with its large Uzbek population, is one of the most fertile regions in Central Asia and carries significant agricultural value. As a result, Kyrgyzstan and Uzbekistan engage in border disputes regarding the control of this territory. These ethnic tensions create an unstable environment for foreign businesses that would like to enter Kyrgyzstan.

Political Environment

Tribal and regional origins remain an integral part of Kyrgyz identity and society (Stewart & Weldon, 2002). Therefore, the cultural differences between the north and the south have direct implications on Kyrgyzstan's political environment. Both northerners and southerners support politicians from their respective regions, regardless of ideology, and strongly resent the presence of "outsiders" in the government. Hence, it has been very difficult for political leaders to govern the entire country against such resistance from a particular region. As a result, Kyrgyzstan suffers from a chronic problem of weak political leadership. Political leaders, so far, have not been successful in overcoming the regional differences and uniting the country around a common ground.

Political environment in Kyrgyzstan is a frequent scene for government corruption and mismanagement (Oleynik et al., 2004). It is not surprising that governmental appointments are often based on political connections or even family relations (Engvall, 2007). In Kyrgyzstan, politics and business are closely integrated. Owners of large enterprises sometimes occupy key government posts and have the authority to make critical decisions. This causes a massive conflict of interest, resulting in bribery, favoritism, fraud, and other illegal practices. Moreover, authorities occasionally restrict citizens' right of association since the government hinders any kind of political opposition (Ahrari, 2003). As many other transition economies, Kyrgyzstan is currently experiencing political instability. Yet, these adverse conditions are predicted to change as the country makes further progress towards a market economy.

Legal Environment

The Kyrgyz legal system still lags behind the Western standards in many areas. Although many reforms have been made in the legal environment, there have been considerable shortcomings in their implementation. One of the biggest problems is the widespread disregard for rules and regulations by citizens and government officials. Under such a legal vacuum, protests and violent confrontations have become common approaches to resolving disputes. Besides,

the laws and regulations have been worded so broadly and vaguely that their interpretation by the government officials is inconsistent (Klawonn, 2001). Since most politicians have controlling interests in major companies, bribery and favoritism are commonly encountered in the legal arena. Some state institutions, such as the judiciary, function quite inefficiently given that they are directly influenced by the state (Stewart & Weldon, 2002).

Foreign investment in Kyrgyzstan is subject to excessive bureaucratic regulations. In addition, there is a lack of sound structures regulating property rights and contract enforcement (Engvall, 2007). Despite all these barriers, the country began restructuring its legal infrastructure by adopting special laws in an effort to attract foreign investment. Nevertheless, multinational companies should keep in mind that legal system in Kyrgyzstan is highly unpredictable and to a large extent, shaped by the political climate.

Economic Environment

Kyrgyzstan, unlike its other Central Asian neighbors, has limited natural resources. The economy is largely based on agriculture and livestock production. The country has negligible oil and natural gas deposits which is quite insufficient to meet the domestic demand. However, Kyrgyzstan is well endowed with enormous reserves of minerals. Furthermore, the country hosts significant water supplies which constitute a major energy source and represent a substantial economic value. Industrial production in Kyrgyzstan was primarily defense-related during the Soviet era and declined considerably after the independence (Abazov, 1999).

Since independence, Kyrgyzstan has been one of the leading Central Asian republics in terms of the sound economic restructuring efforts taken towards a successful transition to a market economy. To employ the market economy principles, the Kyrgyz government started a reform initiative by liberalizing trade and prices, privatizing state-owned enterprises, breaking up monopolies, and supporting investments (Oleynik et al., 2004). As a result, Kyrgyzstan was the first of all Central Asian republics to become a member of the World Trade Organization (WTO) in 1998. Also, the Kyrgyz som has become one of most stable and easily convertible currencies in Central Asia (Dana, 2000). As the country embarks on further reforms, more multinational companies are expected to enter this market, contributing to a speedier economic transition.

ASSESSMENT OF KYRGYZSTAN'S BUSINESS CONDITIONS

Multinational firms that would like to take advantage of the attractive business opportunities in Kyrgyzstan should first prepare for the various challenges existing in the country. These challenges originating from the old Soviet regime are expected to fade away as Kyrgyzstan demonstrates further advances in its transition to a market economy. This section examines the major obstacles encountered by the foreign companies operating in the country.

Transition Economy with Lagging Systems

Adoption of numerous economic reforms has made Kyrgyzstan one of the most economically liberal countries among the former Soviet republics. Yet, the current economic system still has weaknesses in the areas of deregulation, privatization, and the legal structure. Kyrgyzstan successfully started deregulation programs to eliminate the old rules and restrictions in many industries but the discrepancies in the execution of these prevented the country from achieving the expected results. Privatization initiatives play a critical role in Kyrgyzstan's transition to a market economy. Under mass privatization programs in various industries, many Kyrgyz companies, ranging from small businesses to large enterprises, have been sold to private investors (Abazov, 1999). However, the state still owns controlling shares in large Kyrgyz enterprises in mining, energy, telecommunications and several other key sectors (Oleynik et al., 2004). Since privatization of these establishments requires large resources, the Kyrgyz government aims to attract foreign investors to provide the capital, technology, and technical expertise needed to revitalize these industries with new and efficient enterprises.

An investor-friendly legal framework based on market economy principles is crucial to attracting additional foreign investment to the country. Kyrgyzstan offers foreign businesses one of the most ideal legal environments in Central Asia. The Foreign Investment Law grants foreign businesses equal or even enhanced rights as domestic

companies. Among the incentives provided by the law are full protection of intellectual property, the rights to own land and transfer funds abroad as well as exemptions from taxes and import duties (Oleynik et al., 2004).

Weak Transportation and Telecommunications Systems

Kyrgyzstan suffers from a severe problem of inadequate transportation and telecommunications systems. The road and railroad networks are quite underdeveloped and centered around the population centers in the north and south. The northern part of the country is integrated with the transportation networks of Kazakhstan whereas the southern part is linked to the networks of Uzbekistan (Oleynik et al., 2004). Due to the mountainous terrain, there is no major transportation infrastructure connecting the two regions. In addition, Kyrgyzstan faces constant shortages of fuel since it imports all of its oil supply from other countries (Dana, 2000). These factors further add to the serious economic and social division in the country and require urgent attention.

Likewise, the telecommunications systems in the country are quite inefficient to support the needs of the population. Kyrgyzstan still uses the outdated telecommunications equipment left from the Soviet era. The current equipment operates at full capacity and is not capable of sustaining heavier service loads that are expected to occur along with the economic expansion (Oleynik et al., 2004). There is a significant need to replace the outmoded equipment and upgrade the existing telecommunications technology. Telecommunications services are not available in the remote areas which are already isolated from the population centers by the mountains. As a result, Kyrgyzstan desperately needs widespread phone and broadcasting services as well as other digital communications systems. The weak transportation and telecommunications infrastructure represents a challenge for multinational companies operating in Kyrgyzstan. There are routine delays in the flow of goods between the north and the south, within the supply-chain and distribution networks. Foreign investors may also find it difficult to communicate with their suppliers, distributors, and customers located outside the two major population centers.

Underdevelopment of Human Resources

Although the majority of the Kyrgyz employees are highly educated and skilled, it is mostly the Russians who have traditionally occupied the technical and managerial positions in Kyrgyz enterprises. Thus, since the outflow of the many expert Russian personnel after the independence, Kyrgyz companies have been suffering from the lack of know-how and experience required to run their businesses (Stewart & Weldon, 2002). In addition, despite the efforts for transition to a market economy, the old socialist style of management is well alive in majority of the companies. This is because the middle- and upper-level managers of the state-owned enterprises under the planned economy do not yet possess a comprehensive understanding of the market economy principles. However, these managers have been transferred to the recently privatized establishments and are expected to run these businesses according to the market-oriented economic system. Such expectations cannot be realized until the key managerial personnel undergo rigorous training programs on the fundamentals of market economy. To assist with this organizational evolution, foreign companies can utilize their own personnel to train and supervise the Kyrgyz employees. Foreign personnel can transfer their business approach and experience to their Kyrgyz counterparts. As a result, Kyrgyz workforce can achieve a smoother and faster transition to the market principles of doing business.

Low Productivity and Poor Quality

Despite being the center for high-tech manufacturing during the Soviet times, Kyrgyzstan experienced a dramatic decline in productivity after the independence (Spechler, 2003). This situation was mainly caused by problems in obtaining raw materials, drop in demand, and difficulties in arranging for payments (Oleynik et al., 2004). Likewise, Kyrgyzstan's Soviet era industrial infrastructure emphasizing defense-related manufacturing was not designed for other types of production and became obsolete after independence. Today, many of these antiquated and state-owned production facilities are still kept open. They operate with outdated systems and worn-out equipment, which have severe efficiency and cost implications. With long lead times in production, inefficient equipment causes Kyrgyzstan's manufacturing plants to operate below full capacity. Also, since these facilities do not possess the latest manufacturing technology, the quality of output is far from the Western standards. Hence, multinational firms may need to make large

investments towards the reconstruction of Kyrgyzstan's industrial infrastructure to improve the current levels of productivity and quality.

Socialist Ideology and Bureaucracy

Despite the notable progress demonstrated in the economic and socio-political environment, the remnants of the old Soviet socialist philosophy are still encountered in some aspects of the Kyrgyz business arena. The most evident example of this ideology is the intensive government controls on the operations of the newly privatized enterprises. Many Kyrgyz entrepreneurs are suppressed by over-regulation and constant government interference in their business decisions (Stewart & Weldon, 2002). Moreover, majority of Kyrgyz firms function under rigid organizational structures with clearly established lines of authority. Therefore, information flows through vertical channels of communication, from top management down to the rest of the organization. Such an approach creates hierarchical structures leading to high levels of bureaucracy (Oleynik et al., 2004). Resulting in a slow and inflexible administration, bureaucratic barriers in Kyrgyz organizations cause complexities for both domestic and multinational companies operating in the country. Hence, many companies have been reported to employ unethical and even illegal practices such as bribery to deal with bureaucratic obstacles.

Lack of Commercial Technology

During the Soviet era, majority of investments in Kyrgyzstan were made in the defense-related industries. Hence, the country has a well-established infrastructure for manufacturing heavy machinery and equipment (Pomfret, 2003). In contrast, light industries desperately require a large amount of foreign investment in order to contribute to the economic development in Kyrgyzstan. The country's broad range of agricultural and livestock products prepares the potential foundation for light industries such as textiles and consumer goods (Oleynik et al., 2004). Kyrgyzstan is expected to benefit from commercializing its advanced heavy industry technology to develop its light industries. To accomplish this objective, Kyrgyzstan needs to adopt the latest technological developments especially in the commercial area to enhance its light industry base. Light industries offer numerous business opportunities for multinational firms that are interested in entering the Kyrgyz market. Once strengthened with foreign investment, these industries will represent a critical source of economic activity in the country.

Shortage of Raw Materials and Suppliers' Inabilities

Kyrgyz suppliers are often unable to provide high quality raw materials and parts to their customers due to several adversities. First, since the old production facilities and equipment are quite outdated, the quality of output is very poor. Second, majority of the middle- and upper-level managers who were trained under the Soviet system are not knowledgeable and experienced in quality management concepts. Thus, quality management is one of the most crucial areas to be addressed in most Kyrgyz businesses. Furthermore, Kyrgyz suppliers also face problems in meeting the demand from their customers. The country faces considerable difficulties in obtaining a variety of raw materials needed for industrial activity and suffers from repeated shortages of materials and goods. As a result, current production levels are inadequate to fulfill the customers' orders. Transportation of raw materials and components is yet another problem throughout the country. The rough landscape, underdeveloped transportation infrastructure, and the scarcity of fuel make it extremely hard to ship materials from one location to another.

PROMISING BUSINESS AREAS IN KYRGYZSTAN

Kyrgyzstan is among the most favorable investment destinations in Central Asia with its relatively improved legal system and commitment to attract foreign investment. Yet, the country still needs to establish its national industries and modernize its existing sectors. Such challenges rising from Kyrgyzstan's old economic system create excellent business prospects for foreign firms. The following sectors, which need immediate foreign investment, are promising business areas for multinational companies that would like to expand into Kyrgyzstan.

Transportation Infrastructure

Kyrgyzstan's poor physical infrastructure makes transportation one of the most promising areas for foreign firms. Kyrgyzstan desperately needs a reliable national transportation network to accomplish a rapid economic development. Central Asian republics are linked to one another by rail and road networks which do not always follow the national boundaries. The railways and roads from Osh to Bishkek pass through Tajikistan, Uzbekistan, and Kazakhstan before reentering Kyrgyzstan (Oleynik et al., 2004). Thus, there is an urgent need for a modern highway linking these two population centers. Construction of this highway will provide various benefits to the country by boosting the economic activity between the north and south as well as uniting the ethnic groups in these regions. Furthermore, there is a need to upgrade the highway from Bishkek to Almaty, Kazakhstan. Almaty is expected to become the financial hub of Central Asia in the near future. Bishkek, which is in close proximity to Almaty, will then play a key role as a major center for trade between Kyrgyzstan and Kazakhstan. Moreover, a highway connecting Lake Issyk-Kul to the other cities in Kyrgyzstan and Almaty should also be developed. This value-added investment will significantly increase the tourism prospects around Lake Issyk- Kul.

Recently, the Chinese government has started to build a railroad network which will link China to Uzbekistan, passing through Kyrgyzstan (Spechler, 2003). Many Asian countries also agreed to finance the revival of the "21st Century Modern Silk Road". Connecting Asia to Europe, this extensive road network will greatly enhance the trade and tourism among the countries in Central Asia. More foreign direct investment is needed to undertake these substantial construction and maintenance projects to improve the country's transportation networks.

Tourism

Tourism is a vital sector with a huge potential to contribute to Kyrgyzstan's national economy. Lake Issyk-Kul in the northern Tien Shan Mountains has historically been a popular holiday destination for visitors coming from other parts of former Soviet Union (Stewart & Weldon, 2002). Although Kyrgyz government is taking steps to encourage tourism, taxes, restrictive border regulations, and the lack of proper accommodations hamper these efforts (Stewart & Weldon, 2002). Kyrgyzstan is already endowed with the natural resources needed for the growth of its underdeveloped tourism industry but requires foreign assistance to fully utilize these assets.

Tourism industry presents a broad range of business opportunities for foreign companies that would like to invest in Kyrgyzstan's emerging sectors. Kyrgyzstan carries bright prospects to become the major tourism center of Central Asia, Russia and other neighboring countries. Currently, there is a strong need for the development of the tourism infrastructure, including construction of hotels, shopping centers, restaurants, and recreational facilities. Kyrgyzstan should also improve its tourism services by training the personnel working in the hospitality industry. Foreign businesses can provide valuable financial and managerial assistance in building Kyrgyzstan's tourism sector. Construction of a highway linking Lake Issyk-Kul to Almaty coupled with the booming economy in Kazakhstan is predicted to bring an increased number of Kazakh tourists to Kyrgyzstan. If the tourism industry in Kyrgyzstan is thoroughly strengthened, it will clearly bring large amounts of hard cash inflows to the country.

Agricultural Processing

Agricultural processing is one of the most attractive sectors for foreign direct investment as it lies at the heart of the Kyrgyz economy. The main agricultural and livestock products include wheat, vegetables, fruits, tobacco, cotton, meat, and wool of which the latter four are among the major export commodities (Stewart & Weldon, 2002). The sector is under state's strict control of production, marketing, distribution, and prices (Oleynik et al., 2004). Land owners suffer from excessive government interference and the lack of financial resources. Kyrgyzstan needs multinational investors that can provide the much required capital to upgrade its agricultural establishments. There is a need for state-of-the-art production plants and machinery to revitalize this industry.

Such large investments will also aid agriculture-based industries such as food processing and textiles. With the support from foreign companies, Kyrgyzstan has the potential to become a self-sufficient nation in food production. After serving its small population, Kyrgyzstan can export its surplus output to neighboring Kazakhstan, a country that imports numerous food items. With the upgrading of the Bishkek-Almaty highway, Almaty will become as close as a

domestic market for Kyrgyzstan's food exports. Furthermore, several foreign businesses have built wool, silk, and cotton processing factories, addressing the need for textiles products in the country.

Mining and Metallurgy

As a result of its mountainous landscape, Kyrgyzstan possesses numerous mineral reserves such as gold, coal, copper, lead, uranium, zinc, mercury, and other rare earth metals. Although a partial investigation of the capacity of mineral deposits was conducted under the Soviet rule, the Kyrgyz government needs to administer a thorough geological investigation before the country's natural resource potential can be predicted accurately.

So far, gold mining is the only sub-sector that has attracted foreign investment (Oleynik et al., 2004). Yet, there is an urgent need to acquire foreign investment in other sub-sectors to attain a balanced growth in mining and metallurgy industries. These industries have been facing difficulties since the collapse of the former Soviet Union, including the loss of traditional export markets, obsolete facilities and technology, shortage of qualified personnel, and exhausted deposits. Multinational enterprises can provide the capital, technology, and management know-how to overcome these problems. With foreign investment support, the Kyrgyz government aims to expand the current production capacity by locating new deposits and building more processing plants (Oleynik et al., 2004). The surplus mineral output will be exported to new international markets. There is also a potential for metal processing projects in the country to manufacture electronic parts, microchips, semi-conductors, and ceramics products.

Logistics

With many development initiatives well underway in numerous industries, there is a great need in Kyrgyzstan for logistical support services, including supply and distribution networks as well as warehousing. Since majority of the industrial activity is concentrated around Bishkek, the rest of the country benefits from the goods and services disproportionately. This results from the severe lack of proper distribution channels and warehouses throughout the country. The poor transportation conditions, formidable terrain, and monetary problems have historically prevented Kyrgyzstan from establishing such an infrastructure. However, the country cannot achieve the targeted level of economic development without building a well-linked distribution system. These centers should be dispersed all around the country to reach the businesses and customers who otherwise cannot receive these goods and services. The construction of Bishkek-Osh highway will create opportunities for foreign companies that would like to provide logistical services in Kyrgyzstan. Above all, Osh is strategically located at the crossroads of the "21st Century Modern Silk Road" and carries an important logistical value as it has the potential to become the main distribution center in facilitating regional trade with neighboring Uzbekistan, China, and Kazakhstan.

Warehousing services and well-organized supply-chain networks are required to ensure an adequate supply of goods in the country in order to avoid shortages of food and daily consumer products since such shortages are experienced quite frequently in Kyrgyzstan. Many Kyrgyz businesses face problems with their suppliers in terms of quality, delivery times, and unfilled orders. Multinational companies can construct the logistical infrastructure, introduce advanced technology, and train personnel on logistics management to develop this highly critical industry.

Telecommunications and IT Services

Development of Kyrgyzstan's telecommunications infrastructure was largely neglected during the Soviet era (Oleynik et al., 2004). Thus, Kyrgyzstan's weak telecommunications industry offers numerous opportunities for foreign businesses. The coverage of both fixed-line and wireless telephone services as well as broadcasting and internet services is limited to urban centers and virtually nonexistent in remote mountain areas. Foreign companies can capture large market shares by providing such services in regions where telecommunications services are poor or absent. With the forecasted economic expansion in the horizon, Kyrgyzstan has to rapidly increase its service capacity, which will require additional equipment to carry the heavier loads. Foreign manufacturers of telecommunications devices can be successful in Kyrgyzstan where a substantial growth in digital communications services and data transmission is expected to occur.

Above all, there exist untapped business opportunities for foreign investors in the field of Information Technology (IT). Kyrgyzstan has bright prospects to become the IT services hub of Central Asia for several reasons. First, although there is an unsatisfied demand for IT services in the region, Kyrgyzstan's neighbors have so far not shown any interest in establishing this industry. Thus, foreign companies that would like to launch IT services in Kyrgyzstan can capture the massive combined market of Central Asian republics without large initial investments and competition. Second, the country has a well-educated and highly skilled workforce to be employed in IT services industry. Multinational companies can train the Kyrgyz personnel to develop the level of technical expertise required. With this training, the Russian-speaking Kyrgyz personnel can offer IT support services to the entire Central Asia and Russia. Likewise, Kyrgyzstan's IT services industry can effectively serve Kazakhstan's booming economy given the close proximity between the two countries. Besides, with the economic growth, developments in financial services, tourism, and logistics will prompt an even increased need for IT services in the country. IT services represent a value added industry with a great potential to contribute to the advancement of Kyrgyzstan.

Financial Services and Banking

Since independence from the Soviet Union, the Kyrgyz government has implemented a restructuring initiative of the state-controlled financial and banking system. Under this program, many financial and economic reforms have been introduced, tightening the banking and credit laws, establishing a central bank, privatizing the banks, and adopting the International Standards of Accounting and Reporting (Oleynik et al., 2004). As a result, Kyrgyz financial institutions now provide a broader range of services to their clients. Although the banking system in Kyrgyzstan largely remains under state control, foreign investors have recently started up many banks and financial institutions. Yet, because of the limited lending capabilities of these institutions, the industry is still small and the level of competition is low (Oleynik et al., 2004). The secondary financial institutions in Kyrgyzstan need significant improvements as well. The capital markets in Kyrgyzstan are still in the process of development and the national stock exchange is inactive with low volumes of trade. Furthermore, services provided by non-bank financial institutions such as investment banks, insurance companies, and pension funds are very limited in scope.

Kyrgyzstan needs support from multinational financial institutions to stabilize its financial services and banking sector. International organizations can be instrumental in introducing the Western financial and banking practices in Kyrgyzstan. Moreover, they can partner with domestic organizations to share the start-up costs of various financial institutions and offer technical training to the Kyrgyz personnel in the areas of management as well as financial and banking services. Above all, the restructuring and privatization efforts in numerous industries prompt an urgent need for capital to undertake these projects. Therefore, an increased number of credit extending institutions is necessary to help investors finance these costly ventures. Besides, prospects of Almaty becoming the financial hub of Central Asia will bring a considerable advantage to the development of financial services in Kyrgyzstan. If Kyrgyzstan can advance its financial and banking services, multinational financial institutions can establish branches in Bishkek to supplement their operations in Almaty.

Hydroelectric Energy

Kyrgyzstan possesses vast water resources originating from its mountain rivers throughout the country. This makes hydroelectric energy production one of the most promising business areas available in Kyrgyzstan. Since the country is highly dependent on large amounts of oil and natural gas imports to meet its domestic energy needs, hydroelectric energy especially bears significance as an alternative energy source. If operated at full capacity, Kyrgyzstan's hydroelectric energy industry alone is capable of meeting the domestic electricity needs as well as producing surplus electricity for export (Oleynik et al., 2004). Unfortunately, the country's hydroelectricity resources are far from being utilized at full capacity. Several large hydroelectric plants left from the Soviet era are quite inefficient to achieve the desired levels of production. Due to limited financial and human resources, these plants failed to satisfy the increased demand for electricity necessitated by the recent developments in the industrial landscape. Hence, the Kyrgyz government aims to build new facilities with the guidance from foreign businesses. The demand for hydroelectric energy is expected to increase not only in Kyrgyzstan but also in neighboring countries. The Chinese

government has undertaken a policy initiative to develop the western part of the country. This will create an additional need for energy and electricity in the area. Close proximity to western China presents a big advantage for Kyrgyzstan to export its hydroelectric energy (Spechler, 2003). Moreover, the booming economy in Kazakhstan and developments in Uzbekistan make these two countries excellent markets for energy export.

In addition, Kyrgyzstan's plentiful water resources also represent other opportunities for foreign businesses. The country has an abundant supply of high-quality water that is ideal to be used as drinking water. However, the systems and equipment to process drinking water need to be replaced and new personnel with special training in water management should be hired. Water is a scarce natural resource in neighboring Kazakhstan, Uzbekistan, and western China. Kyrgyzstan can use its water exports to secure more favorable terms on its imports from these countries. Exports of hydroelectric energy and bottled water would also mean hard currency receipts for the Kyrgyz economy which desperately needs export-oriented industries as a fixed source of cash inflows.

RECOMMENDED STRATEGIES

Foreign businesses entering Kyrgyzstan should initially be prepared to forego short-term profits due to the weaknesses present in this transition economy. Multinational investors must be ready to make large investments especially in the area of building the country's infrastructure. These huge cash outlays coupled with the absence of quick returns require foreign businesses to be financially sound to survive the early stages of market entry. Multinational firms that would like to enter Kyrgyzstan are recommended to employ a phased market entry strategy due to the unstable business environment that exists in many transition economies. Through this strategy, foreign companies initially follow a small scale entry with limited investment and then gradually expand their presence based on the opportunities and challenges encountered in the unfamiliar market environment. Since the Kyrgyz market is not as nearly advanced as the Western markets, a phased expansion approach is very important for foreign firms to minimize the potential losses and risks involved in the early stages of market entry.

Although Kyrgyzstan has managed to spread private ownership to many industries, there are some sectors such as energy and tourism where the state-controlled companies are still dominant powers. As a result, multinational companies operating in various Kyrgyz industries may have to shape their business activity around strict government controls. However, more foreign companies are predicted to enter these industries following the privatization and demonopolization initiatives undertaken by the government.

Unlike Kazakhstan and Uzbekistan which receive steady hard cash inflows from oil and natural gas exports, the Kyrgyz government does not possess adequate financial resources to support its economic transition. Hence, Kyrgyzstan desperately needs financial assistance from foreign investors whose contribution towards the economic development in Kyrgyzstan would be substantial. As a result of the Kyrgyz government's efforts to encourage foreign investment in the country, joint ventures between domestic and foreign companies have become a common entry approach to co-finance the development projects in many industries such as mining and construction. Kyrgyz companies have benefited immensely from their foreign partners who provided them with the capital, technology, and expertise. Joint ventures have also enabled multinational firms to not only limit their capital exposure in the initial entry phase but also acquire valuable insights as to doing business in Kyrgyzstan.

CONCLUSION

In the recent years, Kyrgyzstan has emerged as a transition country with an enviable record of economic transformation. At the same time, there are numerous promising business areas in Kyrgyzstan that desperately need foreign investment. For multinational firms, potential gains from these promising ventures well outweigh the risks that exist in the initial stages of the market entry. A phased entry strategy involving joint ventures with Kyrgyz businesses will not only limit the risks assumed but also help foreign companies establish a solid presence in this new market environment. A thorough analysis of Kyrgyzstan is integral to crafting sound business strategies that will succeed in this

market. Multinational businesses planning to enter Kyrgyzstan should cautiously assess the opportunities and the challenges in the country before formulating their ultimate business strategies.

Consequently, Kyrgyzstan is an ideal investment destination for multinational companies looking for untapped business opportunities. Besides, the country's geographical location along with its future growth prospects makes Kyrgyzstan a strategic entry point in the region for companies that would like to expand into other Central Asian countries and China. The combined market size of these countries presents great business prospects for foreign firms in Kyrgyzstan. As the economic transition continues, an increased number of foreign firms are expected to penetrate the Kyrgyz market. Hence, it is of utmost importance for multinational companies to reap the benefits in Kyrgyzstan before the competition intensifies in the near future.

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