

Adaptability in times of change



Foreword

Welcome to the third Kazakhstan edition of PwC's 18th Annual Global CEO Survey in which more than 1300 CEOs from 77 countries including 44 CEOs from Kazakhstan shared their thinking with us.

When we spoke to CEOs last year about their view of the business environment and prospects for growth, we summed up their attitude as '*cautious optimism*'.

Since then, we have witnessed significant external developments with considerable implications for the business and economic environment of Kazakhstan. For example:

- Geopolitical tensions in the region heightened levels of concern about stability.
- Falling global oil and other commodity prices badly hit natural-resource-based economies like Kazakhstan thereby exposing their vulnerability to dependence on commodities as the major contributor to their economic growth.
- Other trading partners such as Russia share similar exposure to commodities but Russia is also impacted by Western sanctions, leading to a much weaker rouble and fears of recession.
- The slowdown in China's GDP growth raises questions about the volume of bilateral trade and transit traffic between China and Europe across Kazakhstan.



The launch of the Eurasian Economic Union this year built on the earlier Customs Union, coincides with a period of geopolitical uncertainty, and prospects for persistent low growth for the foreseeable future. The growing interdependence that comes with any economic union raises questions about its members' resilience, innovation capabilities and ability to shape new strategies for growth while the Union is facing strong headwinds.

Our business leaders are acutely aware of the complex external factors and growing disruptions facing their businesses and are working hard to ensure that they master the one 'must-have' attribute for future success – *'adaptability in times of change'*.

The challenge for CEOs in such a fast changing environment is not only to rapidly build lean and cost efficient organisations, but also work more closely with others to access new geographic markets, technologies and customers.

On the positive side, CEOs remain confident in their organisations' ability to weather turbulent times in the short to medium term and position their business for future success.

My sincere thanks go to all the CEOs who shared their thinking with us. Their active and candid participation is the single greatest factor in the success of this Survey. You will see some of their comments throughout this report.

A handwritten signature in black ink that reads "A. Akdeniz". The signature is fluid and cursive, with a large initial "A" and a long, sweeping underline.

Alper Akdeniz
Managing Partner,
PwC Eurasia

March 2015





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Global Economic Growth

Global economic growth prospects over the next 12 months

CEOs from Kazakhstan are less hopeful than they were a year ago about global economic growth prospects for the next 12 months, with optimism declining from 34% to 20% over this period. CEOs from other countries are a bit more sanguine about global economic prospects, even though the proportion of respondents who are confident dropped slightly to 37%. CEOs from Russia remain discouraged in their views with regard to global economic growth.

Global CEOs are plainly anticipating what Christine Lagarde, managing director of the International Monetary Fund (IMF), has called a 'new mediocre' period of persistent low growth.

"It is difficult to predict now, but I believe global economic growth will remain unchanged in the coming year. America will see a speeding up of economic growth although it is unclear whether this will completely offset the slowdown in developing countries, while Euro-zone perspectives remain confusing. There will be a slowdown or even recession in some developing countries, including Russia and Ukraine, while the Euro-zone, will probably maintain a minimum level of growth."

Vladislav Lee
Bank CenterCredit

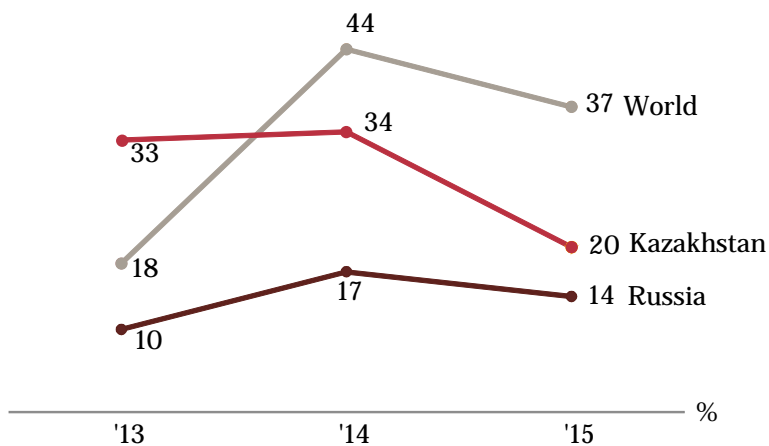
"Economic growth will remain static, but volatility will continue. In the next 3-5 years, regional conflicts, medium-size economic and financial crises will continue although some regions and large countries will grow. Much depends on what happens geopolitically. In general, there are few grounds to believe in any fundamental economic changes."

Kairat Mazhibayev
RESMI

"I believe that economic growth will remain around the same level. In the USA progress is clear, but a slowdown in Europe and China and in developing countries will balance out this US growth so the world economy as a whole will not exhibit any growth."

Eldar Abdrazakov
Centras Securities

CEOs are less optimistic about global economic growth prospects



Degree of confidence in own company's prospects for revenue growth over the next 12 months

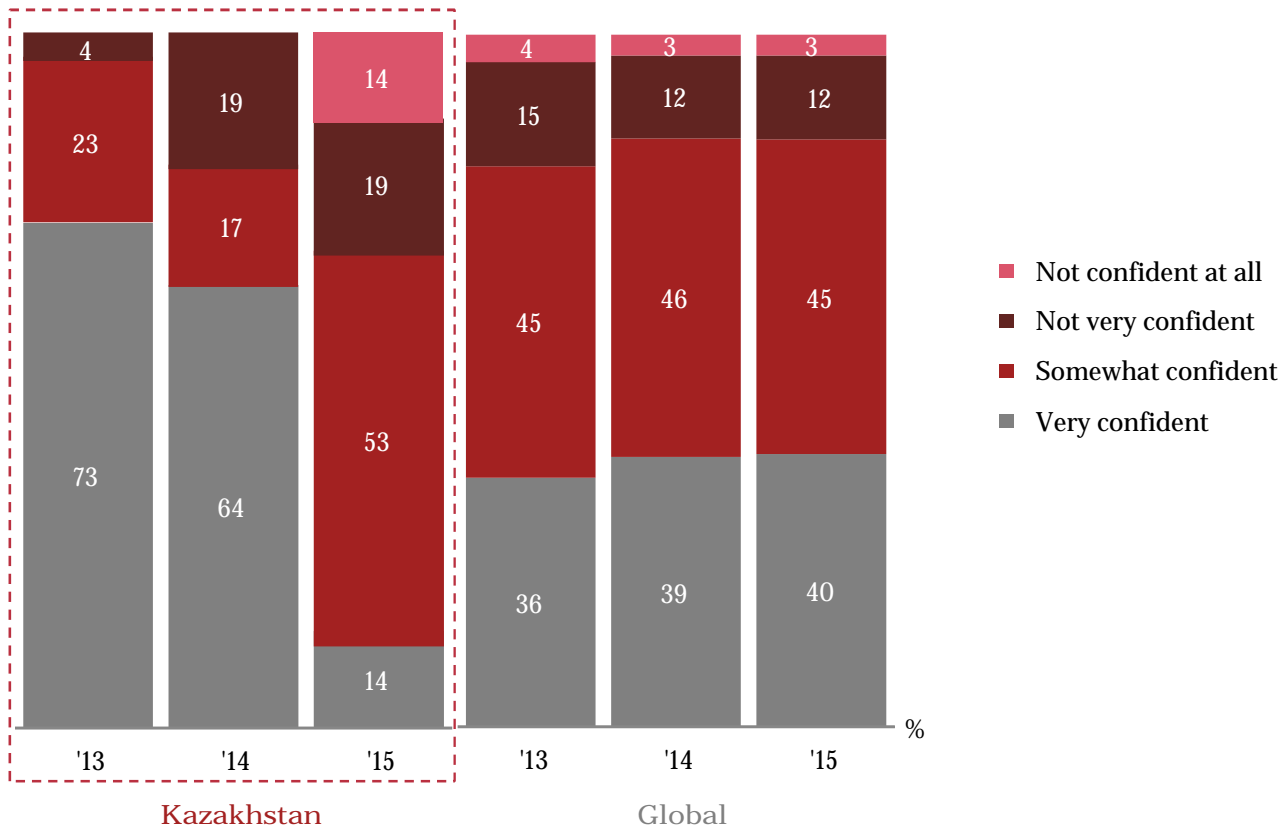
This year CEOs from Kazakhstan are very cautious about their expectations for revenue growth in the short run. Some 67% of respondents expect revenue growth over the next twelve months compared to 81% in 2014. Once again CEOs from other countries are more optimistic (85%) about their business growth prospects for the coming year.

"Coca-Cola continues to invest, create new jobs and to develop its business in Kazakhstan. In June we expect to complete a brand new bottling plant in Astana with the production to start till the end of 2015."

Ahmet Kursad Ertin
Coca-Cola Almaty Bottlers

"To be honest, I'm not quite sure, and associate my uncertainty with the latest developments in Russia, whose influence on us is significant. Economic developments in Russia will continue to influence the Kazakhstan economy, for example, through the rate of inflation. The Russian and Kazakhstan economies are similar, so lower consumption in Russia will lead to a deterioration of the export potential for Kazakhstan companies, despite the fact that we do not export so much."

Vladislav Lee
Bank CenterCredit



Degree of confidence in own company's prospects for revenue growth over the next three years

For the next three years, Kazakhstan CEOs continue to be optimistic about prospects for their business and expect increased revenue growth in the long run. CEOs from other countries have not changed their views over the past 3 years. Some 93% of global leaders remain confident about their company's growth over the next 3 years.

Nevertheless, some 14% of Kazakhstan CEOs indicated less confidence concerning positive changes in prospects for their business compared to only 3% in 2014 and zero in 2013.

"Vladimir Putin's forecast at a press conference that market sentiment will stay negative for another two years is probably realistic. I believe that in the next two years we will face certain challenges linked to worsening economic conditions, but then the economy will start to recover. In terms of the banking sector, within the three-year term, the sector may shrink by 30%, taking into consideration current mergers between BTA and Kazkommertsbank, and Alliance Bank, Temir Bank and Forte Bank and the new regulatory requirements to increase share capital up to 100 billion Tenge."

Vladislav Lee
Bank CenterCredit

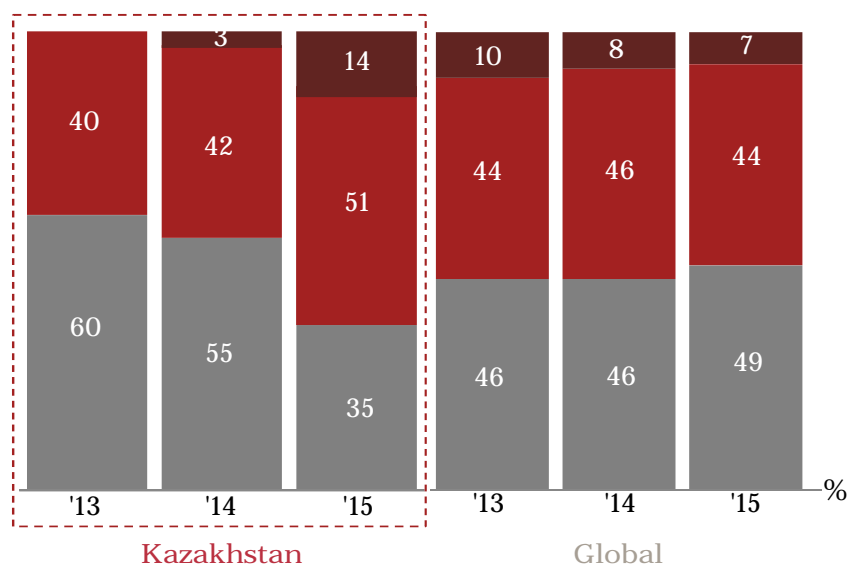
"Despite the global economic slowdown, we feel more confident about the next three years. After the crisis in 2007, many were convinced that by 2009 we would have rapid economic growth. Instead this is the 7th year of turbulence with a high level of volatility and uncertainty. But for our company, we see certain economic trends and niches of significant potential for the bank's development."

Alexander Kamalov
Sberbank

"We continue to be very optimistic about Kazakhstan and its ability to reform and strengthen the rule of law and are expanding our existing operations, which support SME's, banks and diversification, to include agro-business and food processing."

Janet Heckman
EBRD

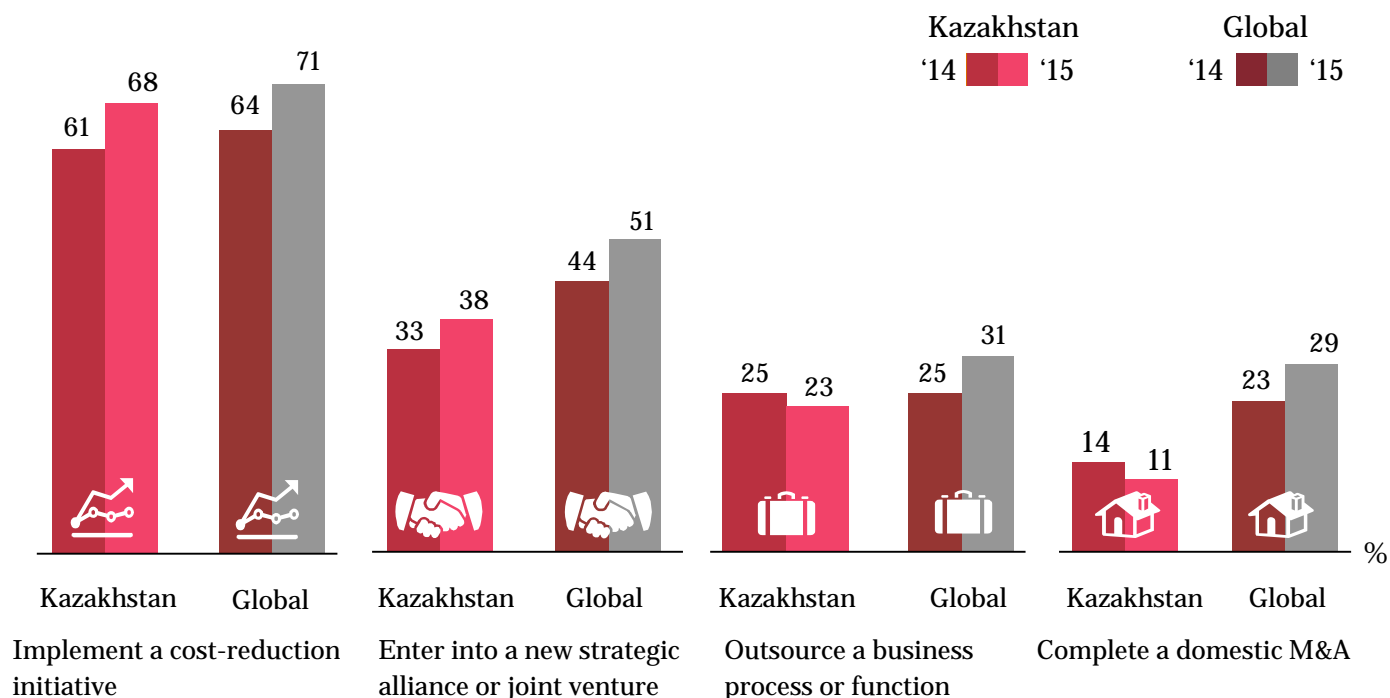
- Not very confident
- Somewhat confident
- Very confident



Restructuring activities planned for the coming 12 months

CEOs from Kazakhstan are historically interested in cost reduction initiatives. The trend strengthened this year when 68% of respondents told us they plan cost reduction initiatives compared with 61% last year. Cutting costs is also on the top priority list for 71% of respondents from other countries.

More business leaders in Kazakhstan plan to enter new strategic alliances or joint ventures this year with 38% aiming to do so, compared to 33% in 2014. CEOs from other countries are more dynamic with 51% expecting enter into strategic alliances or joint ventures this year compared to only 44% in 2014.

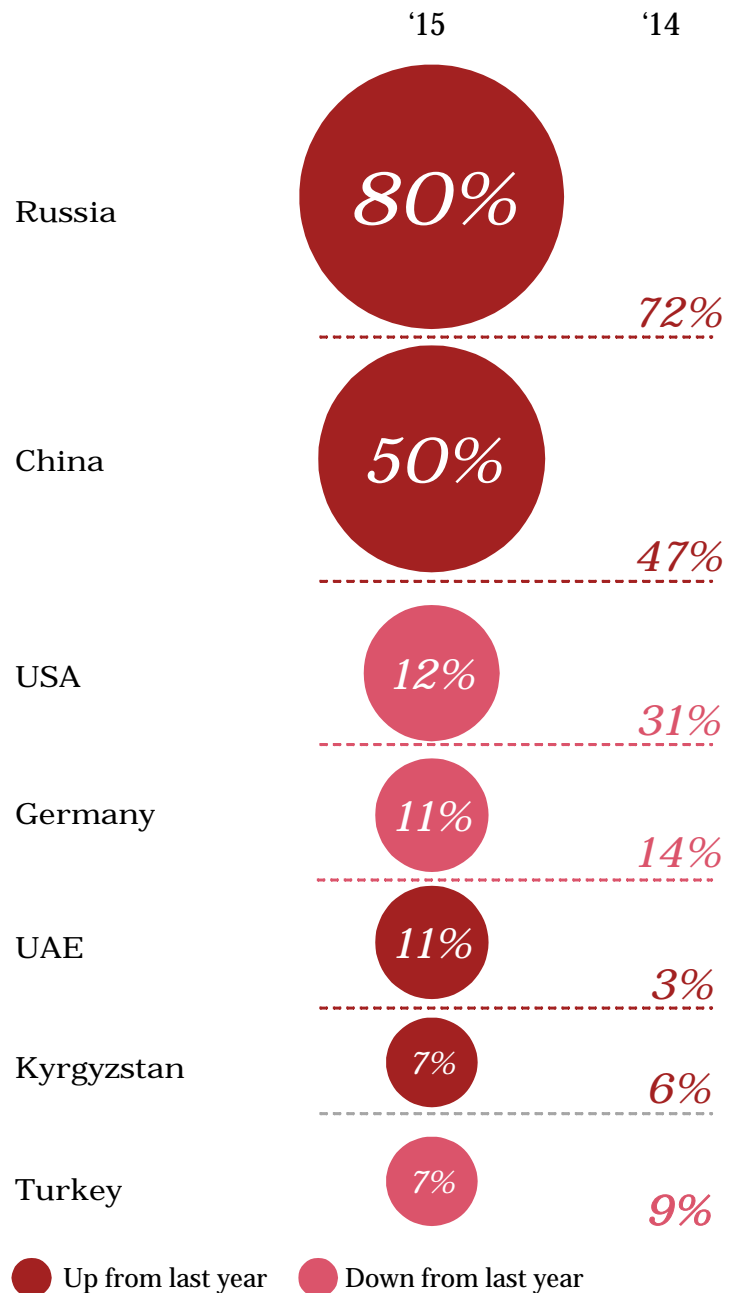


Important countries for overall growth prospects over the next 12 months

The most important countries for business growth prospects have not changed with Russia and China at the top of the list. The birth of the EEU however has added to the historical importance of Russia as reflected in a jump from 72% to 80% citing Kazakhstan's northern neighbour as the key factor in companies' overall growth prospects. The growing importance of China is also confirmed by a 3% increase in its importance share to 50%.

For 12% of CEOs the USA remains important but this is markedly lower than 31% last year. Germany's importance to Kazakhstan business also weakened to 11% from 14% last year. Germany, shared its fourth position with the UAE, which has unexpectedly joined the top countries of interest, up from only 3% in 2014.

The fifth place for business growth prospects is shared between Turkey, cited by 7% of respondents compared to 9% last year and, Kyrgyzstan which climbed up from 6% last year, perhaps in anticipation of its forthcoming membership in the EEU.

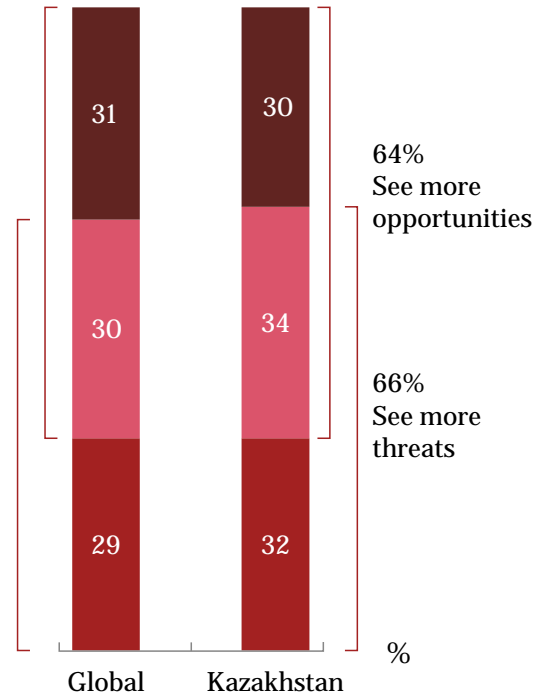


Threats and opportunities

Threats and opportunities today vs three years ago

Nearly a third, 30% of respondents, see an increase in development opportunities, while 32% believe there are more threats than three years ago. This year 34% expect an increase in both opportunities and threats. On balance, 64% of respondents expect more opportunities while 66% are bracing for more threats.

Overseas CEOs differ little with 61% more impressed by opportunities while 59% are more concerned about possible threats.



- see more opportunities
- see more opportunities and more threats
- see more threats

“There are more threats today, but on the other hand, new opportunities are opening up, for example in the retail business. The level of Internet connectivity and banking services in Kazakhstan is much lower than in Europe. But increasing internet connectivity here will lead to the emergence of new markets. A classic example is the telecoms market. At one time, everyone thought that mobile communications would completely displace the landline, but in fact we now have a new cellular market. The same thing was said about the replacement of fixed line internet by Wi-Fi, 3G and 4G services. Greater Internet connectivity promises banks new opportunities for development.

At the same time, Kazakhstan is increasingly integrating into the global economy, and new opportunities are opening up in terms of trade and transfers with our neighbours. The main threat is geopolitical instability.”

Alexander Kamalov
Sberbank

“There are more threats than three years ago, related to the regional situation. Now there is a rift between the Western world and Russia. Unfortunately, this is happening close to Kazakhstan, and involves Russia and Iran as well as China. Kazakhstan has close relations with all of them. I cannot say for sure if the company has more opportunities for development now than three years ago; but the situation back then was more stable than now.”

Kairat Mazhibayev
RESMI

Level of concern in potential economic, political and social threats

In contrast to 2014, where the volatility of exchange rates was cited by 100% of respondents as the major risk factor concerning Kazakhstan, this year 94% chose geopolitical tension as the major risk factor. Conventionally, the second top risk factor has been the inadequacy of basic infrastructure. It still causes concerns but this year it was highlighted by only 77% of respondents compared to 86% in the previous year.

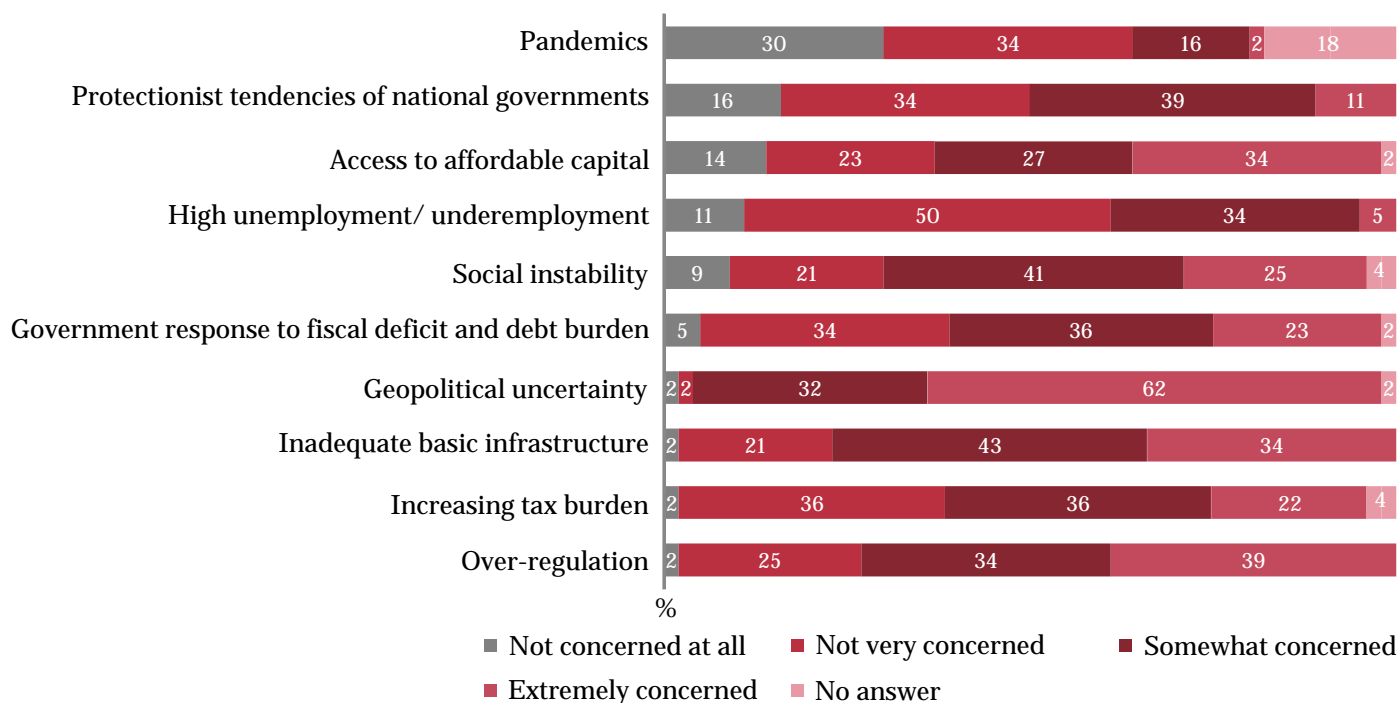
In the previous year, the third most disturbing threat was the slowdown in emerging markets, cited by 84%.

However, 2015 saw a rising threat from over-regulation which crept into this year's top threats for 73% of Kazakhstan CEOs. This is only five percentage points lower than what international business leaders voted for. Overseas CEOs singled out over-regulation as the major trouble facing them in 2015.

Some 61% of senior executives saw lack of affordable capital as a potential threat to the prosperity of their companies while government responses to tackling public debt and budget deficits were quoted as potential problems by 59%.

At the same time 57% of Kazakhstan CEOs expressed their concern about an increasing tax burden.

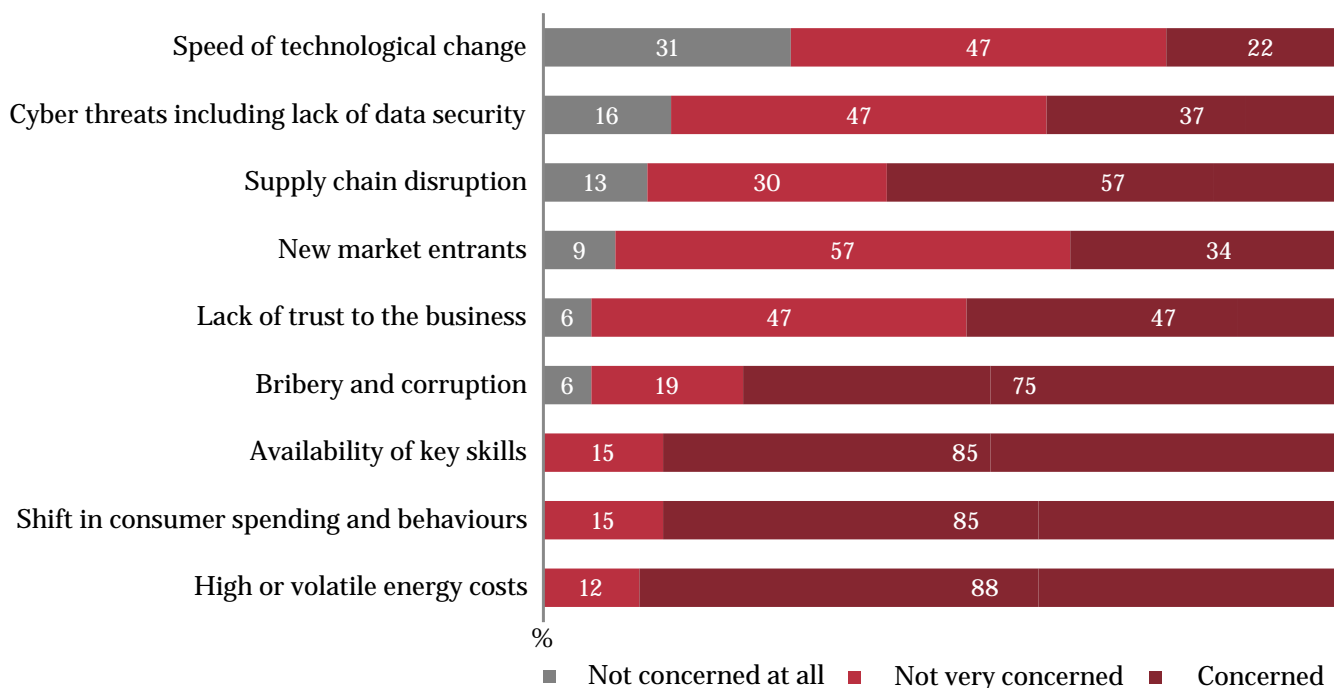
The last two potential threats are interrelated since, in the context of declining state revenues, governments are expected to adopt more stringent policies to address budget deficits and rising national debt. Devaluation expectations, unresolved issues with non-performing loans and the recent lowering of Kazakhstan's sovereign credit rating all call into question the possibility of cheaper money in the near future.



Level of concern about market related threats

Managers of large enterprises are faced with a wide range of risks. In the 2014 survey the two threats that caused any concern to the most number of the CEOs were 'the lack of qualified personnel' (91%) and 'bribery and corruption' (89%). This year the most burning threats were 'the high or volatile energy prices' (88%) followed by 'lack of qualified personnel' (85%) and 'changes in consumer behavior' (85%).

On the global scale, business community is more concerned about threats stemming from 'lack of qualified personnel' and 'cyber threats including lack of data security', while only 37% of respondents from Kazakhstan are worried about cyber security.



"We suffer from a lack of middle managers due to educational problems during the last decade. I hope that over the next 3-4 years the quality of new personnel will improve and employers will benefit from this."

Askar Kanafin
Ordabasy Group

"The main threat to the banking business does not come from banks, but from the IT and telecommunication companies, which are gradually starting to take over segments of traditional banking services."

Alexander Kamalov
Sberbank

Drastic industry changes and their consequences

What proportion of CEOs believe the following trends will be disruptive for their industry over the next 5 year?

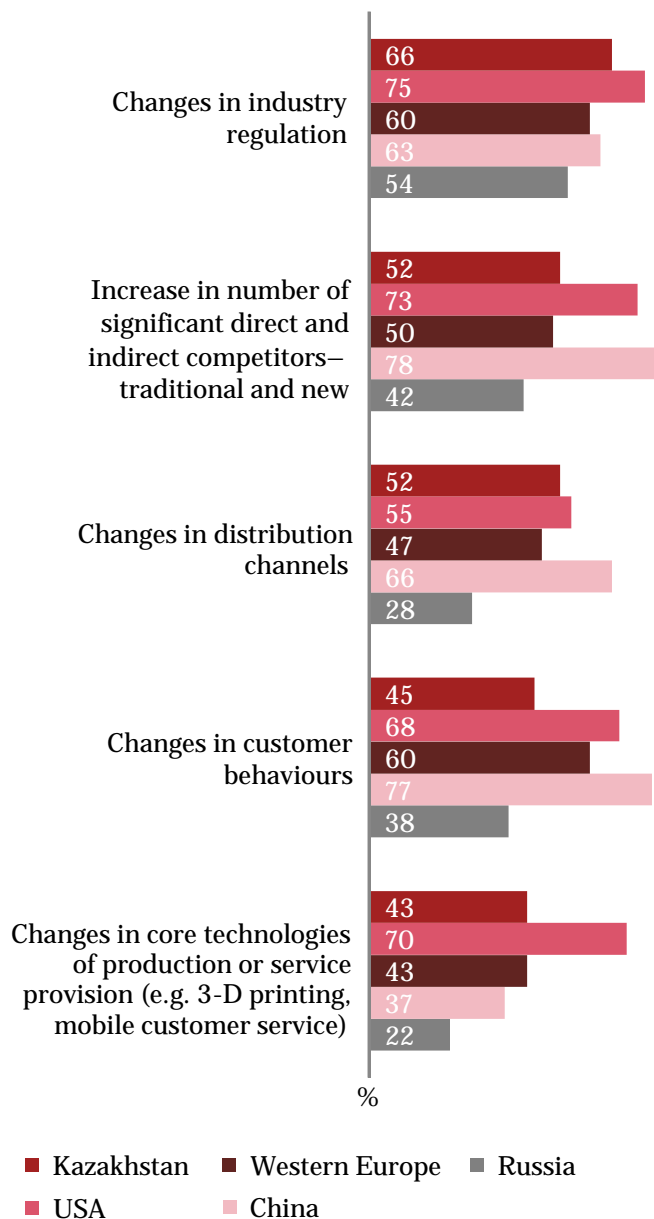
In today's fast changing world, with economies and industries subject to fundamental changes, business leaders worldwide are keenly aware of the challenges to their industries. Over-regulation, availability of key skills and the way governments respond to fiscal deficits and growing debt burdens topped the list of concerns expressed by CEOs globally.

They recognise that megatrends such as shifts in global economic power, technological advances and demographic changes, which were also indicated in the last year's survey, will, in the future, lead to huge shifts in their economies.

While 78% of global respondents identified changes in industry regulation as a key concern only 66% of Kazakhstan CEOs shared that concern together with 54% of Russian business leaders. However, 78% of CEOs in China told PwC that they are most worried about the increase in significant competitors and by rapid changes in customer behaviour, which was cited by 77% of Chinese CEOs.



In the opinion of CEOs, changes in industry regulation can have the most serious influence on business



“We expect quite serious consequences from technological changes underlying both production and service provision and changing customer preferences. Here are two examples. When we were preparing the Sberbank Group’s 2014-2018 strategy we analysed various global markets and identified the following trend. In mature European markets about 65% of the customer base is independent, in the sense that they do not have to visit the office of a financial institution for banking products and services but use a gadget to carry out banking transactions online. Or take for example China’s Alibaba, whose main activities are trading operations between companies on a B2B scheme for retail online trading. But then the Yu’e Bao service was developed on this platform to control excess funds on payment accounts. This service has become very popular because it offers 4.5% annually against 0.35% on bank deposits, and money can be taken out at any time. In the first month it attracted \$931 million which Alibaba used to issue micro-loans in e-commerce.

Our market is gradually heading in that direction. Technological changes affect the nature of buyers’ preferences and the way they buy them through online stores. This then leads to changes in distribution channels. We need to keep up with these changes, offering not just, say, money orders or credit and ready-made solutions. Instead clients will use online application to make a final transaction themselves.

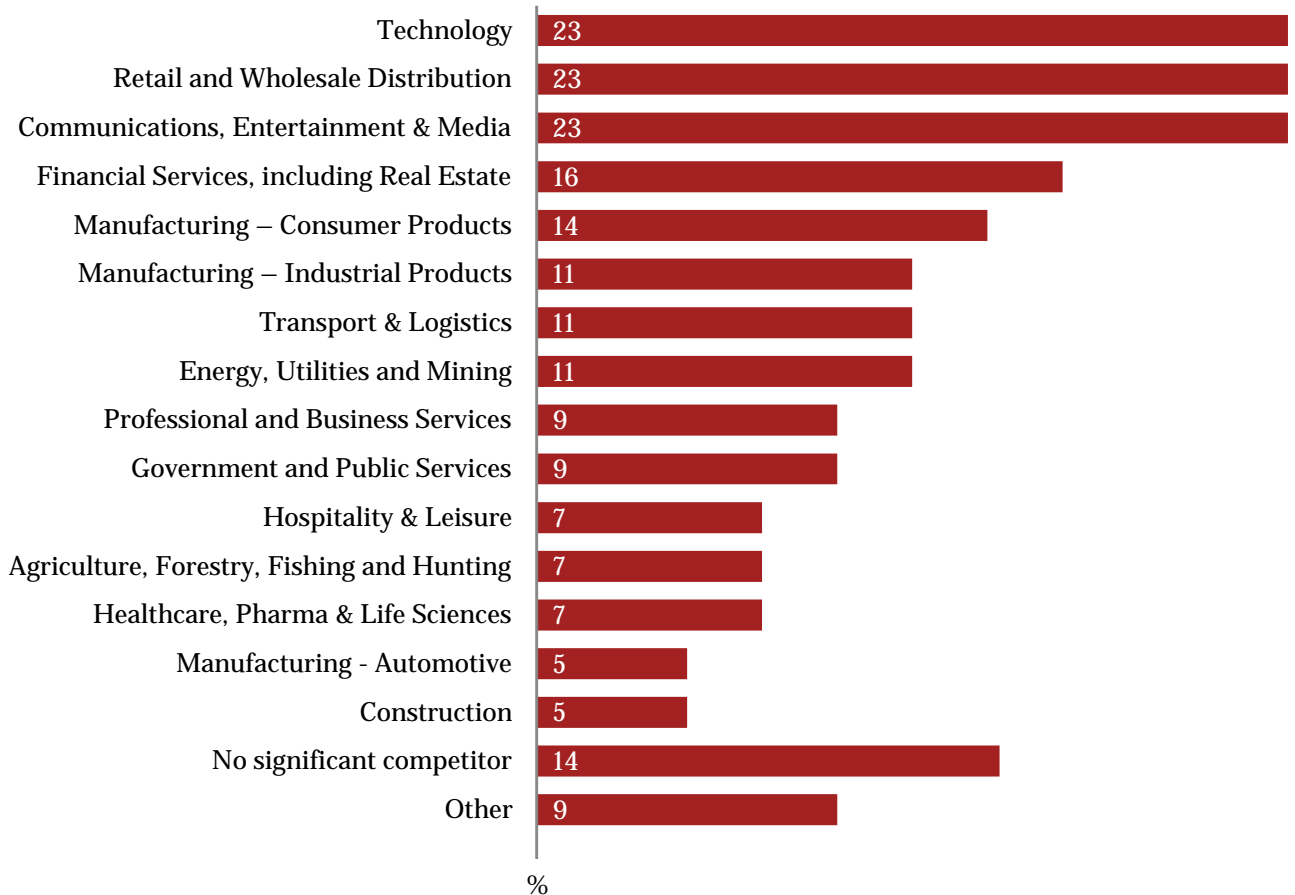
Seeing these new market developments the Sberbank Group acquired a three quarters stake in the “Yandex.Money” electronic payment system. We have signed up to establish a joint venture with them to promote new solutions for Internet retail payments. And this is just the beginning.”

Alexander Kamalov
Sberbank

Competition from other industry players

Current changes in the global economy contribute to raising the level of inter-industry competition. Under these dynamic circumstances most Kazakhstan CEOs expect to see the entry of new players, especially in high tech industries, retail and wholesale distribution and telecommunications.

Meanwhile, rapid developments in telecommunications are already impacting the structure of markets and consumer preferences. Introducing technological advances into production and marketing processes has become an essential factor for competitive advantage in any business.



“In retail and wholesale trade. In Russia, for example after an earlier banking crisis one trading network began to issue its own consumer loans, at its own expense, after having first developed loan scoring. The network issued bonds and took trade credits from suppliers. Goods were sold on installment, with about 30% made-up-rate, which is lower than Russian Standard Bank, but higher than Sberbank and VTB. Nevertheless, they succeeded because customers appreciated an out-of-the-box solution. Someone could buy household appliances by showing their passport and paying a small initial fee. As a result, the trading network won a considerable market share between 2008 and 2011. In Kazakhstan it is possible to buy goods on credit, but only via certain banks, but the next move in e-commerce will probably be facilitating sales by installments in this way.”

Alexander Kamalov
Sberbank

“My industry is banking, a very complex and heavily regulated industry, so I don't expect a significant competitor to emerge from other industries, except for niche players in select areas such as auto-loans, micro-lending, mobile-lending via new devices and so on.”

Ulf Wokurka
Deutsche Bank

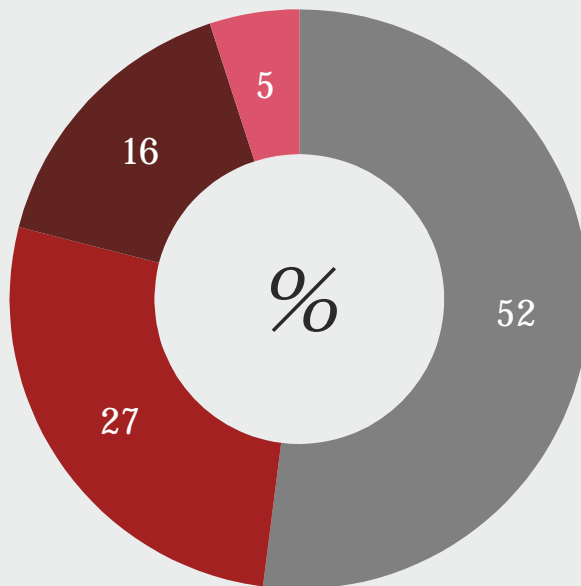


Increase of competitive advantage

How likely is it that organisations will compete in sectors other than their own over the next three years?

Just over half of Kazakhstan CEOs are considering whether to compete in industries other than their own over the next 3 years. At the same time, 27% of CEOs have doubts about entering new markets, while 16% consider that option unlikely.

These outcomes may be the evidence of attempts to diversify risks, as well as indicating increased opportunities in other sectors as a result of new market conditions. Another important factor is the birth of the EEU which essentially creates new opportunities and expands existing ones.



"I doubt it. Since 2008-2009, large business has significantly lost ground. Of course, many companies try to enter different sectors, but they do not have the relevant infrastructure, or the ability to develop new competencies on a large scale. Yes, maybe some attempts can be undertaken, but I don't think they will yield serious changes or competition in other sectors."

Eldar Abdrazakov
Centras Securities

■ Likely ■ Neither/nor ■ Not very likely ■ Don't know

Has your organisation entered a new industry over the past three years?

The majority of companies have considered expanding into new industries in which they were formerly not involved. However, such expansion has not always been successful. Some 34% of companies which have not entered new industries are still considering this possibility.

In spite of potentially lower operational experience, a quarter of the organisations in the survey, entered new industries or markets. This shows that cross-industry shifts are not uncommon. This figure is higher in Western Europe and Russia while slightly below in China relative to Kazakhstan.

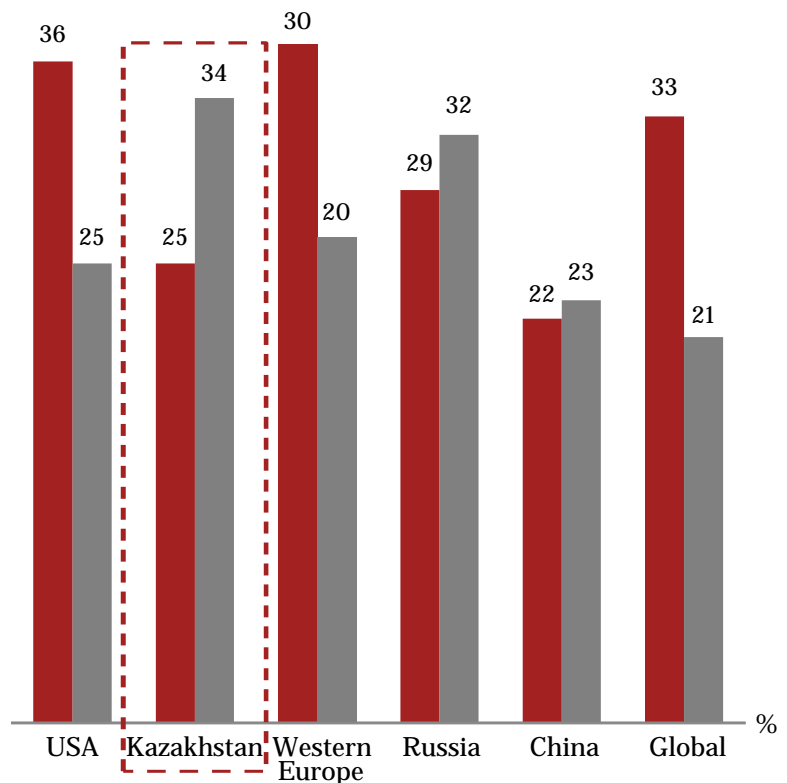
What do these shifts in market strategy imply for business as a whole? Companies that focus management on adaptability in a harsh and rapidly-changing environment appear to have an upper hand over competitors. But the replies indicate that CEOs should handle complex issues such as portfolio diversification and expansion with great care.

“Yes, for example, in 2012 Russia's Sberbank acquired a stake in “Yandex.Money” electronic payment system. Sberbank Group has also established a subsidiary for the development of software, applications and other technologies. Sberbank also entered the life insurance and leasing markets.”

Alexander Kamalov
Sberbank

“We are now considering entering the market for medical services and expanding our insurance activities. We have opened two clinics and are planning further development of our medical infrastructure and business. These clinics are still focused on our insurance companies, we plan to expand and develop this area of focus in the future.”

Eldar Abdrazakov
Centras Securities

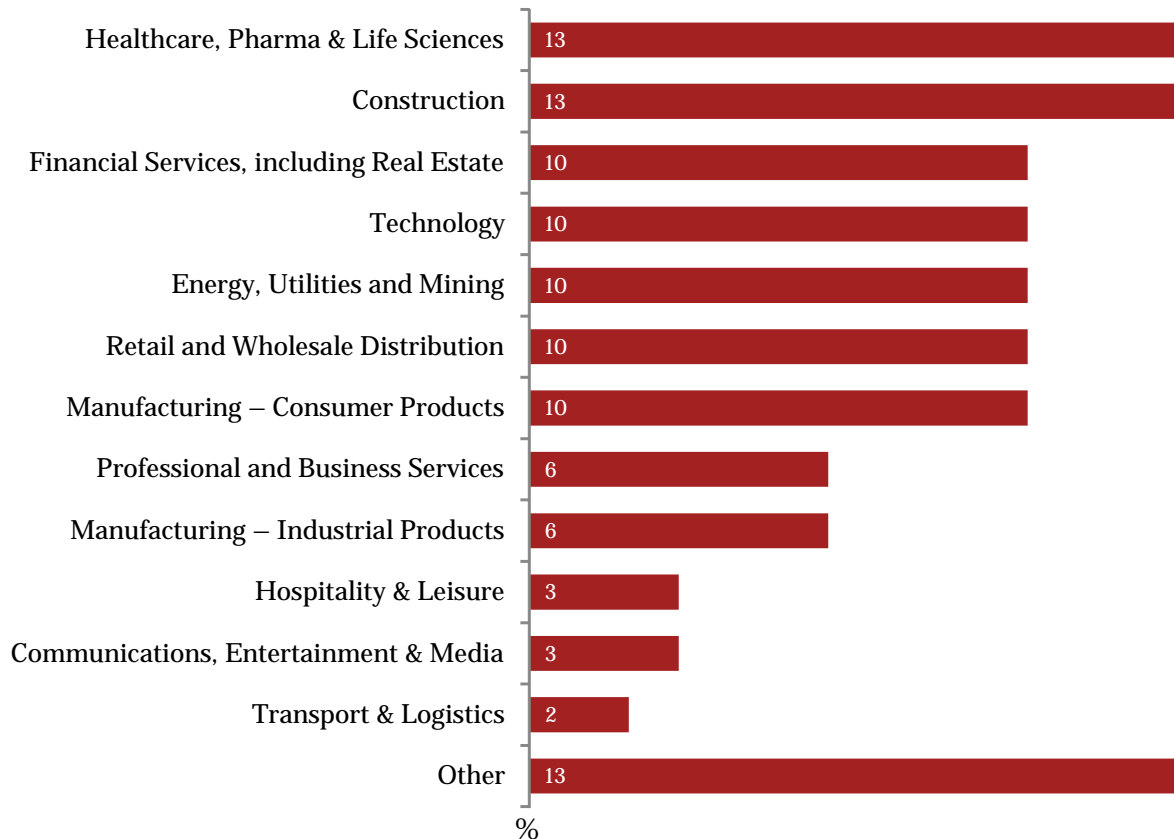


- Yes, we have entered a new industry
- No, we haven't entered a new industry but considered doing so

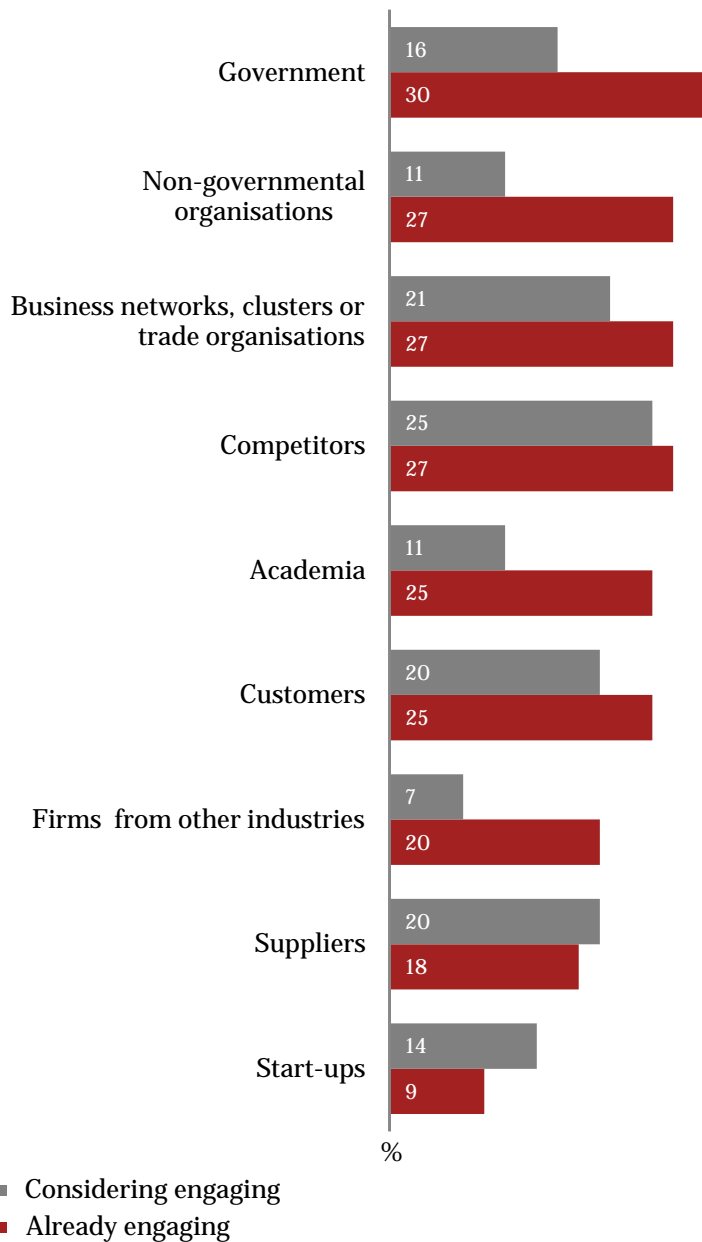
Which industries has your organisation entered within the past three years or considered entering?

Nowadays, it appears CEOs do not adhere to any particular sector. Data shows that health care, pharmaceuticals, and construction were the main target industries for new entry over the last three years cumulatively achieving 26%. Despite the economic downturn, which has had a negative impact on new entries, the construction sector was the main new market for Kazakhstan CEOs over the same period.

In addition to the above, the target industries chosen by CEOs from Kazakhstan are evenly distributed over five industries with a 10% share each. These include financial services, including real estate, technology, energy, utilities and mining, retail and wholesale, manufacturing - consumer goods.



Partners to cooperate with, through joint ventures, strategic alliances or informal collaboration



One way to minimize new risks emerging from constant changes in the world economy is through collaboration with more experienced partners capable of complementing existing capabilities or expanding to take advantage of new opportunities. Just over half, or 51% of CEOs around the world stated that they are planning to enter into new strategic alliances or joint ventures in this way.

The majority of CEOs in the survey who are already cooperating with other entities are doing so with governmental (30%) and non-governmental organisations (27%); business networks, clusters or trade organisations (27%); competitors (27%). Only 9% of companies are cooperating with start-up companies with a further 14% considering such cooperation.

Three main reasons for collaborating in joint ventures, strategic alliances or informal collaborations

Nowadays, new technologies blur the minimum requirements necessary for the firm's existence. Partnerships play an important role in strengthening the capacity of companies. This is especially true for organisations that seek to create new values in more innovative ways.

Replies show that executives are constantly creating new partnerships not only to manage costs, but also to share risks more effectively. Expansion into new geographic regions was noted as the main reason for entering new partnerships (43%), followed by access to the latest technologies (38%) and access to new customers (33%).

The CEOs also noted that brand development and/or image strengthening were important reasons for entering new partnerships (29%). Access to a skilled labour force (24%) and the desire for innovation (21%) were also noted as key reasons for new partnerships.



Nations' high priority objectives

Government priorities expected in Kazakhstan and Russia as the main EEU partner

Adequate physical infrastructure, a skilled and adaptable workforce and access to affordable capital – these are the priorities that CEOs in Kazakhstan would like the government to concentrate on.

Hence, some 77% of Kazakhstan CEOs believe that the main government priority should be the development of adequate physical infrastructure, while 77% of CEOs from Russia want the development of an internationally competitive and efficient tax system to be the main government priority.

Respondents in Kazakhstan also indicated that the business world expects government to concentrate on the creation of an internationally competitive and efficient tax system and an adequate digital infrastructure.

The provision of adequate physical infrastructure



Formation of skilled and adaptable workforce



Ensuring access to affordable capital



“EBRD believes that the challenges posed by lower oil and gas prices, rouble devaluation and sanctions on and by Russia also offer a great opportunity to kick start structural reforms, and sees evidence that the government is thinking along these lines too.”

Janet Heckman
EBRD

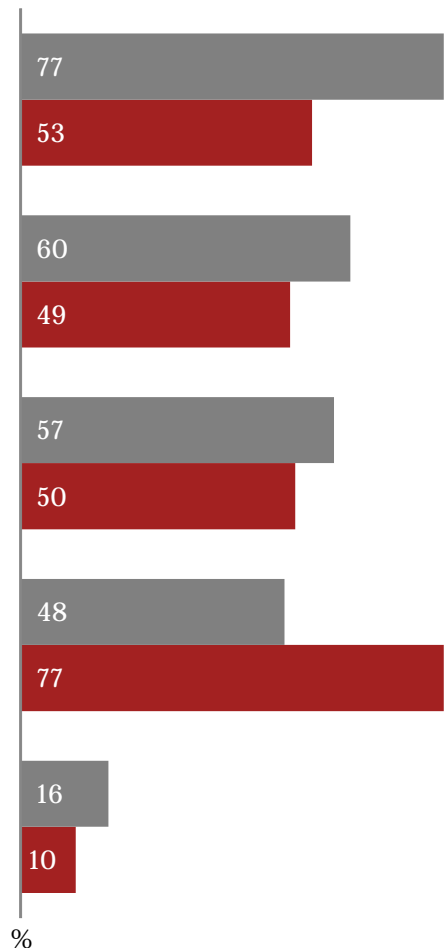
The provision of adequate physical infrastructure

Formation of skilled and adaptable workforce

Ensuring access to affordable capital

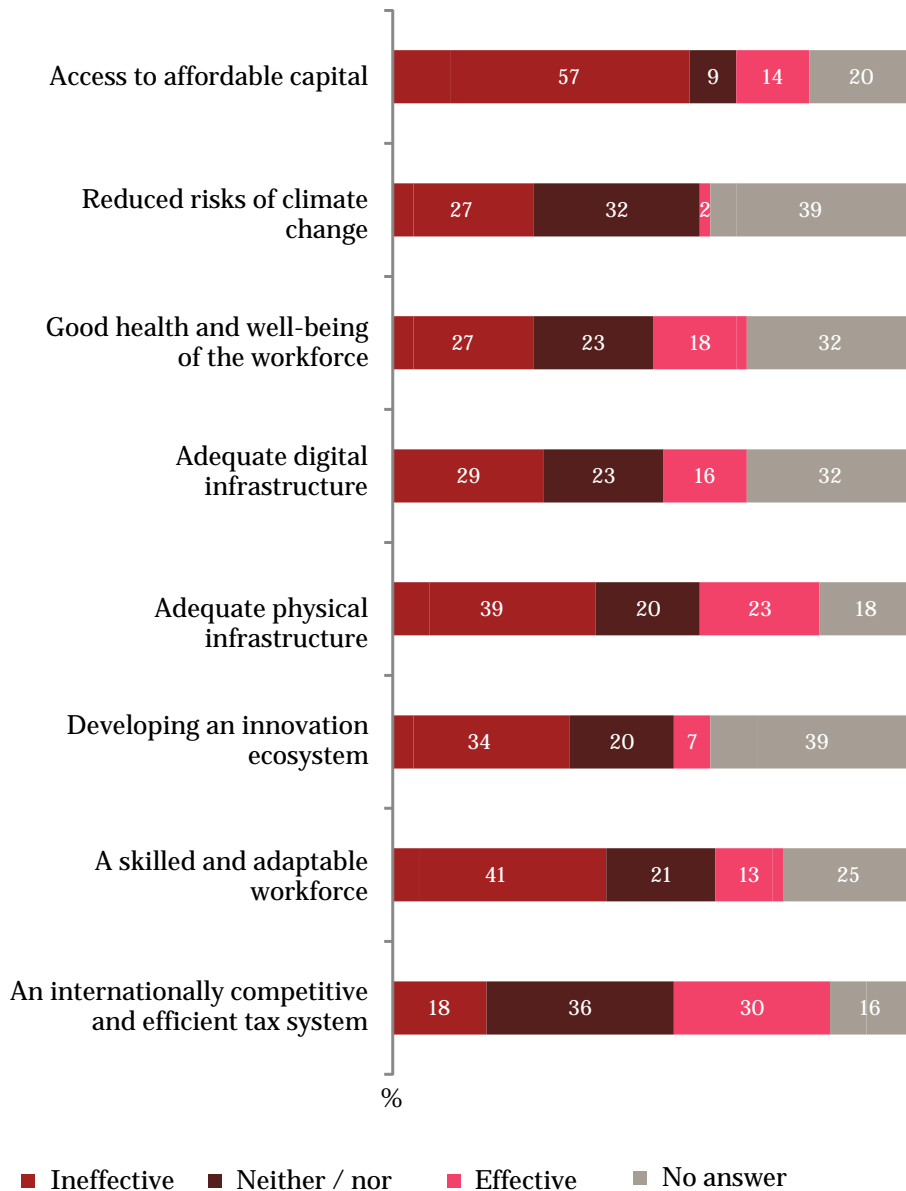
Ensuring internationally competitive and efficient tax system

The provision of adequate digital infrastructure



■ Kazakhstan ■ Russia

Government effectiveness



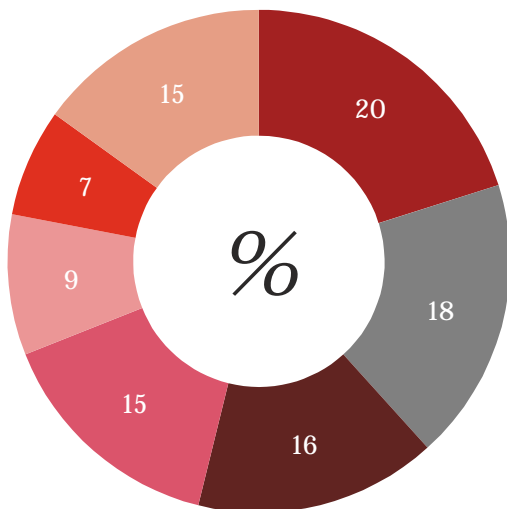
Our survey shows that CEOs in Kazakhstan would like to see the government be more effective in the following key areas:

- access to affordable capital;
- a skilled and adaptable workforce;
- adequate physical infrastructure.

On the other hand, CEOs in Kazakhstan found the government most effective in improving the tax system (30%).

Main outcomes to focus on when collaborating with government over the next three years

Some 20% of CEOs from Kazakhstan are most interested in working with the government in the development of infrastructure. CEOs are also ready to cooperate with government on creating a skilled and adaptable workforce, gaining better access to affordable capital and building an internationally competitive and efficient tax system.



- Adequate physical infrastructure
- A skilled and adaptable workforce
- Access to affordable capital
- An internationally competitive and efficient tax system
- Adequate digital infrastructure
- Reduced risks of climate change
- Other



Workforce capacity

Do you expect headcount at your company to increase, decrease or stay the same over the next 12 months?

Accelerated business growth in most cases requires an increase in staff. Half of CEOs around the world are planning to increase their headcount but only a third of Kazakhstan respondents are making such arrangements. Last year, 63% of CEOs from Kazakhstan planned to increase staff number while complaining that poor quality business processes and low labour

productivity were the main factors affecting the number of personnel. The quality of business processes and productivity has not changed significantly this year but the overall mood of uncertainty about business growth prospects in the short term has had a negative impact on plans to increase personnel numbers.

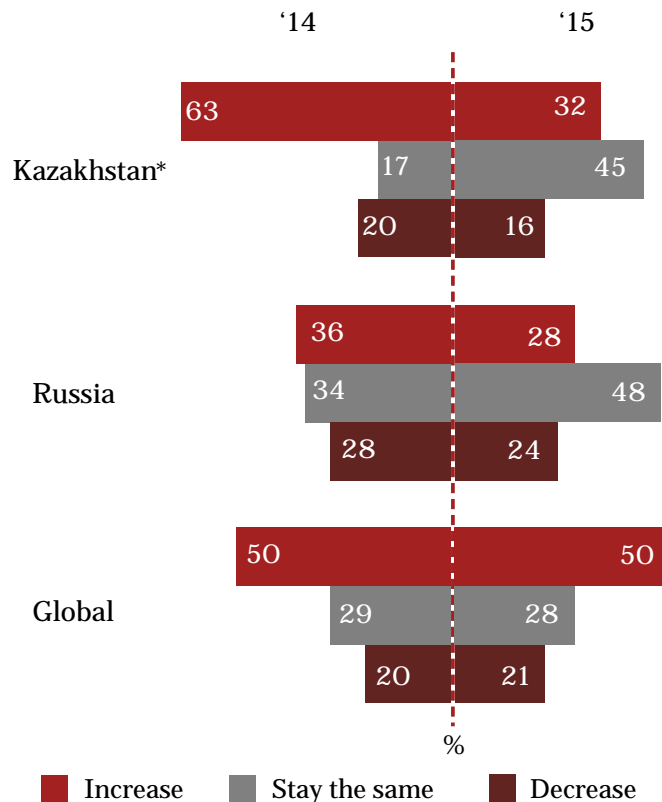
Some 45% of local company heads reported in our survey that personnel numbers will remain unchanged, while 16% plan to reduce employees. Russian CEOs are planning similar retrenchments, in contrast to the more expansionary plans of 50% of CEOs around the world.

“Operational efficiency is very important for us, therefore we would not like to increase personnel but continue the transition to a new level of rationalization of costs and a more economically efficient approach.”

Kairat Mazhibayev
RESMI

“We are optimistic about the future. Over the last five years we grew double digit in volume terms and expect to continue growing. We are also looking to recruit talented people here [in Kazakhstan] who will be able to work for us in other countries too.”

Ahmet Kursad Ertin
Coca-Cola Almaty Bottlers



*7% CEOs refused to answer in 2015

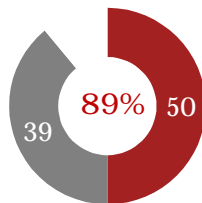
Do you agree or disagree with the following statements about your organisations talent activities?

An optimum balance of technical and soft skills and the ability to adjust this combination to meet the changing business needs is crucial. These objectives require an open-minded approach from management of human resources to allow personnel to think and work flexibly and generate new ideas.

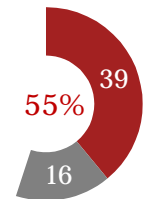
The demand for skilled labour continues to rise, together with the need for employees with multi-functioning capabilities. To acquire such people, companies use a wide range of recruitment strategies and training techniques.

Highly skilled candidates create real value for business: studies show that a more skilled labour force can generate value up to \$130 billion globally due to higher productivity.

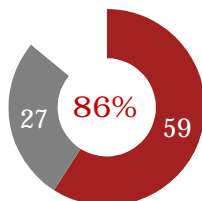
We actively search for talent in different geographies, industries and/or demographic segments



We look for a much broader range of skills when hiring than we did in the past



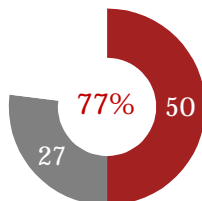
We always use multiple channels to find talent, including online platforms and social networks



We always collaborate with a wide range of external organisations to fulfil talent needs, including sharing of talent with other organisations



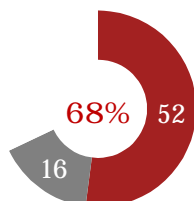
We always equip employees with new skills through continuous learning or mobility programmes



We have greatly increased our reliance on contractors, part-time workers, outsourced functions or service agreements



We always use data analytics to provide better insight into how effectively skills are being deployed within our organisation



■ Agree
■ Strongly agree

The issue of devaluation

Interviews for this year's survey took place against the deeply uncertain background of falling oil prices, fighting in Eastern Ukraine, sanctions imposed by the USA and EU countries on Russia, and Russian sanctions against food and other imports from the West. All these external factors greatly complicated the already challenging task of adjusting to the new reality of membership in the Eurasian Economic Union which introduced a new set of rules and opened up new opportunities and risks.

The Russian rouble has suffered most from the interaction of financial and other sanctions on a resource-heavy economy gravely weakened by the collapse in global oil and commodity prices. Rouble devaluation suddenly made shopping across the border much cheaper for Kazakhstan citizens converting their Tenge at a largely unchanged rate, while pricing out a range of Kazakhstan exports.

Our interviews revealed a widespread conviction that the economic imbalance caused by rouble devaluation is unsustainable for Kazakhstan.

In early February 2015, Kairat Kelimbetov, chairman of the National Bank, declared: "... we will not allow abrupt devaluation, and will work within a smooth and flexible exchange rate policy." He added that a plan to de-dollarize the economy would be worked out by the National Bank together with the Ministry of National Economy of Kazakhstan.

As these policy statements were being made we asked CEOs additional questions about how their companies were affected by the February 2014 devaluation and expectations for the current year.

Their replies revealed how disruptive the 2014 devaluation had been for many, and how difficult, and sometimes impossible it had been to raise prices or increase efficiency sufficiently to fully offset the negative impact of devaluation on their foreign currency debts and the higher cost of imported raw materials and components.

For some, the country's vulnerability to currency uncertainty reflected insufficient diversification of the economy which left it highly affected to changes in global prices for Kazakhstan's oil, gas, minerals and grain.





Views were mixed on the merits and pitfalls of Kazakhstan's membership in the Eurasian Economic Union, of which more later in a separate section, but most agreed that the decision not to devalue the Tenge made it very difficult for Kazakhstan-based companies to compete in the Russian market and made them more vulnerable to competition from Russian companies operating in the Kazakhstan market.

In general, bankers were more sanguine than manufacturers and traders, and several said that they had managed to actually raise their margins after the 2014 devaluation, partly because this had been offset by a combination of higher wages and higher inflation. But in the first half of 2014 oil and commodity prices were still high and underpinning the economy, unlike the present situation of depressed export incomes from oil and commodities and currency headwinds.

As one banker told us "devaluation is a problem because of its effect on jobs and growth. Job loss affects credit worthiness. We deal with around 2 million people. The last devaluation was offset by higher wages and inflation. But low oil prices and rouble devaluation make the overall economic climate much darker now. Last year we managed to get higher margins but from lower volumes. Now we are cutting costs and reducing our work force by 19-20 per cent. That means closing some places but we're not cutting business sectors, yet."

One CEO told us his property company was taking advantage of the rouble's collapse to recruit from Russia the skilled staff and key workers whose Russian salaries had fallen in real terms because of devaluation. But domestic consumer-based companies from pharmaceuticals and cosmetics to super-stores complained that currency uncertainty was undermining consumer confidence and affecting their profitability and growth prospects.

The hardest hit have been the auto-dealers who have seen their market virtually collapse, especially in the northern part of the country, as buyers of new and second hand cars have surged into the south Siberian car dealerships to buy cars at a steep discount thanks to rouble weakness and the Tenge's relative but artificial strength.

Impact of sanctions on Russia

Opportunities and threats

Our survey revealed wide differences of opinion about the impact of the strained geopolitical situation and the impact on the Kazakhstan economy of sanctions imposed on and by Russia.

Most CEOs believe that sanctions are having a mainly negative effect due to Kazakhstan's close association with Russia. Some however think that sanctions could also help to open up new business horizons and provide an unexpected opportunity to become a major regional player. Some also see an opportunity to attract foreign investment that would normally have gone to Russia.

This ambivalent attitude was summed up by one CEO who told us that the impact of sanctions can be both positive and negative. Sanctions give Kazakhstan companies a chance to work in the Russian market, but the negative consequences include greater dependence on Russia. If in the long run the Russian economy continues to decline, this would have an adverse effect on Kazakhstan.

A fund manager reinforced this ambivalent message when he told us “our business is not impacted directly, but any sanctions are detrimental. We closely cooperate with Russian companies and purchase raw materials and equipment partially through Russian channels. So we are forced to develop alternatives to secure our business. This requires certain adjustments in delivery times and to the final value of goods. But for funds such as ours sanctions are also a great opportunity to enter new markets and conclude lucrative contracts with companies from various sectors.”

The CEO of an international bank operating throughout the region also noted that back in 2014 there was significant demand for Kazakhstan sovereign and quasi-sovereign issuers on global bond markets, according to analysts this was due to a lack of major Russian issues because of sanctions.

A CEO actively developing new business opportunities arising from Kazakhstan's emergence as a key link in the China-Europe Silk Way rail, road and logistics projects, distinguishes between the negative short term impact of sanctions and the long term which he believes that it should be positive in the long term as they give Kazakhstan companies an opportunity to do more business in the Russian market.

Looking further ahead one CEO noted that Russia will need at least 10 years to return to the same level of relations with the European Union as a year ago and that long term negative consequences will inevitably affect Kazakhstan as a close neighbour and member of the Eurasian Economic Union.

A banker closely involved in domestic and foreign corporate financing has a more nuanced view noting that tense relations between Russia and the West are certainly having an impact on the Kazakh economy. “We see some investors and foreign partners getting more cautious about cooperating with us due to regional uncertainty and the resulting political and economic risks. At the same time, we see an increase in trade between our two countries. It is no secret that rouble depreciation means that many Kazakhstan consumers prefer to purchase some goods more cheaply in the Russian Federation. In turn, this challenges domestic producers to work harder to improve the quality of their own products and their competitiveness.”

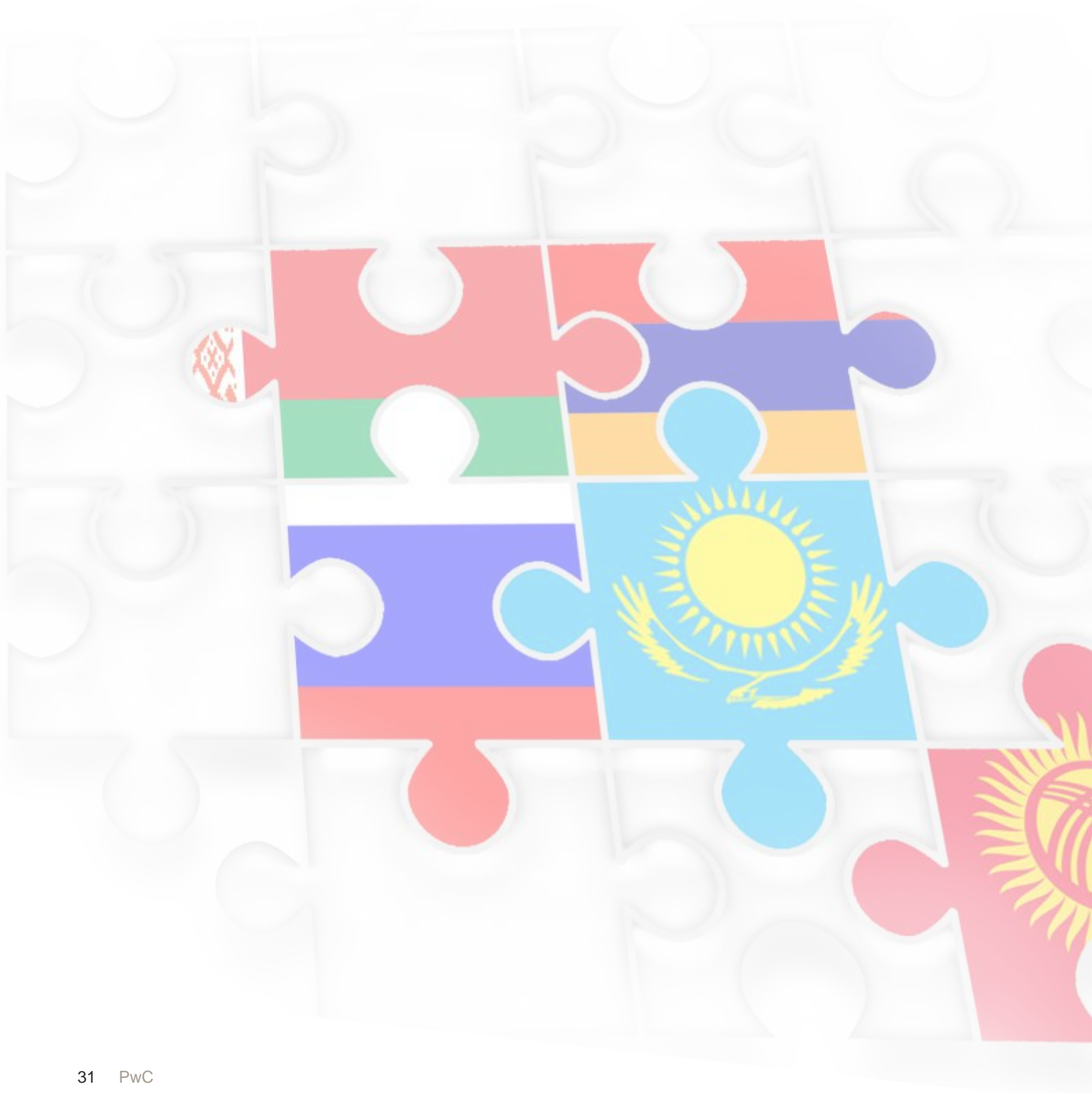
But sanctions are not the only factor affecting business between Russia and Kazakhstan. As one rather world-weary CEO told us “when a Kazakhstan company enters the Russian market for the first time, it has its own difficulties with legal and financing issues and it is very expensive. Large players work at the legislative level or by lobbying. Problems are more acute at lower levels where bureaucracy flourishes, efficiency is very low, and businesses need to learn how to work and interact in such conditions. If Russia continues to suffer problems like these, Kazakhstan will have the chance to become a larger regional player.”

Another CEO added that the insurance markets in Kazakhstan and Russia are highly regulated. But bribery and corruption issues are a reality at all levels. “It is difficult to sell and deliver Kazakhstan goods in Russia, not because they are not let in, but because there are ‘non-tariff’ problems when you get there.”

Banks appear to be most affected by sanctions, not surprisingly because of the finance-focused US sanctions in particular, but have also provoked some interesting reactions. One CEO of a Russian bank operating in Kazakhstan said “while sanctions are impacting rather negatively on our business, leading to deferred opportunities and some funding limitations they have also forced us to pay more attention to Asian and Middle Eastern markets and countries like Turkey, Azerbaijan, Afghanistan and Pakistan.”

Another respondent commented “Kazakhstan is seeking to increase trade with Iran, so, for example, we funded Aktau port which improves access to this market. We have also partnered with Dubai Port World, which will be the operator of Aktau port as well as new trade and logistics centers together with Kazakhstan Railways (KTZ). We are also negotiating with Funds from the Middle East to attract investment and expanding the range of correspondent accounts with banks in China and Korea.”

Perhaps the broadest overview came from a CEO who said from his company point of view “we are in standby mode.” But, he added, “you have to ask how long this power struggle or ‘show of muscle’ [between the West and Russia] can last and who will emerge as the strongest. Ultimately, economic issues will be determined by the outcome of the political struggle.”



The Eurasian Economic Union

Challenging start

The Eurasian Economic Union (EEU) came into force at the start of this year with Russia, Belarus and Kazakhstan as founder members and with Armenia joining shortly afterwards and Kyrgyzstan as a possible additional candidate for membership. Ukrainian membership, so strongly desired by Moscow, is now delayed for the indefinite future.

The new treaty creates an economic union superficially similar to the European Union on which it is loosely modeled. It is designed to facilitate the free movement of goods, services, capital and labour and the creation of coordinated, coherent policies in various key economic sectors. The founding document is based on the legal foundation of the Customs Union and the Common Economic Space and is supposed to take account of WTO rules and regulations, given that Russia recently became a WTO member.

In practice the fact that inauguration of the new Union coincided with a massive devaluation of the Russian rouble and two-way sanctions on Russia and by Russia has greatly complicated the start of the new trade regime.

The CEO of a Kazakhstan company gave a graphic example of how Russia attempts to impose sanctions on the import of a long list of food and other imports from EU countries have had unintended knock-on effects on companies which trade between East and West.

Another CEO added that “Sanctions between Russia and the West have undoubtedly had a negative effect both on our business and the economy as a whole. It is now harder for us to import raw materials due to problems on the Russia-Belarus border, for example. At one point, trucks with our cargoes were just not allowed to pass. And there are many such operating difficulties.”

As a result of the additional sanctions-linked complications to what was expected to be a difficult birth the Kazakhstan business community is taking a much more careful look at the Union's potential merits and drawbacks. Some CEOs already believe that the EEU is a big mistake. Others trust that it is a necessity. This will lead to market consolidation and encourage the development of domestic companies. But most agree that this will take time and requires the quick recovery of both Russia and Kazakhstan from their current difficulties.

Doomed to failure?

The CEO of a European bank operating in Kazakhstan fully recognizes the theoretical advantages to creating a larger, harmonised market but worries that the Eurasian Union could be doomed to failure “because the national interests of the participants are too diverse and the members are also too unequal, with a dominant power able to impose its will on the others,” he said.

The European CEO of another Kazakhstan subsidiary notes that the new Union is likely to be more profitable for Russia and will give Moscow more control over neighbouring countries. “I do not see significant benefits for Kazakhstan. Kazakhstan exports to Russia are only 6.9% of its total exports. Since rouble devaluation we started to feel more competition from Russian companies,” he added.

“Tougher competition is not only felt in the domestic market. At current exchange rates Kazakhstan firms are very uncompetitive on the Russian market and can not export to Russia where domestic prices are now very low,” notes the CEO of a consumer goods company with growing production in Kazakhstan.

Concerns go well beyond cargoes being detained or turned back at the Belarusian border due to sanctions imposed by Russia. Several CEOs worry that the new Union will make relations with Europe and the rest of the world more complicated, and not just over trade. “Union membership also means that we have to align our technical standards and regulations with Russian ones, rather than remain open to more advanced European, US and Asian standards,” one CEO said. “Basing our operations on European standards, could open significant opportunities for us going forward, including the development of new technologies, the establishment of joint ventures and so on,” he added. This is a particularly important point given Kazakhstan's ambition to build increasingly more Made in Kazakhstan brands for foreign markets.

Another foreign banker also believes Union membership will prove to be a big mistake for Kazakhstan: “Because of rouble devaluation both dumping and inflationary tendencies are exaggerated by membership of the Union and can't be offset by higher exports.”

Several CEOs suggested that Kazakhstan should have pushed harder for WTO membership instead. One noted “when Russia became a member of WTO, it had to reduce tariffs. Import tariffs on cars fell from 30% to 10%. In Kazakhstan, they are still 30%. Unfortunately, Kazakhstan is not able to use the Customs Union in its own interests and for us it is now important to join WTO.”





Large market – big opportunities

Not all businesses see drawbacks in economic integration however. “I am familiar with the sceptics' who fear for the competitiveness of our goods. But I believe in the talents and business acumen of our businessmen. I am sure Kazakhstan companies will be able to take advantage of the Customs Union and Eurasian Economic Union,” says the CEO of a consumer marketing company. “This is because I see in the Union above all the creation of a stronger market in which our national companies can grow and develop,” he adds.

“Market consolidation will contribute to the country's industrial development,” another CEO active in the logistics sector agreed. “Kazakhstan is a medium sized partner. The combined market of Kazakhstan and Russia as a whole is significant and more attractive. Attracting more investment will enable us to increase the pace of industrial development in the country,” he noted.

“It is too early to judge the Customs Union and Eurasian Economic Union. The details and implementation need very careful negotiation. The devil is in the detail.”

Janet Heckman
EBRD

The CEO agenda

What is needed to compete in today's economy?

When asked to name one capability that tomorrow's CEO must have, strategic thinking and adaptability were cited by an overwhelming number of business leaders around the world.

We asked CEOs in Kazakhstan to name one important feature which company heads need to work successfully in the new business environment.

1. Build sustainable relationships

"The ability to interact with clients, investors, partners and staff in order to ensure further development of the successful business."

Siddique Khan
Globalink

"Communication skills. They are key in both internal (staff) and external communications in order to outline and define the company's position, objectives, policy and practice."

Ulf Wokurka
Deutsche Bank

2. Ability to adapt

"The ability to adapt to a changing business environment. Kazakhstan is part of the world economy, so it is very important to understand and adapt to changes occurring abroad in order to be competitive, otherwise countries with more developed economies will engulf the market with their companies."

Tomas Mateos Verner
Kazakhstan Kagazy

"Promptness and one's own vision of the market trends. Since in the current situation it is very important to quickly make decisions and be able to correctly develop a long-term strategy of the company."

Zhanat Umarov
Medservice Plus

"The main requirements are flexibility and responsiveness to change. This refers not only to technological processes, but also to innovative management skills. The geopolitical situation worldwide is changing so fast that the ability to adapt and make quick and rational decisions is essential for the survival and development of your company in the new business environment."

Marat Seitkulov
-BestGroup

"Flexible management. Many companies are faced with various problems: devaluation, inflation, competition. The search for talent in these conditions must always remain flexible, tuned to negotiations and the search for optimal solutions."

Pietro Cala
Jambyl Cement

"Professional competence in all aspects of work, mobility and the ability to quickly react to changes."

Raimbek Batalov
Raimbek Group

3. Disciplined approach

“Disciplined approach – to ensure consistency of thinking and analysis of the external and internal environment to provide a clear action plan.”

Umyt Shayakhmetova
Halyk Bank

4. Develop ethical approach and social responsibility

“First of all a modern manager should adhere to a code of ethics. Professional skills are widely available. High technologies and copyrights are also accessible, if sufficient capital is available. The standard of business ethics of executives will increasingly be seen as the key element. Social responsibility should not only be a form of PR for the company, but a norm of life.”

Konstantin Kulinich
Mary Kay Kazakhstan

“Integrity is the key factor. Most CEOs succeed by demonstrating their organisational talent, decision making skills, leadership and expertise in their business. But if we analyse the many corporate failures of recent years, the major reasons behind them tend to be failure to achieve direct answers to simple questions, disrespect for the law, poor risk management and sometimes breaking the code of ethical conduct. An honest CEO who consistently acts with integrity encounters fewer ‘unknowns’ in his business and enjoys more trust from his team.”

Andrey Kurilin
Citibank Kazakhstan

5. Think bigger

“What is required is a strategic vision for the development of your projects and your industry.”

Yerzhan Mandiev
Asia Avto

“Two features in combination. Firstly, systematic thinking, the ability to take into account various factors that exists not only in your industry but in the economy generally. Secondly, adaptability, sensitivity to changes in the external environment within the context of high volatility.”

Alexander Kamalov
Sberbank

“It is important to be proactive and have one's own vision and share it with the team. The business environment is more entrepreneurial than 5-10 years ago. Decisions based on a concept, vision can yield the best result.”

Kairat Mazhibayev
RESMI

Conclusions

View on the global economy

Geopolitical tension and high level of uncertainty were very important factors in CEO's attitudes and expectations globally.

Only 37% of the CEOs surveyed globally and just 20% of the CEOs from Kazakhstan are confident that the global economic situation will improve over the next 12 months.

Political and business risks for companies

The mood of CEOs globally indicates much stronger confidence than their peers in Kazakhstan. This year CEOs from Kazakhstan are very cautious about their expectations for revenue growth over the next 12 months compared to last year. The decline in optimism of CEOs in Kazakhstan may reflect recent developments such as geopolitical tensions, the fall in oil and commodity prices, the impact of sanctions on Russia as a member of the Eurasian Economic Union and the outlook for growth in China.

The basic instincts of business

The majority of CEOs globally (71%) plan to implement cost-reduction initiatives in the coming 12 months. In Kazakhstan, 68% of those surveyed told us they are planning to do this.

At the same time, mergers and acquisitions activity both globally and nationally may be increasing.

This year CEOs in Kazakhstan and around the world indicated a greater willingness to enter new strategic alliances or joint ventures (51% globally and 38% in Kazakhstan).

In the new year, half of CEOs globally plan to increase headcount in their companies. In Kazakhstan, only a third are making such arrangements. Some 45% of CEOs in Kazakhstan told us that their headcount will stay the same, while 16% plan to reduce their headcount.

Government priorities

In the opinion of CEOs globally, the aim of governments should be to establish internationally competitive and efficient tax systems (67%), as well as to train more highly qualified personnel (60%).

In contrast to their foreign counterparts, respondents in Kazakhstan named adequate physical infrastructure and access to affordable capital among important governmental priorities. They also agree with their global peers, that the formation of skilled and adaptable workforce should be one of the top governmental priorities.

Given the importance of the Eurasian Economic Union and its impact, business also wants the Government to ensure that regulations are defined more clearly and accurately and reflect a long-term view of ultimate goals.

Meet the CEOs



*Aleksandr
Kamalov*
Sberbank



Askar Kanafin
Ordabasy Group



Andrey Kurilin
Citibank
Kazakhstan



*Ahmet Kursad
Ertin*
Coca-Cola Almaty
Bottlers



Almas Siranov
Alassio Capital



Danila Smirnov
Alfa-Bank



*Eldar
Abdrazakov*
Centras Securities



Janet Heckman
EBRD



*Kairat
Mazhibayev*
RESMI



*Konstantin
Kulinich*
Mary Kay
Kazakhstan



Marat Seitkulov
-BestGroup



*Michael
Eggleton*
Eurasian Bank



Pietro Cala
Zhambyl Cement



Raimbek Batalov
Raimbek Group



Rinat Kassymov
Mercury Properties



Siddique Khan
Globalink



Tomas Mateos Verner
Kazakhstan Kagazy



Ulf Wokurka
Deutsche Bank



Umyt Shayakhmetova
Halyk Bank



Vladislav Li
Bank CenterCredit



Yerzhan Mandiev
Asia Avto



Zhanat Umarov
Medservice Plus

Research methodology

In total 44 CEOs took part in the Kazakhstan Survey this year and 22 of them gave us extensive, detailed interviews. The CEOs of Kazakhstan national companies did not take part in the Survey.

To obtain a comprehensive picture we selected CEOs from the following industries: metals, oil and gas production, finance, energy, telecommunication, automotive, retail and consumer, engineering and construction, transportation and logistics, entertainment and media.

The CEOs were asked questions regarding development prospects for the world economy, their companies and different markets, changes in business practices, and business development trends. They were also asked to express their opinions on government's monetary policy, the effect of mutual sanctions between Russia and the West on their businesses and attitudes towards the Eurasian Economic Union.

The majority of interviews in Kazakhstan were conducted from 1 November 2014 to 7 March 2015.

Confidentiality was maintained throughout the research. Information obtained in the study was not attributed to any particular company, but referred to only in relation to the industry as a whole, the size of organisation and other demographic data. All the quotes of CEOs from Kazakhstan cited in this study have been checked and agreed with them.



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