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5. Surviving uncertainty through exchange and patronage networks: a business case from Kyrgyzstan

Gül Berna Özcan

INTRODUCTION

Economic and political uncertainty in transition hampers economic development. Yet uncertainty also creates new opportunities for entrepreneurs and can bring massive gains in emerging market economies from the many gaps that exist in the chain of production, service delivery and consumption. However, managing uncertainty is a crucial day-to-day challenge for entrepreneurs, especially when property rights are not fully secured, legal and institutional structures are weak and enforcement is arbitrary. Social networks are often the most reliable and efficient ways of dealing with pervasive uncertainty and day-to-day business problems for entrepreneurs. As we illustrate in the following case study from the tourism industry in Osh, located in southern Kyrgyzstan, such networks provide a degree of stability and opportunities for businesses to develop.

In this chapter we illustrate the ways in which innovative entrepreneurship emerged during the meltdown of the Soviet command structure and its industrial base. This is accompanied by governance issues related to the weak state capacity in the newly independent states of Central Asia. However, entrepreneurial innovativeness in post-Soviet transition takes markedly different forms and demonstrates different characteristics than would be found in its counterparts in capitalist Western societies. The innovative challenge in transition countries tends to be less concerned with technological and product development and more profoundly based on managerial ability to deal with uncertainty in business start-up and to develop a successful survival strategy. On the one hand, the business strategy in peripheral states of the former USSR has to cope with inherited Soviet distortions in resource allocation and factor endowments, while on the other hand, it has to accommodate weak states and arbitrary law enforcement.

The Soviet territorial distribution of industrial plants, control of professional cadres with limited geographical mobility and the dominant command structure created inherent rigidities for post-Soviet market transition. For decades individuals remained dependent upon state allocation and quotas for their career choices and services such as employment, education and housing. Job security and service provision provided a degree of stability, albeit with limited mobility and personal choice. These conditions also deepened the territorial specialization across the USSR and increased functional dependency on one or a few economic units in many peripheral cities. As one such town in Kyrgyzstan, Osh suffered a serious economic blow when old industries collapsed. The Soviet command economy and central planning resulted in the creation of distorted urban economies where a single enterprise or a very few companies were often the sole source of skills, incomes and jobs.¹ The situation in Osh was less severe than that of the Kazakh single-factory towns where the whole working population was employed in massive factories and in effect the towns functioned as the factory's dormitories.² Still, the closure of the cotton gins, the silk factory and the pump production firm, each of which employed five to eight thousand workers during the Soviet era, brought deep economic recession to Osh.³ There were huge lay-offs, and small trade became the sole income source for thousands of unemployed inhabitants of Osh.

Instead of choosing to engage in trading activities in crowded bazaars like many other women, our case study entrepreneur, Aigula, built a new business against all odds by establishing one of the first guesthouses in Osh. She chose to operate in a field where she did not have any prior expertise but she recognized the future potential of tourism. She established her business by applying to a small privatization scheme and gaining the ownership of a former store. As discussed in more detail in the case study, this example shows that different forms of innovative entrepreneurship can emerge even when there is no obvious market for goods and services provided. In evolving sectors such as tourism, the creativity and practical thinking of local entrepreneurs filled the vacuum left by crumbling state-owned resorts in Kyrgyzstan. Another aspect of this business case addresses how the entrepreneur dealt with uncertainty through imaginative and innovative use of her existing social networks for business start-up and survival. However, building a business in a post-Soviet state meant coping with market distortions often linked to favouritism and unequal access to resources. In this respect, the case study also illustrates how the social status obtained in the Soviet system affected post-Soviet business survival and success through the use of exchange and patronage networks.

This chapter is divided into five sections. In the following section, we will briefly outline the state of the Kyrgyz economy. This is followed by an

analysis of the business environment with specific attention paid to the tourist industry. The third section provides a discussion on the ways in which exchange and patronage networks are used for business start-up and survival in Kyrgyzstan. In the fourth section, a detailed account of Aigula's strategy in establishing her guesthouse will be examined with a specific focus on her ways of dealing with uncertainty through the use of networks. The chapter ends with a conclusion that highlights the importance of patronage and exchange networks in the business environment but also stresses the risks of entrenchment imposed by network closure on market opportunities and fair business.

POST-SOVIET TRANSITION IN KYRGYZSTAN

As one of the small landlocked former Soviet states in Central Asia, Kyrgyzstan gained its independence when the Soviet Union (USSR) was dissolved in 1991. The country is surrounded by three Soviet successor states, Tajikistan, Uzbekistan and Kazakhstan, and China borders on the east. The Kyrgyz Republic was a product of Soviet power consolidation in Central Asia when national delimitation in 1924 created autonomous republics with new borders and Soviet-assigned national identities. Throughout the first two decades of the USSR, communism was transplanted through mostly European and Slavic activists (Park 1957). Subsequent power consolidation of the regime eliminated reformist nationalist intellectual movements and all armed resistance of the indigenous population (d'Encausse 2002). The long-term negative consequence of Soviet power building in Central Asia was the loss of an emerging national consciousness and indigenous reformist movements as well as an entrepreneurial class that had been forming since the early nineteenth century among both the settled and nomadic societies of Central Asia (Sabot 2003; Park 1957).

Following the settlement of Slavic and European populations by the Russian colonial rulers in the nineteenth century, the forced migration practices and deportations of Stalin's regime dramatically altered the ethnic composition of the country. This process made Kyrgyzstan one of the most ethnically heterogeneous states in the region in which the titular group, the Kyrgyz, constituted only half of the total population of 4.5 million. In addition to a large number of Slavs and Volga Germans, Caucasians and Koreans, the country is also now home to many Turkic peoples including Tatars, Uzbeks, Uyghurs, Kazakhs and Meskhetian Turks.⁴ The ethnic composition has changed again since independence as many Germans and Slavs have left the country due to worsening living conditions and rising unemployment.

The Soviet regime was broadly successful in converting Muslim Central Asians into loyal citizens through economic and political incentives. But, for the most part Central Asia remained a source of raw materials and agricultural products for the USSR economy and its low rates of urbanization depended on the movement of industrial and professional workers from Russian lands (Wheeler 1960; Menges 2002).⁵ Regionalism was an important policy tool in Soviet governance. Loung's study (2002) illustrates how regionalism was used to reinforce the territorial power consolidation of the USSR through administrative structures, economic specialization, and the creation and expansion of national elite cadres. Regionalism not only created competition between regions within the same autonomous republics but also contained tribal and religious social structures through patron-client relations within Communist Party politics. At the national level, economic specialization was based on a division of labour among the Soviet Republics. Despite the efforts of economic planning and awareness of regional economic imbalance by the Communist Party, the western regions of the USSR continued to grow faster and attract more industrial investment than the mostly rural south (Granick 1960). Regional specialization led to mono-economies like that of cotton in Uzbekistan and animal husbandry and hydro-electric power in Kyrgyzstan.

At the autonomous republic level, officials acted essentially as mediators and brokers between Moscow and the various regional leaders to extract the maximum amount of production. Regional leaders had to achieve economic performance according to set targets. Consequently, the power and prominence of national and regional leaders would be defined according to these output maximization incentives (Granick 1960; Loung 2002, p. 67). Consistent with the Soviet structure of competing regions, Kyrgyzstan was divided into different industrial, ethnic and agricultural endowments between north and south. The ethnic Kyrgyz were spread between the industrial and urban north, which was dominated by Russians and other Slavs (in particular the republic's capital, Frunze, now called Bishkek, and Chui Oblast) and the agricultural south, which was Uzbek-dominated. There was very little mobility between the two.

The Kyrgyz economy was heavily cross-subsidized by the central administration of the USSR. After independence, the government replaced this loss of cross-subsidy with international aid and consequently relied on aid agencies and other donors to sustain the livelihood of the Kyrgyz population and the viability of the state.⁶ Extensive borrowing led to increasing levels of accumulated debt (Pomfret 2006).⁷ As shown in Table 5.1, the 2004 GDP and aid dependency figures indicate that Kyrgyzstan, with less than \$400 per capita income and high external debt, is one of the poorest and most indebted countries among the Commonwealth of Independent States

Table 5.1 *Kyrgyzstan and the Commonwealth of Independent States, 2004*

	Population	Land area (sq. km)	GDP per capita (constant 2000 US\$)	Aid (% of imports of goods and services)
Armenia	3 026 089	28 200	951.92	14.21
Azerbaijan	8 306 400	82 600	945.34	2.48
Belarus	9 824 469	207 480	1 695.19	0.27
Georgia	4 517 981	69 490	882.73	11.92
Kazakhstan	14 993 529	2 699 700	1 818.00	1.20
Kyrgyzstan	5 092 802	191 800	324.59	20.87
Moldova	4 217 911	32 870	399.62	5.23
Russia	143 849 568	16 380 980	2 285.78	0.85
Tajikistan	6 430 265	139 960	223.33	16.01
Turkmenistan	4 766 009	469 930	752.50	n/a
Ukraine	47 451 292	579 350	928.16	1.00
Uzbekistan	26 209 056	425 400	638.50	n/a

Source: World Bank development indicators accessed via Economic and Social Data Services (ESDS) 2006.

(CIS). Kyrgyzstan has also the highest ratio of dependency on aid, measured as a percentage of its imports of goods and services (20.87 per cent).

In the immediate aftermath of its independence, most of the Soviet-era industrial establishments collapsed in Kyrgyzstan. There were a variety of reasons for this, including the loss of subsidies, but the main reason was the dissolution of systems of production distribution throughout the USSR. Once quiet autonomous state borders became symbols of a new assertiveness among the emerging independent states and neighbours established divergent customs regulations and border controls that hampered trade between former Soviet republics. For these reasons, and because of changing regimes of taxation, currency and foreign policies, most Soviet-era industrial complexes were rendered unviable. They also became technologically obsolete.

Kyrgyzstan, landlocked in Central Asia, was left without new markets or overseas connections after the dissolution of the Soviet economic network. The largest single enterprise, a sugar refinery, was no longer viable once it lost Soviet subsidies and its link to Cuban sugarcane growers (Pomfret 2006). Hastily established and poorly administered privatization programmes brought about the collapse of most large enterprises less than a

decade after independence. Thousands of unemployed people were forced to make a living through small trade activities, although some of these grew to form the largest international retail and wholesale hubs in Central Asia, such as the Dordoi, Osh and Kara-Suu bazaars. At the same time, criminal activities in illegal trade and racketeering soared (Özcan 2006; Madi 2004).

UNCERTAINTY AND BUSINESS: THE CASE OF TOURISM

Major economic and political transitions foster uncertainty and bring additional costs for businesses. With the collapse of the command economy and Communist Party control of the USSR, the newly independent states of Central Asia have undergone a process of de-industrialization and the partition of state assets. De-industrialization led to the closure of Soviet manufacturing plants, which led to massive job losses, while dissolution of the Soviet state resulted in the extreme deterioration of the rule of law and the quality of public services. Over the past decade and a half, authoritarian presidential regimes have replaced centralized Communist Party control and deepened what had already started during the period of *perestroika*; the monopolization and re-allocation of economic resources into the hands of the business and political elites (Buitter 2000). While numerous attempts to build a market economy and a legal system modelled on capitalist countries have been made over more than a decade in Kyrgyzstan, arbitrary rule, self-regulatory groups and corruption still dominate Kyrgyz society. This climate hinders indigenous business creation and dissuades foreign investors. Because of the lack of job opportunities, thousands of Kyrgyz leave their country every year to seek employment in Russia, Kazakhstan and elsewhere. A recent EBRD report verifies the increasing dependency on workers' currency transfers and remittances among the transition countries as a form of poverty alleviation and micro-finance (EBRD 2006). In Kyrgyzstan, workers' remittances accounted for around 9 per cent of GDP in 2004 (*ibid.*). Since many informal transactions occur in addition to formal money transfers and banking procedures, the true figure is likely to be much higher. Following the recent restrictions on foreign workers in Russia, the Kyrgyz government decided to restrict foreign traders in Kyrgyz bazaars to address growing discontent with the entrepreneurial activities of foreigners, including Chinese, Uzbek and Turkish traders.⁸

Tourism in Central Asia suffered from the economic and political upheavals that occurred during the transition process. The number of tourists visiting Central Asia declined dramatically. This trend is most

sharply observed in Uzbekistan, which was an important hub for intra-USSR tourism in the region, hosting a million visitors each year. In 1990, Uzbekistan still attracted more than half a million tourists (Airey and Schackley 1997). However, due to the Uzbek government's stringent customs and border controls, industry representatives predicted that the number of tourists visiting the country would drop to around 50 000 in 2005, indicating a situation far worse than that portrayed by official statistics.⁹ This negatively affected Kyrgyz tourism as well. Soviet tourism and Silk Road tours were initially interconnected but they are now disrupted by bureaucratic hurdles since border crossings have become much harder. The Uzbek government introduced stringent customs controls on its borders following the Tashkent bombings in the late 1990s. The Fergana Valley has been under a security blockade since the Andijan protests and the subsequent killing of armed rebels along with hundreds of civilian protesters by Uzbek forces in 2005.

Despite adverse regional circumstances during the second decade of its independence, tourism in Kyrgyzstan began to be shaped by more international exposure, a consumer-driven focus and an emphasis on indigenous culture. Instead of the large state-run organizations of the old system, there emerged many decentralized enterprises and smallholdings along with a few foreign operators. Opening the borders of the former Iron Curtain resulted in more international tourists eager to explore the riches of the Silk Road and the untouched beauty of the highlands of Kyrgyzstan. There has been a recent rise in regional tourism coinciding with the flourishing border trade, most notably by Kazakhs (Table 5.2).

With economic recovery and the stabilization of currencies, in 2000 tourism from the CIS countries began to increase. The official statistics are not always clear or consistent about the composition of these figures, but tourism and recreation do appear to be offering economic opportunities in Kyrgyzstan. Although they only constituted 3.1 per cent of GNP in 2005, the spread and the number of tourism-related establishments is currently increasing (Tables 5.2 and 5.3). Shuttle trade with Kyrgyzstan's neighbours is a major contributor to spending and tourism. The large bazaars, such as Dordoi and Kara-Suu, are filled by Russian, Kazakh, Uzbek and Chinese traders among many others; such retail and wholesale transactions, in addition to overnight stays, also foster recreational tourism by traders and their families.

As seen in Table 5.2, the official statistics indicate a sharp increase in the number of tourists visiting the country from 2003 onwards. The number of tourists surpassed half a million in 2004 and in 2005 the number of enterprises reached over 4700. Tourists from outside the CIS are mostly from Western Europe, the US and Japan. These non-CIS tourists are

Table 5.2 Tourism indicators in the Kyrgyz Republic, 2002–05

Indicators	2002	2003	2004	2005
Number of registered enterprises rendering tourist services	3918	4261	4479	4771
The total added value in the sphere of tourist activity (millions of som)	3019.7	3010.9	3592.2	2288.1
Percentage of gross national product (GNP)	4.0	3.6	3.3	3.1
Investments in 'fixed capital' in the sphere of tourism (millions of som)	1357.1	739.5	988.8	584.9
Turnover of retail trade in the sphere of tourism (millions of som)	1691.3	1930.8	1566.9	1709.5
Turnover of restaurants, bars, cafés, others (millions of som)	1143.8	1469.9	1196.6	1457.7
Export of tourist services – that is, the income received for the reception of foreign citizens – Inbound tourism (millions of US dollars)	35.7	47.8	58.7	55.8
The number of foreign citizens arriving in the country (thousands)	139.6	211.3	737.7	601.1

Note: For comparison purposes: US\$1 = approximately 40 som; and €1 = approximately 55 som.

Source: The National Statistics Committee of Kyrgyzstan (2006).

Table 5.3 The number of tourist establishments in the Kyrgyz Republic, 2002–04

	2002	2003	2004
Total number of 'tourist establishments'	325	349	379
Sanatoria	37	46	44
Boarding houses	55	58	53
Resthouses	11	11	11
Campsites	11	7	9
Children's activities	45	39	38
Hotels	84	79	101
Tourist agencies, tour operators and travel agencies	80	103	115

Source: The National Statistics Committee of Kyrgyzstan (2006).

increasingly attracted by adventure and nature tourism. The number of foreign tourists quadrupled between 2002 and 2005, coming mainly from Russia and Kazakhstan, indicating a reversal of the earlier dissolution of tourism patterns from the CIS countries. However, most tourism businesses, as well as international tourists, tend to be concentrated in the capital city Bishkek and on the northern shores of Issik-Kul, an alpine lake that was popular during the Soviet period and is now one of the main attractions for Kazakh and Russian tourists. The accessibility of summer resorts around Cholpon-Ata on lake Issik-Kul, only a few hours' drive away from Almaty, the former capital city of Kazakhstan, makes them popular with increasingly affluent Kazakhs. New ski resorts and nature tourism are also developing around old Soviet resorts in the town of Karakol, on the eastern end of the lake (MacWilliam 2006). Table 5.3 shows the range of Soviet recreation activities. In addition to hotels, sanatoria, boarding houses and children's camps were the most common forms of holiday provision for state employees during the Soviet era. Over the years these old establishments declined. Summer camping and holiday activities for children suffered the most. The major change came with the growing number of tour operators and travel agencies.

However, there are three main sources of business uncertainty in tourism. The most common form is related to governance problems in defining and protecting property rights. With the collapse of the Soviet Union, many recreational facilities were privatized, but rarely found competent owners or new owners were exploited by gangs. Many large old establishments were eventually divided up floor-by-floor to be rented as business premises. Since property rights are not well defined and protected for resort owners, self-governing groups such as racketeers and gangs influence transactions and determine ownership rights. More recently, tourism became another way to hide illicit earnings, to build influence and to channel money for self-governing groups. Our interviews and other anecdotal evidence show that illegal earnings are being camouflaged by investments in new restaurants and hotels (Madi 2004). The political power and influence of self-governing groups appear to be intertwined with the ruling elite and diffused into the state apparatus. Thus, businesses face dual governance 'distortions'; state absorption through bureaucratic corruption and illicit group influence and extortions.

Second, demand-related uncertainty is linked to larger-scale economic and political distortions that create unpredictable booms and busts in the demand structure. Businesses need customers to survive, and there is neither a regular flow nor a fair spread of tourists beyond the Issik-Kul region in Kyrgyzstan. Due to little effort on the part of mass tourist operators and the ignorance of foreign tourists about a region that has long

been a distant backwater, large Soviet-era hotels initially failed to attract sufficient customers to meet their capacity. Furthermore, many of these large establishments either failed to find competent, genuine investors or simply could not survive the slow emergence of the market economy and the decline in intra-CIS tourism. In other instances, the establishments were stripped of their assets by racketeering groups, including the removal of their décor and furniture, and left abandoned as ghostly, massive concrete blocks.

The third form of uncertainty is linked to the supply-side distortions in terms of market provisions of private and public goods. Unexpected electricity and gas outages or restrictions, a limited range of consumption goods, and poor public services all create day-to-day management problems and long-term uncertainty that businesses have to address in order to maintain their products or services. Other problems include the lack of credible banking services and saving schemes, poor urban infrastructure and inadequate transportation and health provision. All these are common problems that businesses face and they have to bear additional costs in tackling them. Overall, in the hospitality business, the poor provision of essential public services hinders the scope of tourism and business growth.

WEAVING A BUSINESS THROUGH EXCHANGE AND PATRONAGE NETWORKS

The use of social networks and local ties has long been recognized in the literature as a common phenomenon and an important practice for small firms. Many researchers point out the positive link between business success and business networks enhanced by social relations (Aldrich and Zimmer 1986; Triglia 1989; Curran et al. 1993).

However, scholars differ in interpreting and analysing the merits and definition of social networks and their physical and social limits. The size of networks and type, density and frequency of links and boundaries within and between various networks are not easy to identify. Fluidity of social relations makes this even harder. Szarka (1990) limits the definition of networks to focus on networks of exchange, communication and social relations. Granovetter (1985) pointed out the way in which economic action was embedded in social relations and networks. In most small-business studies, the network structure is identified with the entrepreneur and his/her social and business relations. Entrepreneurs often use their existing social networks and develop new ones in their day-to-day experiences.

Business and social networks overlap and enhance survival, growth and innovation (Robertson et al. 1996). However, the notion of networks as a

benevolent support and even an impetus for innovation is challenged by empirical evidence from different cultures. Social networks might also hinder innovative entrepreneurialism, nurture conformity and bring inertia (Özcan 1995). In the transition context, as in developing economies, where there are weak institutional structures and law enforcement, social ties and networks become paramount to enterprise development and business survival (Ledeneva 1998; Welter et al. 2006; Özcan 2008). Social networks play a crucial role in ameliorating market distortions and providing access to jobs in the labour market in post-Soviet transition (Tartakovskaya and Ashwin 2006).

Social networks also played an important role during the Soviet era in alleviating supply and demand distortions and widening economic opportunities for individuals and tribal or regional groups. Patronage and exchange networks emerged as the most commonly observed forms. First, exchange networks developed through bartering as workers and managers began to appropriate and exchange public goods and factory products. This practice existed, but was not widespread until the 1950s, and deepened during the Khrushchev years. Patronage relations between Moscow's national party leaders and their regional clients became widespread during the Brezhnev era. Increasing household incomes and growing urban demand encountered only a limited supply of poor-quality goods and badly-planned distribution. From the 1970s, while urban incomes increased, the availability of consumer goods remained limited in range, quality and provision. Thus, bartering and shuttle trade played an important role in alleviating Soviet distortions in the supply and demand structure (Werner 1998; Yükseser 2003; Bal 2004).

Patronage networks were based on the use of influence and contacts to obtain positions through political patronage and were built into the administrative and party mechanism. As Loung (2002) shows, this was situated within the structure of Soviet regionalism. As with bartering, the Brezhnev years witnessed an increased influence of patrimonial patronage networks in resource allocation and governance. All three major Central Asian states were ruled by long-reigning leaders: Rashidov (1959–83) in Uzbekistan, Kunaev (1964–86) in Kazakhstan and Usualiev (1961–85) in Kyrgyzstan. Between 1960 and 1980 patrimonial patronage networks were legitimized at national and regional levels as loyal leaders delivered the required output and negotiated their gains with Moscow (Ikhamov 2004). The administrative and enterprise decentralization initiated during *perestroika*, under the leadership of Gorbachev, deepened and spread the corruption further (Buiter 2000). Illicit use of personal relations, known as 'blat', became part of patronage networks as the main method of distributing resources (Ledeneva 1998). Families frequently used personal connections

and friendship ties to find housing, obtain a job, advance their careers, and even get their children into a university (Nazpary 2002). After the dissolution of the Soviet Union, the patronage networks deepened while exchange networks transformed along with market changes in an effort to counter the shortage of cash and the mismatch of demand and supply. Increasingly, these two networks overlapped and layered as they became the legitimate source of power and status in post-Soviet societies (Özcan 2008).

THE CASE OF AIGULA'S GUESTHOUSE

Aigula runs a pleasant, income-generating guesthouse in Osh, Kyrgyzstan's second largest city. Osh sprawls across the banks of the Ak-Buura (White Camel) River, flowing out of the majestic Pamir Mountains. It is the administrative centre of a rich agricultural hinterland at the eastern end of the Fergana Valley. Locals claim the city to be older than Rome and it was certainly a major hub of the silk route trade. The most famous symbol of the town is the so-called Solomon's Throne, a rocky hill in the middle of the city. Babur, the founder of the Mughal dynasty in India, sought refuge in a cave in Solomon's Throne when he was fleeing his native Andijan, a nearby town across the border in what is now Uzbekistan. A blend of sedentary Uzbek and nomadic Kyrgyz traditions survive in the city, where there are also a small number of Tajiks, Uyhgurs and other inhabitants.¹⁰ However, despite these qualities, the town is far from the capital city and the major tourist attraction, Lake Issik-Kul.

At the age of 58 Aigula wakes up every morning at 6 a.m. and after jogging she goes to her vegetable garden where she grows fruits and vegetables, including melons, corn and berries. Then she prepares breakfast for her guests. While the guests eat, a casual worker cleans their rooms. After working for 30 years for state-run stores and cooperatives as a sales manager, Aigula has recently discovered the world of tourism. Her guesthouse is situated on the ground floor of a massive five-floor apartment block near the main road connecting Osh to Bishkek. The area formerly inhabited by members of the Soviet elite is now filled with large newly-built houses surrounded by gardens and allotments. There is no sign outside the building or on the road announcing the location of the guesthouse for visiting tourists or potential customers. But as Aigula works with the Community Based Tourism (CBT) network, customers are brought by a local representative.¹¹ The immediately striking characteristic of this guesthouse is the immensity of its space and its high ceilings. Aigula decorated the interior with Western-style furniture and hung heavy curtains

at the huge windows. She furnished four guest bedrooms, with two shared bathrooms, a dining room and a lounge. She lives with her husband in the same apartment building.¹² The business was built gradually after she and her husband secured the ownership of the property in 2001. Her business has developed well and provides a decent and stable income. Aigula plans to expand the business further and establish a small hotel if she can buy the large apartment next door. This massive first floor could provide sufficient space for a decent ten-room hotel.

Aigula utilized both exchange and patronage networks in order to set up and manage her business. For the past decade and a half her life has been turbulent. She was laid off from her job, and engaged in subsistence agriculture before getting involved in tourism. She says that she felt as though 'a massive haze had descended on my life' and that she was terribly distressed for weeks. She recalls those days: '. . . as if my life was shaken by a huge tremor, all structures and routines were suddenly in ruin'. It was hard for her husband as well, who was a minor administrator in a *kolkhoz* cooperative and the chairman of the Communist Youth and Sport Organization, Alga-Kyrgyz SSR. They both had to find a new way to survive and to instil meaning into their lives. They used their long-standing Soviet-era exchange networks to obtain food, clothes and other amenities. During the last decade of the USSR these exchange networks became as acceptable as they were common. Aigula's husband would exchange *kolkhoz* products for smuggled electronic or branded goods and cigarettes while Aigula was able to trade some goods from the store she worked for. For example, she would trade cotton oil in lieu of payment for cured meat, imported utensils, garments and so on. These exchanges did not constitute a business venture but were just a way of getting by and of obtaining goods they would not be able to find in the local market. Most of the people they traded with were their friends, co-workers and relatives or others linked to them in a loose social network.

During the early 1990s, those who were involved in the growing shuttle trade helped to obtain necessities at a time when there were severe shortages of many essential goods – winter coats, garments, blankets, shoes and foodstuffs. Aigula says: 'we had to learn to live on our own'. She and her husband benefited from their small but deepened social network to rebuild their lives and developed a set of exchanges based on mutual interest and trust. Aigula, her husband and her sister bought a two-hectare plot from the *kolkhoz* and grew cotton and sunflowers. Her husband's and son's contacts helped them to market their crops and with these savings Aigula redecorated the store space as a guesthouse. Indeed, Aigula's social ties were enhanced and determined by the degree of trust her friends and relatives offered in exchange for goods and favours. Her close supporters

Table 5.4 *Aigula's strategy of coping with uncertainty through networks*

Sources of uncertainty	Patronage networks	Exchange networks
Governance and property rights	Securing property with privatization through Communist Party and Youth League contacts Solving problems with bureaucracy and inspectors through protection	Favouring powerful bureaucrats through social networks Solidarity against the absorption through illicit groups Limited public exposure
Demand-side distortions	Building reputation and connections via business patronage Using the CBT network	Solidarity with the CBT friends Diversifying income with parallel ventures
Supply-side distortions	Seeking privileges in public service delivery to deal with the shortage of goods and amenities Building leaner and more effective networks	Bartering and exchanging goods and services Alternative solutions to scarcity and poor quality of public goods and banking

included female as well as male contacts and relatives such as her sister, daughter-in-law, the CBT coordinator, two neighbours, several former co-workers and members of the former Communist Party and the local youth organization. In order to obtain seeds and fertilizers she relied on her son's contacts along with a small number of good friends for credit sales, transport and marketing. A friend of Aigula's daughter-in-law first introduced her to the CBT and she developed the business idea through these contacts. With time Aigula linked into the CBT network. By utilizing these social ties Aigula was able to deal with all three forms of uncertainty characteristic of the transitional environment in Kyrgyzstan (see Table 5.4).

She dealt with the first form of uncertainty by securing the property rights of a huge flat when it was privatized. This flat was formerly a big state-owned store where Aigula worked as a sales manager and she was able to gain control of it when it was privatized. For this she used her access to the party patronage networks through her husband's link to the Communist Party and the Communist Youth and Sport Organization. As an insider she was better informed and knew how to take advantage of the privatization scheme. As soon as she realized that the site was going to be sold, she contacted the governor, whom she had known since her childhood. She pleaded

with him that acquiring the site would be the only way for her to survive economically. Her husband used his former party channels and friends to lobby further. The couple eventually succeeded in their attempts.

Aigula worked out how to finance the deal through her savings and also borrowed money from relatives. In addition, she financed the decoration of the flat through income generated from farming along with short-term credits from close friends and her sons. Currently, charging US\$20 per night, she offers a comfortable room, hot water and shower as well as a simple but good breakfast to her customers. Even if she nets only \$100 a month she says she can survive easily, supplemented by the exchange of goods with her friends. Annually, Aigula earns from \$5000 to \$7000. This income was well above the average monthly salary of \$20–30 of a civil servant in 2004. Her business is registered with the CBT and she operates using a patent, a tax status given to small-business owners by the state. However, she fears gangs and other predators and thus keeps a very low profile. That is why there is no sign or advertisement about her business in front of the apartment block or in the entrance. She believes that the government should support businesses and should eliminate corruption in the state bureaucracy. Yet, at the same time, her business survival is also dependent upon the idiosyncratic protection offered by various contacts she enjoys in the bureaucracy.

The second form of uncertainty associated with demand-side problems and fluctuations has been harder to manage. As soon as she got connected to the CBT programme, she immediately joined the network of guesthouses set up in Osh and became an active member. The group met regularly, developed leaflets and information about the tourist attractions of the region and also maintained a small liaison office through which they developed links with Bishkek-based tour operators. This allowed them to open up and tap a larger market. However, these efforts have only partially been successful as Osh is still an isolated town in the south. In order to supplement the family income, Aigula rented a nearby urban garden and began producing vegetables and fruit. She conserves and processes these not only for household consumption but also to sell and trade with her CBT friends.

Third, Aigula can only rely on her social network to handle the effects of the supply-side distortions and frequent shortages. Her contacts in the bureaucracy help her to sort out most daily issues, but these patronage networks cannot address the larger structural problems such as poor banking, broken sewage pipes, vandalized street lights and the generally deteriorating urban infrastructure. At night she gives all her guests a flashlight and keeps spare heaters and extra blankets on hand. Finding furniture, lighting, spare parts and utensils continues to be a problem. She has to order such goods through her sons and friends visiting Bishkek or she

travels herself to obtain many products. Her husband does most of the repairs and maintenance. The CBT members in Osh are able to save money but they do not trust local banks. Thus, they formed a savings scheme and systematically invest funds in young sheep and horses to be sold in the spring. This generates further income, albeit with some potential risks, such as disease and accident, but it protects their savings from inflation and the predatory involvement of officials.¹³

However, there are a number of risks inherent in extensive dependency on solidarity and exchange networks. For example, they can lead to various forms of social and business casualties. On a number of occasions, Aigula lost money and was exploited by friends and contacts with whom she eventually ceased to do business. Over-reliance on networks due to increased insecurity and poor economic prospects also breeds exploitation and mistrust. When Aigula wanted to use her friends and relatives to outsource some services during busy seasons, some exploited her trust and tried to cut corners. A neighbour, for instance, overcharged her several times for laundry services. A relative tried to poach her customers by discreetly offering lower accommodation charges. In several instances distant relatives who borrowed money to provide supplies, household utensils and sightseeing tours to Aigula's guests either did not supply their agreed service or cheated her over the price. Some lowered the quality or quantity of the service in order to make more money. Tax inspectors and local administrators asked for kickbacks in order to not interfere when she first opened her business. Thus, both exchange and patronage networks might bring disadvantageous consequences for businesses such as those encountered by Aigula. However, because of these difficulties, Aigula learned to develop leaner, stronger, and more functional ties within these networks.

CONCLUSION

In this chapter we illustrated how uncertainty is part of the emerging market economy and a feature of private business ownership in Kyrgyzstan. We identified three prevailing forms of uncertainty, namely poor governance, demand-side distortions and supply-side distortions. The effects of these uncertainties were demonstrated in the tourism sector, which has been going through a major change towards a more client-friendly private business-oriented structure. Our business case illustrates how entrepreneurs, as individuals, get around market and governance distortions and establish successful businesses.

The success of Aigula is first and foremost related to her good standing developed during the Soviet era and her ability to use exchange

and patronage networks successfully. As a sales manager, she and her husband, a former *kolkhoz* administrator and party member, were part of the middle echelons of the local elite. Thus, they were able to understand and act upon the changes taking place in Kyrgyzstan more quickly than others. They also had access to information and patronage networks. This helped them to obtain a large premise when it was privatized. Second, her business aptitude and risk-taking attitude played an important role. She took the risk of investing in, decorating and furnishing the store space for her guesthouse venture. Third, Aigula's endowment of exchange and patronage networks helped her overcome the unwanted effects of uncertainty.

Network endowments and access to powerful individuals are shaping business development and societal trends in Kyrgyzstan. We also see a divergence between rich and poor networks in terms of the opportunities they offer. People with better economic standing and professional middle-class ties are not only good at improving their positions but are also able to offer wider opportunities to their friends and family. Studies of post-Soviet societies show increasing polarization between the poor and the wealthy and their network opportunities (Gubin and Kostiouchenko 1997; Tartakovskaya and Ashwin 2006). The formerly functioning patronage and exchange networks were not equitable and often led to unfair wealth accumulation in the hands of party bosses and regional leaders, but they had political incentives to keep their local clients content and to please the Communist Party. With the dissolution of the state legitimacy preserved within the USSR, the immediate post-independence period unleashed greater abuse of power in patronage relations and evidence shows that the poor and dispossessed are increasingly becoming isolated (Nazpary 2002).

Finally, we argue that network embeddedness may bring inertia and mitigate against deeper changes in the process of building markets and fair governance regimes. By solving and addressing uncertainty in day-to-day lives, entrepreneurs secure their survival through existing mechanisms of exchange and patronage networks at their disposal, yet this practice does not improve the governance and market conditions for all. Recent studies on transition economies point out that social networks help businesses emerge and survive but after the initial start-up phase these social network relations might hinder innovative capacity and entrepreneurial success (Özcan 1995; Welter and Smallbone 2006). With limited entrepreneurial capacity and weak institutional provisions, collectively businesses lose as enterprise development and growth remains slow. Business opportunities and market expansion become skewed towards those who can handle and benefit from uncertainty, contributing to the shortage of successful businesses in a variety of sectors. This in turn distorts the local economies with

slow business generation, sparse economic relations, low income and under-employment. The importance of patronage and exchange networks for business start-up and survival is undeniable but it also carries the risks of entrenchment in social embeddedness, thus hampering further business development and growth.

NOTES

1. This was also the case in Western economies with heavy industry focused on one or a few companies in a town or city during the first three-quarters of the last century (such as the Detroit car manufacturing plants in the US), albeit with more flexibility in the markets and geographical mobility in society for re-adjustments.
2. See Rama and Scott (1999) for an extensive labour market analysis of Kazakh one-company towns.
3. There is no study available on the extent of the cotton industry in Osh. The employment estimate was provided by local experts.
4. These include ethnic Russians (9 per cent) concentrated in the north and mostly urban areas and Uzbeks (14.5 per cent) mostly living in the south. Small, but significant minorities include Tatars (1.9 per cent), Uyghurs (1.1 per cent), Kazakhs (0.7 per cent) and Ukrainians (0.5 per cent). However, due to recent migration and mobility for seasonal work in and out of the country, these percentages only reflect approximate figures.
5. Figures from 1926 to 1959 indicate a rapid urbanization in Central Asia. In 1959, the urban population accounted for 44 per cent of the population in Soviet Kazakhstan, 34 per cent in Soviet Kyrgyzstan and 34 per cent in Soviet Uzbekistan. Yet, these figures were still lower than the Soviet Union average which was 48 per cent and dominated by Russians and other Slavs (Menges 2002). According to the 1970 Soviet census data, there were only 72 707 indigenous Central Asian residents in Bishkek compared with 313 601 Russians and Slavs (Allworth 2002, p. 523).
6. Roman Mogilevsky, an economist from the American University in Bishkek, claims that 30 per cent of Kyrgyz GDP used to be subsidized by the USSR. After independence, this was partially replaced by foreign aid, providing 5 to 10 per cent of GDP (personal interview, Bishkek, March 2004).
7. As Pomfret (2006, p. 82) points out, international aid to Kyrgyzstan between 1992–2000 amounted to \$1.7 billion. Assistance started to increase when the Kyrgyz Republic established itself in 1993–94 as a leading economic reformer and liberal country among the post-Soviet states of Central Asia. Over half of the aid came from the major multilateral agencies: the World Bank provided 23 per cent, the Asian Development Bank, 15 per cent, the IMF, 15 per cent, and the EBRD, 5 per cent. The major bilateral donors were Japan (15 per cent of the total), and Germany, Switzerland and the European Union (4 per cent each).
8. As reported by Orozobekova (2007), the decision to limit non-Kyrgyz workers came after Russia's January 2007 announcement banning market traders from other countries. This could lead to up to 100 000 Kyrgyz nationals becoming unemployed in Russia.
9. Interviews with several major tour operators in Samarkand and Bukhara in April 2005.
10. But with some tension; a clash between local Uzbeks and Kyrgyz took place in Uzgen and Osh in 1990. As in Soviet-era upheavals and violent demonstrations, such as the one which took place against the appointment of a non-Kazakh president in Almaty in 1986, the anti-Jewish protests in Andijan in 1989 and ethnic clashes between Meskhetian Turks and Uzbeks in the same year in the Fergana Valley of Uzbekistan, there is a lack of credible information about this incident. However, eyewitness accounts suggest that several hundred people were killed and many were injured.

11. A Swiss agency, Helvetas, initiated this network of tourist services and CBT members enjoy good access to Bishkek tour operators.
12. Two of her sons moved to Bishkek and got clerical jobs while another took up cotton farming in Osh.
13. In autumn 2004, a good horse was valued as high as \$2000 and a small sheep was valued at \$30 in the animal markets of Osh. With the Helvetas credit of \$800, the local CBT bought approximately 100 sheep. After the spring breeding, the CBT would get around 200 sheep in return; selling them at \$30 per head would bring a substantial income.

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6. How to be successful in an adverse business environment: Knitwear Factory in Moldova

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INTRODUCTION

Considerable changes in Moldova in the last 15 years have had their effect on every aspect of life. One of the most remarkable of these changes was the transformation of forms of ownership, which resulted in private entrepreneurship. However, while there have been positive business developments overall, such as an increasing share of private businesses, the competitiveness of private enterprises and their innovativeness changes only slowly. This is to a large extent a result of the business climate. This chapter will illustrate the development of private business at different stages through the example of a typical 'successful' entrepreneur and her business in Moldova, in order to analyse those factors which encourage and challenge enterprise growth in Moldova's turbulent business environment. First, we present a brief review of business development in Moldova, followed by a review of the link between the business environment and business development. We then present the case of a successful business in Moldova, before developing conclusions.

A BRIEF REVIEW OF BUSINESS DEVELOPMENT IN MOLDOVA

The Republic of Moldova borders the Ukraine in the east and Romania in the west. Moldova occupies a territory of 33 800 sq. km and has 3.9 million inhabitants. The market reforms of the 1990s exerted a pronounced negative influence on the economy in Moldova. For example, in 2004 real GDP amounted to a mere 44 per cent of that of 1989; the rate of inflation was 12 per cent annually from 2003 to 2005. As a result Moldova is one of the