Uzbekistan: why investors are propelled to 'frontier' markets

Low yields in developed markets force investors to scour the globe for opportunities

After years of oppression and isolation, Uzbekistan is opening itself up

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On the second floor of an office building in downtown Tashkent, entrepreneur Akmal Khodjanov is pitching his business to around a dozen foreign investors and corporate financiers.

His company, Vak-Mak, has cornered the market for vacuum-packed corn on the cob in Uzbekistan. Now he wants the firm to expand in Russia, where demand is booming, and grow more of its own corn. The investors, an eclectic group hailing from the UK, continental Europe and central Asia, like the business but tell it to focus on branding not farming.

This is a new front in modern investing. With interest rates and bond yields in developed markets at extremely low levels and showing few signs of rising, investors are having to scour the globe in search of more attractive returns.

Uzbekistan, some believe, offers an extremely rare investment opportunity — a market almost untouched by Western capital. After years of oppression and isolation, the country is opening itself up.

"I'm somewhat surprised I'm here," said Swen Lorenz, a German private investor who has focused on emerging markets since the early 1990s. He joined a group led by London-based Sturgeon Capital, a hedge fund that specialises in so-called "frontier markets" such as Iran and Mongolia, on the trip to the central Asian country last month.

"This is now one of the very few opportunities in the world where the capital market is Ground Zero, laws are being written, new products are being created, companies are being privatised," added Mr Lorenz. "This is where the opportunity lies."

Sturgeon and co are keen to tap opportunities in a young country of nearly 33m people, almost double the population of neighbouring Kazakhstan, but which is much poorer. Gross domestic product per capita was just over $6,000 on a purchasing power parity basis in 2017, compared with Kazakhstan's $24,000, according to the World Bank.

Under former dictator Islam Karimov, Uzbekistan used to rank alongside North Korea for its political rights and civil liberties. With strict currency controls and widespread corruption, it was off limits for most investors.

But following Mr Karimov's death in 2016, new president Shavkat Mirziyoyev, who had served under Mr Karimov as prime minister, shocked the international community by embarking on major reforms. Political prisoners have been released, exchange restrictions lifted and political debate encouraged — though US campaign group Freedom House still rates Uzbekistan as one of the world's least free countries.

Russia has been quick to latch on to the opportunities. Last year a delegation of Russian ministers and officials, led by president Vladimir Putin, arrived in Tashkent. The delegation filled the city's hotels and some of the party had to be put up in private houses.

"Russia does see Uzbekistan as part of its sphere of influence," said one foreign observer with knowledge of the region. "It's a country they know well."

To the east, meanwhile, China sees Uzbekistan as a part of its "Belt and Road" infrastructure initiative, which includes a gas pipeline linking central Asia and China.

Western investors, however, have been slower off the mark. There is little sign of the US private equity groups that have piled into Africa, for example. Uzbekistan has no McDonald's restaurants, although KFC has planted a flag.

"In my memory this is the first time people like this have come here," says Eldor Mannopov, managing partner at law firm Dentons in Tashkent, of the Sturgeon-led party.

The group — lurching in a minibus along crowded and potholded roads, often five lanes in each direction — has a packed schedule of meetings with freshly-appointed government ministers and officials. Atabek Nazirov, an eloquent former Goldman Sachs banker, is in his second week as head of the country's newly formed Capital Markets Agency. Sardor Umurzakov, minister for Investments and Foreign Trade, was appointed the week before meeting the group. The sign outside the ministry has not yet been updated.

"We're so behind the curve on so many things," said Mr Nazirov, as he outlines ideas for reform in areas such as private pension funds, company law and securitising mortgages.


President Shavkat Mirziyoyev has embarked on major reforms including lifting exchange restrictions © EPA

There are plenty of signs the country wants to open up to foreign capital. Last month it raised $1bn for its first international bond offering. The prosecutor's office has set up a special hotline for foreign investors who encounter potential concerns when investing.

Mr Umurzakov describes how the country's leather industry has been transformed to focus on finished products.

"We're planning to do that with all the sectors of the economy," he says in an interview in his plush ministerial offices, on the walls of which hangs a portrait of president Mirziyoyev.

Still, investors have to overcome various hurdles. The Tashkent stock market's free float, for example, is a mere $300m (compared with the FTSE All-Share's $3.3tn), although several privatisations are expected. As in most frontier markets, corporate governance in private companies is an obvious, major risk.

Foreigners wanting to buy stakes in Uzbek banks, meanwhile, must first seek approval. Mr Umurzakov says he believes "we will reach a point when this [requirement] will be removed".

Entrepreneurs' access to capital, too, is limited. Vak-Mak's Mr Khodjanov said his firm does not use bank loans because of high interest rates, the benchmark rate is 16 per cent, and onerous documentation requirements. "With [equity] investors we can work much faster," he said.

If reforms continue, though, then foreign cash may come.

"People are coming and testing the water," said Zafar Khashimov, founder of Korzinka, a supermarket chain. "They want to see how it progresses. It's so new."

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