# THE ACQUISITION EXPERIENCES OF KAZOIL


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Disclaimer: This case is intended to be used as a basis for class discussion rather than as an illustration of the effective or ineffective handling of an administrative situation. The name of the company is disguised.

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*Everything is better now – we have medical insurance, we have good bonuses… But people are still leaving, and that is directly caused by the different style of management* (KazOil Manager, Corporate Taxes, 2006)

Nurlan Ospanov, the Head of Corporate Finance at KazOil, was deep in thought when the phone on his desk rang. "This is Pete Sampton from Global Headhunting. I am calling because our client, an American company with large operations in the Caspian region, is looking for a new senior manager in production in Atyrau. With your outstanding profile and long years of experience in the industry, you are the ideal fit for this position." Nurlan answered briefly: "Thanks for calling, but I'm currently not interested." He hung up. These headhunters are everywhere nowadays, he thought. By now they've probably called everyone in the company.

After glancing at the clock on his laptop, Nurlan sighed. He had to leave his office in just a few minutes to attend the annual employee appreciation dinner. Although he still had some tasks that needed to be wrapped up before he left, he found it difficult to focus on them. His mind continually wandered to other, more pressing issues that were affecting his day-to-day activities at the office.

He asked himself whether these "social" events arranged by top management served any purpose. In his eyes, they seemed to be nothing more than pomp and circumstance, a show put on by management for its own benefit. In his 25 years at KazOil, he had never seen anything like what he experienced at the social events put on by the new Chinese management team. He felt their attempts at "socializing" with the staff were weak, designed less to motivate the staff and more to fulfill management's own perceptions of greatness. In fact, with the meeting rooms covered in red decorations, the booming, self-glorifying speeches, and the near-complete ignorance of the staff members in attendance, Nurlan felt that attending a management-hosted social event at KazOil was much like standing on the sidelines when forced to watch a military parade in Red Square under the Soviet rule 40 years earlier when he was a child.

When Nurlan joined his table at the appreciation dinner, there was a heated debate going on. A manager of public affairs department, who was actually Nurlan's sister-in-law, was arguing with a couple of other employees and saying that the new owners were very good at dealing with government officials: "Certain things need to be done in certain ways. For example, if there is a conflict with, say, a governmental organization. They say, 'All right, we found these and these mistakes and operational deficiencies. Pay the formal fee and we will end the conflict'. I know that the Chinese would say 'yes' to that deal. The Canadians – never! They would push it further and further, hitting their heads against the wall … These kinds of things did not make them popular among government officials, you know…"

A young marketing manager sitting across the table interrupted her: “We are a progressive company. We should show the way and do things differently. Like the Canadians did: they would go all the way, discussing things in the media, appealing in courts, etcetera.”

“You are too young to remember what the Canadians did,” an older employee from drilling replied. “When the Canadians came, there was a lot of resistance, especially because they took over all the managerial positions and pushed all the locals – regardless of their age and company experience - one step down. Then came young boys like you, who never even knew how to operate a hydraulic pump! It was a tough period for all of us with lots of resistance.”

“Resistance was there, but not for too long,” a middle-aged women from HR joined the conversation from across the table. “When the Canadians entered the company they engaged in a dialogue with the employees. Everyone was involved in training measures and customized career planning, safety requirements were increased across all departments, there were broad and inclusive social events and we all participated in English courses.”

Nurlan quickly thought: Through these measures the Canadians managed to create a positive company spirit. We could see the direction the company was moving in, and felt that our work had an impact. Now, people frequently approach me because they feel lost.

The women from HR continued: “Now, there is none of that. There is no room for personal development anymore since the new owners arrived. They don’t have an overall training strategy, and merely act because the government imposed some requirements on them.”

Nurlan saw his sister-in-law choking, as she couldn’t wait to interfere: “This is certainly the perception of a very limited group of people, mainly in HR. In my department, most people actually value the stability and benefits that the Chinese have introduced. Just take a couple of simple facts: They have increased our insurance benefits, introduced extended maternity leave, and now we barely work overtime anymore. Our company has become a lot friendlier for family people with children. What’s wrong with that?”

People around the table exchanged looks. Many had kids, many knew about the challenges of combining work and family obligations. They were certainly not going to challenge the importance of a healthy work-life balance.

But people still leave, thought Nurlan. Then his thoughts were interrupted by the announcement of the speeches by Chinese top management. As he sat listening, Nurlan was at a loss for how to deal with the Chinese management style.

## KAZAKHSTAN IN THE POST-SOVIET ERA

When Soviet power began to disintegrate in the late 1980s and then crumbled completely in 1991, countries that had been part of the Soviet Union found themselves on uncertain ground. The sudden dissolution of the centrally dominated planned economy resulted in a power vacuum, which brought with it the potential to introduce elements of western democratic political systems and free-market economic structures, and the possibility to once again develop and encourage local cultures. Former citizens of the Soviet Union were left wondering where to turn first. Among the nascent economies struggling to choose a relevant path in the post-Soviet world was the Soviet Union's second-largest republic, Kazak SSR. On December 10, 1991, after more than 70 years of Soviet rule, the republic was renamed the Republic of Kazakhstan. A few days later, it declared its independence, a declaration that in itself reflected the meaning of Kazakh – "a free spirit".

Kazakhstan, located in northern and central Eurasia, was the ninth-largest country in the world in terms of area. Its area of approximately 2.7 million square meters surpasses that of Western Europe. The national culture of Kazakhstan was not just influenced by "Kazakhness" but also by its history as a Russian colony, its 70 years of Soviet rule, and a range of other forces. In the 1990s, the country experienced a large outflow of Russian-speaking people from the region. However, by 2000the population growth trend was positive, mainly driven by immigrants and returnees. As a result of its history, the country's population of nearly 17 million included 120 nationalities, and only 63% of the population could claim Kazakh origins[1]. Kazakhstan was a bilingual country: Kazakh had the status of the "state" language, while Russian, which was spoken by almost all Kazakhstanis, was declared the "official" language, and was used routinely in business and day-to-day communication.

The country, which was a member of the Commonwealth of Independent States (CIS), was officially a presidential republic and, owing to its significant crude oil resources, it enjoyed significant economic growth since independence. In 2001 and 2002, in an acknowledgement of Kazakhstan's efforts to transition away from the Soviet planned economy, the European Union and the United States (U.S.) recognized Kazakhstan as a market economy. Since 2000, the economy had grown at an average annual rate of 10%, which exceeded the corresponding figures for most other countries in the world[2]. This impressive development could be attributed to Kazakhstan's significant oil, gas and mineral reserves. At the beginning of the 21st century, Kazakhstan's oil and gas reserves were estimated to be the third largest in the world. At the same time, Kazakhstan was acknowledged as one of the world's top twenty oil producers.

## FDI IN KAZAKHSTAN

After independence, Kazakhstan followed Russia's economic reform strategy, which was based on price liberalization and the privatization of state enterprises, as it began the transition to a market economy. However, Kazakhstan's natural resources enabled the country to procure foreign direct investment (FDI) and, in turn, to significantly reduce its reliance on Russia and ensure stable economic growth. Early FDI centered on the purchase of state assets or management contracts that included purchase options. For example, Almaty Tobacco plant sold to Philip Morris (U.S.) for US$296 million; Shimkent Confectionery plant

[1] Sabol, S. 2003. *Russian colonization and the genesis of Kazak national consciousness.* Palgrave Macmillan, London.

[2] Arystanbekov, K. 2005. Kazakhstan's economic policy with high levels of foreign investment. *Problems of Economic Transition,* 48(2): 29-42.

sold to RJR Nabisco (U.S.) for US$65 million; and Unilever purchased Almaty and Karaganda Margarine plants for US$60 million[3]. However, FDI concentrated most on mineral extraction, especially the oil and gas sector. As an example, in 2001 the oil and gas sector accounted for 81% of all FDI[4].

Despite the abundance of attractive natural resources, possible investors faced several factors that may have restricted them from engaging in FDI in Kazakhstan. These factors included an unstable economic environment, weak infrastructure, poor corporate governance systems, lack of transparency in the legal and tax systems, corruption and crime, heavy bureaucracy, and government intervention. Nevertheless, oil, gas, mineral and energy resources, as well as Kasakhstan's relatively untouched markets, made it an attractive FDI target, particularly among firms active in the petrochemical and mining industries.

In the 90s, firms headquartered in the U.S. were the largest investors in Kazakhstan, with 29.8% of all investments. In the period of 1993 to 2000, Canada and the U.S. accounted for 36.8% of FDI. The United Kingdom was the second heaviest investor accounting for 13.2% of FDI for the same time frame. In 2003, total FDI from Western nations accounted for over 55% of the foreign investment in Kazakhstan[5]. Asian organizations had also invested significant amounts into Kazakhstan. From 1993 to 2000, the Republic of Korea, China, Japan and Indonesia represented just over 21% of total FDI. In 2000, the neighboring country, China, was the fourth-largest investor in Kazakhstan[6].

# KAZOIL

KazOil was an oil production cooperative located in the small town of Kyzyl-Orda. With 5,000 employees, it was the town's main employer and the biggest contributor to community development. Even after the demise of the Soviet regime, the Kazakh Ministry of Energy maintained control of KazOil until 1996, and the company was actively protected from international competition. As a result of its history as a state-run organization, KazOil had a strong bureaucracy, which was clearly evident in its highly centralized structure. Its employees were characterized by their extreme respect for authority, high uncertainty avoidance, and tendency to focus on the short term. The company's technology and its business processes were out of date. Although the pre-acquisition management team held a significant amount of control, that control was generally ineffective. Furthermore, the organization was permeated by a "them versus us" attitude, which reflected the distance between management and staff. Communication between managers and staff members was

[3] Promfret, R. 2005. Kazakhstan's economy since independence: Does the oil boom offer a second chance for sustainable development? *Europe-Asia Studies*, 57(6): 859-876.
[4] Promfret, R. 2005. Kazakhstan's economy since independence: Does the oil boom offer a second chance for sustainable development? *Europe-Asia Studies*, 57(6): 859-876.
[5] Update provided at http://www.kazembassy.org.uk/#
[6] Umurzakov, K. 2003. Investment climate in Kazakhstan. *United Nations Economic and Social Commission for Asia and the Pacific*. Retrieved September 26th, 2006 from http://www.unescap.org/tid/mtg/rrtpaper_kazakh.pdf#search= %22fdi%20kazakhstan%22

virtually non-existent, and the management team showed little interest in employee development. Decisions were made at the top and handed down, without input from lower management levels or staff members[7].

## THE FIRST ACQUISITION

In 1996, just five years after Kazakhstan began its transition from the Soviet planned economy to a market economy, KazOil was sold for US$120 million by the Kazakhstan government to Hydrocarbons Ltd., a Canadian company. Under Canadian management, KazOil initially flourished. Already in January 1998, KazOil’s proved plus probable reserves were independently assessed at over 429 million barrels, an increase in reserves of 10% since 1997. KazOil drilled 20 successful wells in its southern field and obtained a 100% interest in a 455,672 acre exploration license in 1997. In 1998, the exploration program included the drilling of three unsuccessful wells and the gathering of 290 miles of seismic data, data that was necessary for future development. Plans for future growth and long-term investor value return focused on such initiatives as the development of licensed areas, the acquisition of new licenses, and the export of crude oil and refined products to markets in Central Asia and China.

However, oil prices on the Kazakh market dropped dramatically during the last half of 1998 from a high of US$11.13 per barrel to a low of US$5.89 per barrel. General market conditions in Kazakhstan remained bleak into early 1999. Although KazOil had examined the feasibility of exports in 1998, the option was not viewed as economically viable. However, in the second quarter of 1999, KazOil entered into three export contracts: one with Russia and two with China. The Chinese contracts entailed the export of up to 100,000 tons of oil per month, representing approximately 30% of KazOil's anticipated production.

## NEW EMPLOYEE RELATIONS

Hydrocarbons’ contract with the Kazakh government included a clause that required it to maintain KazOil’s staff for at least three years. As opportunities to reorganize its workforce were limited, Hydrocarbons focused on cost reductions and the elimination of all capital expenditure that was not absolutely necessary. In addition, in order to enhance the workforce, the company agreed to provide general training programs for all managers and staff members. Hydrocarbons also undertook a complete evaluation of the safety measures that were in place and introduced safety training programs in all departments.

Employees viewed the transition to Canadian ownership as positive, and perceived Hydrocarbons corporate culture as highly professional. For its part, Hydrocarbons worked hard to gain the acceptance of KazOil employees. In the five years following the acquisition, most employees were offered the opportunity to take part in a large-scale training program,

[7] Minbaeva, D., Hutchings, K. and Thomson, B. (2007), ‘Hybrid Human Resource Management in Post-Soviet Kazakhstan’, *European Journal of International Management*, 1/4, 350-371.

which was provided by the Canadian headquarters. All operational fields – from field operations to safety to management skills – were covered in the training program. There were numerous team building exercises and social events, some of them open to the general public. The human resources (HR) department employed a Canadian instructor to run a three-hour seminar on Canadian culture every Wednesday afternoon for about one year. The seminar was open not only to KazOil employees but also to their relatives, friends and anyone interested. English language courses ran on a continuous basis for employees at all levels. The management also supported English language courses at local schools and kindergartens.

The training program assisted KazOil in achieving its goal that was stated in the Corporate Philosophy of Training: “to build employee confidence, broaden the employees’ business perspective and increase job satisfaction”. Furthermore, Canadian expatriates at the KazOil unit coached employees on a day-to-day basis, making themselves available for open discussions and encouraging employee initiatives. Numerous local managers were soon included in KazOil’s succession planning for the region, with the aim of eventually replacing expatriate managers with a local management team. Already in June 1997, in a formal survey of management, 26% of local managers stated that they fully supported the changes, while 52% indicated their belief that the company was moving in the right direction.

The Canadians also implemented a detailed human resources strategy, with the immediate goal of developing common, but locally adapted, HR policies and practices for all business units. As a part of this move, policies and procedures related to recruitment, job descriptions and performance appraisals were introduced. As a result, the local HR department found itself directly involved in the strategic decision-making process.

Local employees were also directly involved in the decision-making process and encouraged to provide feedback. This familiarized them with the company strategy and enabled them to work towards fulfilling that strategy in their day-to-day activities. A middle manager from KazOil’s IT department described the impact: “There was a company spirit. There was a unity, cohesion. You worked not only for yourself, for your salary”. The strong company spirit was present despite the fact that, at the end of 1999, KazOil had three business units in three different cities. The company headquarters were located in Almaty, but the main production field and the support offices were located in Kzylorda, some 900 kilometers north-west from Almaty, and the newly purchased refinery plant was in Skymkent, 600 kilometers south from Almaty. All three units had vastly different organizational cultures. These differences were caused by labor market dynamics, regional variations in economic development and diversity in employees’ educational backgrounds.

KazOil employees referred to the working environment under the Canadians as professional and informal, characterized by open lines of communication, unity, and an interest in employee development and well-being. One described his view of the situation following the Canadian acquisitions as follows: “The Canadians really put things in order… We could see the effects immediately: no fatal accidents, a safe working environment, certain norms of behavior… It definitely works!” Employees reported believing that they “had an impact” on their organization.

Despite some operational difficulties and the market volatility, KazOil's management remained optimistic about the future. In fact, a one-page advertisement run by KazOil in a large international media outlet stated the following:

> Through our investments in capital and technology, we contribute to Kazakhstan's vibrant oil industry. We have increased the production of our fields, introduced health and safety measures for employees, and implemented international standards for financial and operational planning and management… Our commitment and shared goals are the foundation of our success in Kazakhstan. Our strong relations with our employees, the government and the people in the communities in which we work ensure that success will continue in the future.

## THE SECOND ACQUISITION

Hydrocarbons agreed to sell KazOil to China Petrol, a state-owned company in 2005. By offering US$4.2 billion, China Petrol beat out its competitors from Russia and India. The transaction was the largest takeover ever undertaken by a Chinese company and, together with China Petrol's agreement to cooperate with a Kazakhstan's state-held oil company, was designed to provide the 3,000 kilometer long Sino-Kazakhstan oil pipeline with a "reliable supply".

Soon after the acquisition, China Petrol transferred 30 managers to KazOil. Despite the introduction of the Chinese management team, China Petrol retained the existing personnel and maintained, in general, the company's mode of operations. However, approximately half of KazOil's international employees resigned shortly after the takeover.

When China Petrol took over KazOil, the latter was widely viewed as a successful "western" subsidiary. It owned a total of 12 oil fields and exploration licenses in Kazakhstan. KazOil had just experienced several years of a "western" style of management, which included individual-focused compensation schemes and incentives. The new owners were different. China Petrol shared many traits with state-owned enterprises in the Soviet Union. Both were characterized by high levels of bureaucracy and hierarchy, allegiance to set rules and practices, centrally set goals, and the distribution of resources on grounds other than market efficiency.

Within two years of the acquisition by China Petrol, many of the local managers who had flourished under Canadian management left soon after the acquisition, citing such grounds for leaving as the "non-professional Chinese management" and the possibility that staying with KazOil might "slow down their career". Headhunters were known to approach KazOil managers directly, easily luring them off to more western-inspired companies.The Chinese management team did little to retain employees, especially those who were highly skilled. One effort towards retaining employees was to boost the bonuses during the first two years: bonuses were paid once or twice a year and represented up to 50-70% of the monthly salary. Yet, many employees were leaving, and those who decided to stay with the company did so for reasons other than career development. Often they were more interested in the perceived stability and comfort offered by KazOil, or the company's maternity leave or insurance benefits. Overtime was virtually non-existent. As one employee stated, "Chinese managers come to work at 9 a.m. and leave at 6 p.m. regardless of whether there is an urgent project or not… If the boss does not care, then the subordinates do not care either". Nurlan knew that, in general, his employees viewed the change in ownership as a shift backwards towards the Soviet style of management. As one of his colleagues had recently mentioned to him: "If we had not known the Canadian style of management, the Chinese way would have been very easy to accept… but we now know that there is a better, more professional way to do business".

The employees' negative perceptions of the top-down decision-making style adopted by China Petrol were strengthened by the lack of transparency and almost complete dearth of communication, which was compounded by the lack of language skills among the Chinese managers. They viewed the new management team as secretive. As one senior manager stated, "The Chinese culture is a culture of silence. Nothing is explicitly articulated". As a result, decision making was slow and frustration was growing: "In the eyes of the Chinese managers, we are doing a good job: we follow the law, fulfill the budget and obey the rules".

Much of the responsibility for HR issues was moved from the individual units to the company's headquarters in Almaty, a move that was generally not well received. One manager was overheard complaining that "HR managers meddle in everything". In addition, the bonus system was systematized, the English-language courses were discontinued, and Chinese-language courses were offered only to a select group of managers. These moves resulted in a general lack of trust between employees and the new owners, and the widespread opinion among employees that they could "not learn much from the new owners".

## WHERE TO GO FROM HERE?

After a round of applause, the appreciation dinner continued. As Nurlan took another bite of gong *baoww jee-ding*, many thoughts filled his mind. He knew the staff was becoming restless, struggling with the new reality that they were obligated to face. Many of his best employees had left as soon as the acquisition had been announced, while many more had taken advantage of opportunities elsewhere when they began to understand how working life would change under Chinese management. He found himself struggling day in and day out with the question of how to retain employees in a work environment where they did not believe they were valued. He felt he could not speak to top management about the issue – the new management team did not seem to welcome approaches on any level, particularly when one was bearing bad news. In fact, despite his years of experience and his position as a long-standing member of upper-middle management, Nurlan had often been ignored when he approached the Chinese management.

The list of questions he had seemed almost endless: How could he motivate his employees to give their best? What kind of incentives could he offer them to stay at KazOil? What kept those that remained from seeking out other opportunities? How could he attract the most qualified employees to KazOil? More importantly, how could he get messages across to the management team in a way that would cross the seemingly imperceptible cultural barriers without being disrespectful? How could he best combine his skills and those of his colleagues with the strengths of the Chinese management team?

Nurlan looked out over the red tablecloths and watched the seemingly happy faces at the management table. He was once again struck by the impression that this was all nothing but a façade, meant to impress rather than to signal real appreciation. In fact, he could hear his tablemates grumbling, albeit quietly: “It’s like in the old Soviet days: red carpet, flowers, music. *Déjà vu*!”