

SECTOR ASSESSMENT (SUMMARY): MICRO, SMALL AND MEDIUM-SIZED ENTERPRISE DEVELOPMENT¹

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Uzbekistan is the most densely populated country in the region, with one third of the population under the age of 29 and half residing in rural areas². As 800,000 people under the age of 29 join the labor market every year, job generation is an urgent and challenging priority. Small businesses play an important role in Uzbekistan's economy, and have the capacity to generate growth, exports, and particularly jobs.

2. Small businesses in Uzbekistan are defined by the number of employees and include individual entrepreneurs and micro and small enterprises.³ The threshold number of employees varies by sector.⁴ There is no legal definition for medium-sized enterprises.⁵ In 2011, there were 246,411 small businesses and 161,000 individual entrepreneurs. Their contribution to gross domestic product (GDP) increased from 35.0% in 2003 to 54.6% in 2012 and is expected to increase to 57.2% by 2015.⁶ Small businesses are important in agriculture (contributing 98.0% of total output), construction (70.7%), retail trade (45.3%), and services (44.7%). The small business share of exports increased from 10.2% in 2000 to 15.8% in 2012. Small businesses contributed 75.7% of total employment in 2012.⁷

Table 1: Key indicators of Small Business in Uzbekistan

Indicator	2007	2008	2009	2010	2011	2012
Small businesses registered ('000)	390	400	425	455	470	...
Contribution to employment (%)	72.0	72.5	73.0	74.5	74.8	75.7
Contribution to GDP (%)	45.7	48.2	50.1	52.5	54.0	54.6
Bank lending (SUM million)	110.0	202.5	322.1	485.2	752.3	1,171.6

... = data not available, GDP = gross domestic product.

Sources: State Statistics Committee, Central Bank of Uzbekistan.

3. Women accounted for half of the population and 45.5% of the working population in 2010. However, women's economic participation has been declining since 2007, with their formal labor force participation rates dropping from 59.3% in 2007 to 45.5% in 2010.⁸ The gender gap—the difference between male and female rates of participation in the formal labor force—has widened from 6.5 percentage points in 2007 to 9.0 in 2010. The unemployment rate

¹ This summary is based on ADB. 2012. *Financial Sector Development in Central and West Asia. Country Assessment Uzbekistan*. Consultant's report. Manila (TA 7709-REG). Unpublished. Available on request.

² Average population growth rate is 2.5% per year. State Committee on Statistics. 2011.

³ The definition of small business is stipulated in Article 5 of Law N 69-II, enacted on 25 May 2000 and amended on 2 May 2012, which states that small business includes individual entrepreneurs, microfirms, and small enterprises. (Government of Uzbekistan. 2000. *The Law of the Republic of Uzbekistan N 69-II on Guarantees for Freedom of Entrepreneurial Activity*. Tashkent; Government of Uzbekistan. 2012. *Presidential Decree N328 on Measures for Further Improvement of the Business Environment and to Provide Greater Freedom of Entrepreneurship*. Tashkent).

⁴ The average number of employees in a micro enterprise should not exceed 20 in industry and 10 in services. A small enterprise has up to 100 employees in industry and up to 25 employees in services.

⁵ In 2012, the terminology for the subsector changed from micro, small, and medium enterprises to micro and small enterprises for better monitoring and compiling of statistics.

⁶ Government of Uzbekistan. 2013. *Welfare Improvement Strategy of Uzbekistan (2012–2015)*. Tashkent.

⁷ Government of Uzbekistan, State Committee on Statistics. 2013. *Statistical Review of the Republic of Uzbekistan*. Tashkent.

⁸ State Committee of the Republic of Uzbekistan on Statistics. 2012. *Women and Men of Uzbekistan. 2007–2010 Statistical Bulletin*. Tashkent.

for women was 6.3% in 2010, considerably higher than the 4.6% recorded for men. While there is no legal definition of “women’s small businesses” in Uzbekistan, the Central Bank of Uzbekistan (CBU) defines them for reporting purposes as businesses either managed or owned by women or with women accounting for at least half of employees. National statistics do not include sex-disaggregated data for small businesses except for individual enterprises. In 2010, women were 38.3% of all individual entrepreneurs.

4. Banks provide most formal financing for small businesses. According to the CBU, commercial banks’ microcredit loan portfolio increased from the equivalent of about \$0.1 billion in 2007 to the equivalent to about \$0.6 billion in 2012.⁹ The total banking sector loan portfolio is \$9.9 billion equivalent. Despite the increase in the number of microcredit loans, the banks’ microcredit loan portfolio accounted for 5.7% of their loan portfolio in 2012. Estimates of the demand for small business loans vary. An analytical report conservatively projected demand for microcredit loans at \$1 billion in 2013 and \$6.5 billion in 2020.¹⁰

5. A number of factors affect the further development of small businesses:

- (i) **Insufficient access to finance to start their business or expand.** Bank products tend to target enterprises with profitable investments and sound collateral. Commercial banks view lending to small businesses to be costly and risky. The transaction cost of providing a microcredit loan is higher than for credit to a large enterprise. Small businesses often lack profitable projects with stable revenues, sufficient collateral, or credit histories. Banks need assurance that the owner of a small business will be able to repay the loan and that banks can earn a return on their investment.
- (ii) **Lack of loan collateral** to mitigate the risk of business failure. Collateral requirements are generally high for small businesses, at 146% of the loan amount, compared with 128% for large companies.¹¹ Alternative sources of collateral and security such as future cash flows, business reputation, third parties, or group guarantees are rarely considered acceptable. Insufficient collateral limits the size of loans and constrains entrepreneurs’ access to larger loans for business expansion and capital investments.¹²
- (iii) **Limited outreach to women due to their concentration in informal businesses.** Women’s small businesses have a low utilization of financial products and services, though women face no legal constraints to financial access. Banks prefer to lend to registered businesses with balance sheets. This is evidenced by the low number of microfinance accounts opened for women (30% of all accounts in 2011¹³) and the small bank loan portfolio for women beneficiaries (15% of the total bank loan portfolio in 2011¹⁴).
- (iv) **Difficulties getting cash loans.** Many small businesses, mainly individual entrepreneurs engaged in trade, need cash loans for working capital. Existing regulations place restrictions on cash transactions and promote the use of electronic payment cards.

⁹ The exchange rate was SUM1,290 per US dollar in 2007 and SUM1,885 per US dollar in 2012. Country Economic Indicators (accessible from the list of linked documents in Appendix 2).

¹⁰ United Nations Development Programme. 2011. *Microfinance Development Perspectives in Uzbekistan*. Tashkent.

¹¹ World Bank. 2011. *The World Bank Group’s Enterprise Survey*. Washington, DC.

¹² The World Bank’s Enterprise Survey indicates that in 2010 only 8.2% of firms in Uzbekistan used bank loans to finance capital investments (footnote 10).

¹³ ADB. 2012. *Country Partnership Strategy: Uzbekistan, 2012–2016*. Manila.

¹⁴ Central Bank of Uzbekistan. 2012. *Banking Sector Statistics*. Tashkent. Unpublished.

- (v) **High cost of bank credit.** Lack of liquidity and available capital, coupled with the perceived high risk of lending to small businesses and higher administrative costs, compel banks to charge high interest rates.¹⁵
- (vi) While the government encourages banks to offer medium- and long-term loans, **most deposits and financial products are short term.** Only one-third of banks' microcredit loan portfolio is for more than 3 years, with the rest issued with maturities varying from 6 to 24 months.¹⁶
- (vii) **Business skills, experience, and knowledge are often lacking** in small businesses. Limited information about banking products and services makes it a challenge to prepare business plans and to market products and services. Insufficient technical, managerial, and professional skills constrain profits.
- (viii) **The cost of doing business in Uzbekistan is high for small businesses.** Uzbekistan ranked 154 out of 185 economies in the *Doing Business 2013*. Starting a business requires six procedures, takes 12 days, and costs 3.8% of gross national income per capita. Registering property takes 78 days and requires 15 procedures. Firms make an average of 41 tax payments per year and spend 205 hours per year filing, preparing, and paying taxes. The taxes and mandatory contributions as a percentage of profit can be as high as 98.5%, creating an incentive to stay informal.¹⁷
- (ix) **Rural small businesses lack access to information** on government programs, market opportunities, suppliers, competitors, technology, and banking products. Currently, e-banking channels using debit cards are insufficient to bridge the gap. Other channels that use the internet and/or mobile phones are in the early stages of development.

2. Government's Sector Strategy

6. The Republic of Uzbekistan has adopted a number of reforms and programs to develop small businesses and entrepreneurs. These include an enabling legal framework for establishing and operating small businesses, business registration by simple application, and a simplified tax regime. The government launched these special programs during the Year of Small Business, 2010 and the Year of Family Business, 2011. It has taken further steps to simplify registration and licensing procedures, reduce requirements for statistical and financial reporting, and streamline export and import procedures. The clarification of property rights aims to improve the business environment. The government continues to improve access to finance through targeted credit lines to financial intermediaries for onlending to small businesses and entrepreneurs. It is implementing the rural development program to promote rural small businesses in construction and finance for rural housing (para. 9).

3. Asian Development Bank Sector Experience and Assistance Program

7. Asian Development Bank (ADB) has supported micro, small, and medium-sized enterprises in Uzbekistan through four financial intermediation loans (FILs): (i) the Rural Enterprise Development Project, approved in 1996 for \$50 million; (ii) the Small and Medium Enterprise Development Project, approved in 2000 for \$50 million; (iii) the Small and

¹⁵ PCB's onlending SUM denominated subloan interest rates currently range from 16% to 36% per annum depending on whether the loan is provided in cash or in a bank account, the maturity, and use of funds. PCB's onlending US dollar denominated interest rates currently range from 12% to 18% per annum depending on if the subloan is repaid in US dollars or in SUM, maturity and use of funds. Interest rates include the weighted average cost of capital and a risk premium, which reflects the rate of currency depreciation (10%).

¹⁶ Op. cit. footnote 14.

¹⁷ World Bank. 2013. *Doing Business 2013. Uzbekistan*. Washington, DC.

Microfinance Development Project, approved in 2002 for \$20 million; and (iv) the Second Small and Microfinance Development Project, approved in 2010 for \$50 million. The first two loans aimed to support small and medium-sized enterprises (SMEs), generate jobs in agro-processing to increase rural employment, and achieve balanced and sustainable economic growth with poverty reduction. The third and fourth loans supported small businesses through a viable and sustainable institutional framework and mechanism for effectively delivering financial services, particularly to the poor, low-income households, and small businesses, to enable more individuals to improve their livelihood by running small businesses. Lessons from these four projects indicate the need to (i) engage in policy dialogue on regulatory and other impediments to SME development; (ii) set up a prudential supervisory and regulatory infrastructure for banks and other finance institutions with capacity and commitment to reform; (iii) build capacity in participating commercial banks to ensure sound appraisal and supervision of subprojects, credit and risk management policies, and corporate governance and financial disclosure policies; (iv) strengthen monitoring by requiring participating commercial banks to provide quarterly progress reports; (v) limit the maximum subloan size to \$1 million in future SME FILs; (vi) rigorously review subloans financed by ADB and project implementation units to ensure that subborrower and subloan criteria are met; (vii) ensure that project design is realistic and relevant; and (viii) include covenants allowing ADB to suspend loan disbursements. Preliminary findings from the Second Small and Microfinance Development Project indicate the need to enhance business development and financial literacy skills, particularly among women.

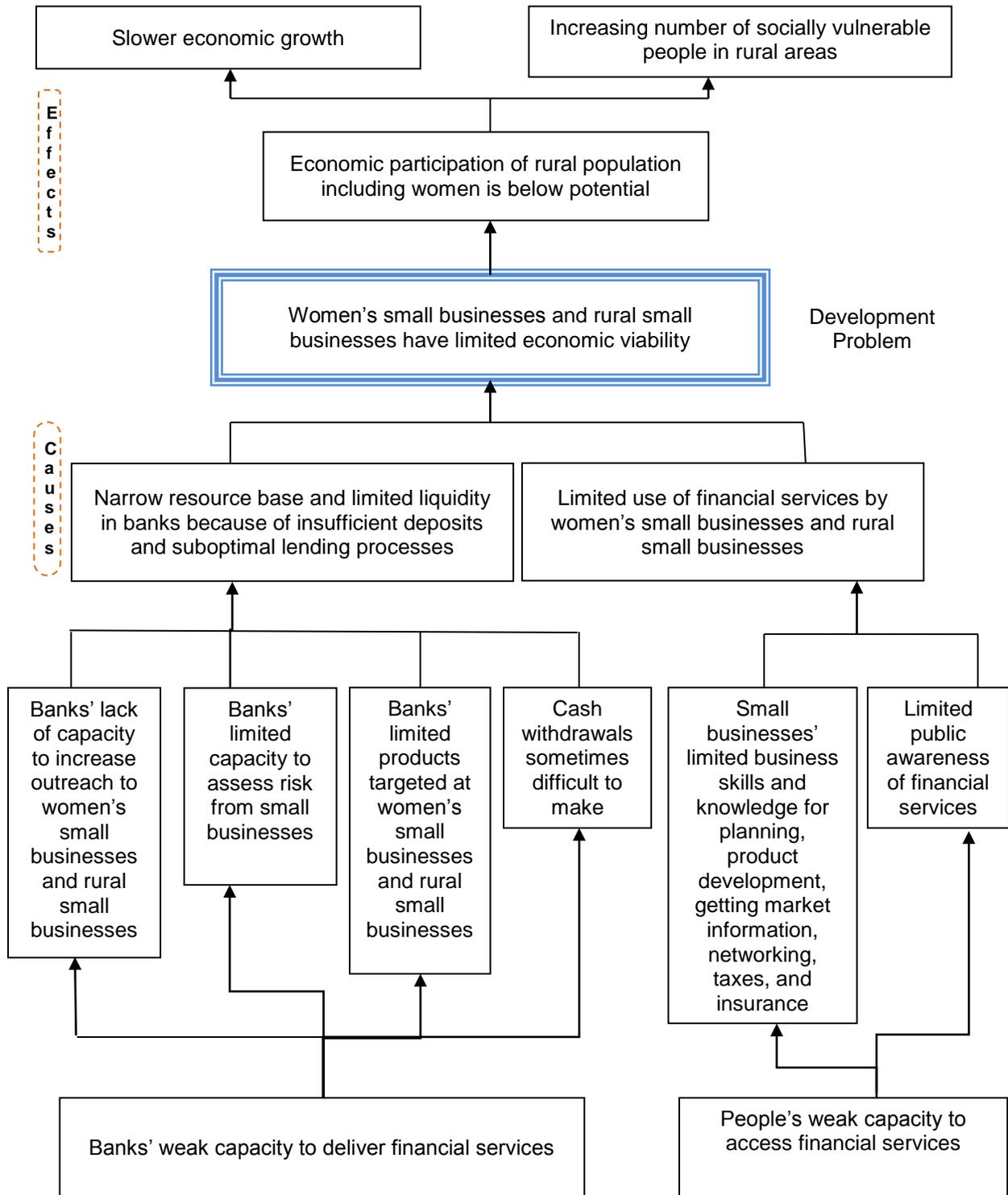
8. ADB has supported capacity building through technical assistance (TA) projects linked to the projects listed in para. 7 and approved in 1996, 2002, and 2010. The objectives were to (i) strengthen National Bank of Uzbekistan (NBU) staff skills for appraising small and medium-sized agro-processing enterprises and assist NBU headquarters in designing and implementing a benefit monitoring and evaluation system for subprojects compatible with ADB guidelines; (ii) strengthen the CBU's capacity to supervise credit unions and determine circumstances under which the CBU may to act as the lender of last resort to address a credit union's temporary liquidity problems, as well as facilitate CBU understanding of microfinance sector policy and performance issues; and (iii) support expanded, viable, and sustainable microfinance operations. Lessons from the TA approved in 1996 are that (i) the simultaneous processing of the loan and the TA enabled the TA to focus on NBU's core needs for successfully implementing the loan, (ii) NBU's ownership of TA deliverables strengthened the sustainability of benefits; and (iii) ADB's flexibility in adjusting consultants' terms of reference enabled the TA to meet the specific requirements of NBU, facilitating NBU's learning of how ADB appraises investment projects and benefits from monitoring requirements. Under the TA approved in 2002, lessons include how building the CBU's capacity to regulate and supervise credit unions contributed to a sound regulatory environment for credit unions in Uzbekistan. Under the TA approved in 2010 lessons include the importance of gender action plan targets to be clearly established during project design to allow effective impact monitoring.

9. ADB is supporting the government's Housing for Integrated Rural Development Program through a multi tranche financing facility.¹⁸ The program aims to develop the rural housing market, enable the development of local construction firms, encourage the creation of micro and small business opportunities within each community, and promote greater access to finance in rural areas. ADB's equity investment in Ipak Yuli Bank supports banking sector development and catalyzes foreign investment in Uzbekistan.¹⁹ ADB is also working with the government to develop the insurance market through TA.

¹⁸ ADB. 2011. *Multitranches Financing Facility to the Republic of Uzbekistan for Housing for Integrated Rural Development Investment Program*. Manila.

¹⁹ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Equity Investment*

PROBLEM TREE FOR MICRO, SMALL AND MEDIUM-SIZED ENTERPRISE DEVELOPMENT



Sector Results Framework (Finance Sector Development, 2013–2016)

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contribution	Indicators with Targets and Baselines	Outputs with ADB Contribution	Indicators with Incremental Targets	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
Increased financial stability and improved access to finance	<p>Increased and more effective financial access for SMEs and other non-state borrowers</p> <p>Outstanding commercial bank loans to SMEs increase to \$2.4 billion in 2016 (2009 baseline: \$1.2 billion)</p> <p>Microfinance lending maintains its present 40% annual increase from 2012 to 2016, while 40% of total new microfinance accounts opened are for women (2012 baseline for microfinance accounts for women: 30%)</p> <p>SUM2.4 trillion committed in housing loans for 40,800 new rural homes from 2012 to 2016 (2010 baseline: 7,647 rural houses) of which 30% beneficiaries are women</p>	<p>SME finance and microfinance</p> <p>Insurance and contractual savings</p> <p>Housing finance</p>	<p>MSME lending increased by \$165 million by 2017</p> <p>Insurance penetration increased to 0.75% of GDP by 2018</p> <p>Insurance density increased to \$10 by 2018</p> <p>Housing finance increased by \$500 million by 2015</p> <p>450,000 rural micro and small enterprises and home-based jobs increased annually by 2017</p>	<p>Planned key activity areas Second Small Business and Entrepreneurship Development Project (\$65 million)</p> <p>Pipeline projects with estimated amounts Small Business and Entrepreneurship Development Project (\$50 million)</p> <p>Ongoing projects with approved amounts Second Small and Microfinance Development Project (\$50 million)</p> <p>MFF: Housing for Integrated Rural Development Investment Program (\$500 million)</p> <p>Equity investment By PSOD (\$6 million)</p>	<p>Planned key activity areas At least 50% of new loans are received by small businesses outside of Tashkent by 2017. At least 50% of new loans are to women's small businesses by 2017.</p> <p>Pipeline project At least 50% of new loans are received by small businesses outside of Tashkent by 2017. At least 30% of new loans are to women's small businesses by 2017.</p> <p>Ongoing projects Outstanding PCBs' microcredit loans are increased to \$360 million by the end of 2013. At least 39,000 with a value of at least SUM2.4 trillion of housing loans provided to targeted beneficiaries, of which 30% are women. Total microcredit lending in rural areas increases from SUM485 billion in 2010 to SUM1,361 billion in 2015.</p> <p>Equity investment The number of SME loans increases from 2,700 in 2011 to 7,000 in 2017. Loan amount to women-owned and women-led SMEs increased from SUM18.4 million in 2011 to SUM32 million in 2017. Number of SME loans provided to women increased from 969 in 2011 to 1,700 in 2017.</p>

ADB = Asian Development Bank, PCB = participating commercial bank, PSOD = Private Sector Operations Department, SMEs = small and medium-sized enterprises.
 Note: ADB interventions include outputs and incremental targets beyond the CPS period 2012-2016.
 Source: Asian Development Bank.