

## SECTOR ASSESSMENT (SUMMARY): FINANCE<sup>1</sup>

### Sector Road Map

#### 1. Sector Performance, Problems, and Opportunities

1. Uzbekistan's small business sector includes micro and small enterprises (MSEs) and individual entrepreneurs.<sup>2</sup> Active MSEs grew at a compound annual growth rate (CAGR) of 3% during 2011–2015 (Table 1).<sup>3</sup> In 2015, MSEs represented 78% of active enterprises. Small business sector's share of gross domestic product (GDP) increased from 35.0% in 2003 to 56.7% in 2015, while its share of employment rose from 60.0% to 77.9% during the same period. In 2015, small businesses employed 10.1 million people, of whom 7.9 million were employed by individual entrepreneurs and 2.2 million by MSEs. In 2015, small businesses contributed 98% to agricultural output, 87% to retail trade, 67% to construction, 51% to services, and 39% to manufacturing, and they represented 27% of exports. Services and retail trade represented 40% of aggregate small business profit, followed by manufacturing (30%) and construction (10%). Agriculture's contribution to aggregate small business profit was marginal, representing only 1.5%. As a result of the government's protectionist policies, the productivity and export competitiveness of small businesses in Uzbekistan trail its peers in Eastern Europe and Central Asia.<sup>4</sup>

**Table 1: Uzbekistan Enterprise Characteristics, 2011–2015**

Item	2011	2012	2013	2014	2015	CAGR 2011–2015
Number of active MSEs ('000) <sup>a</sup>	177.9	177.6	189.9	196.0	225.9	3.0%
Turnover (SUM trillion)	29.5	35.3	45.1	56.5	...	24.2%
Enterprise value added (% GDP)	54.0	54.6	55.8	56.1	56.7	1.2%
Number of MSE employees ('000)	749.5	763.6	762.4	771.7	778.0	0.9%
Small business share of total employment (%)	75.1	75.6	76.7	77.6	77.9	0.9%
Gross profit (SUM trillion)	4.5	5.0	6.7	8.1	...	21.6%

... = data not available, CAGR = compound annual growth rate, GDP = gross domestic product, MSE = micro and small enterprise.

<sup>a</sup> Excluding private and *dekhan* (agricultural) farms.

Source: Government of Uzbekistan, State Committee of the Republic of Uzbekistan on Statistics. 2015. *Small Business in Uzbekistan*. Tashkent.

2. Agriculture has not kept pace with buoyant growth in Uzbekistan's broader economy, as productivity has stagnated. As a result, the agriculture sector's contribution to GDP declined from 30% in 2000 to 17% in 2015. However, the importance of agriculture to the economic and

<sup>1</sup> This summary is based on ADB. 2016. *Uzbekistan: Small Business Sector Assessment*. Consultant's report. Manila (TA 8986). Unpublished. Available on request.

<sup>2</sup> Effective 1 July 2014, the government groups small businesses in the following categories: (i) microenterprises, (ii) small enterprises, and (iii) individual entrepreneurs. A microenterprise is defined as not employing more than 20 staff in industry, 10 in services, and 5 in trade and catering. A small enterprise is defined as not employing more than 100 employees in the light industry, food, and construction sectors; 100 in industry; 50 in agribusiness; and 25 in services, retail trade, and catering. Individual entrepreneurs are defined as persons engaged in business activities. Government of Uzbekistan. 2014. *Presidential Decree No. 4609: About additional measures for further enhancement of the investment climate and the business environment in the Republic of Uzbekistan*.

<sup>3</sup> Government of Uzbekistan, State Committee of the Republic of Uzbekistan on Statistics. 2015. *Statistical Review of the Republic of Uzbekistan*. Tashkent.

<sup>4</sup> World Bank. 2013. *Business Environment and Enterprise Performance Survey*. Washington, DC.

social fabric goes well beyond its contribution to GDP, as it represented 32% of total employment in 2015. While 49% of the population lives in rural areas, the proportion of people below the poverty line remained high at 17.5% in 2015. Small businesses are the backbone of the rural economy, representing 60% of the gross regional product in 10 of 14 regions.

3. **Women's entrepreneurship.** In 2015, women accounted for half of the population and 45.5% of the working population. The unemployment rate for women was 6.3% in 2010, exceeding the 4.6% recorded for men. A World Bank survey conducted in 2013 estimated that 29.2% of MSEs were owned by women (footnote 3). Women-led business activities are concentrated in cottage industries, home-based manufacturing, retail sales, services, handicraft production, and food processing. Small businesses are a significant source of female employment, representing 39% of a total of 404,100 jobs created for women in 2015.

4. Although there is no legal discrimination against women in obtaining banking services, the informal and unsophisticated nature of small businesses, where most women operate severely impedes accessing loans from formal financial institutions, especially banks. Bank lending processes require immovable property, employment records, and audited income statements, which bar small businesses from accessing loans. While 39% of adult women and 42% of adult men appear to equally use accounts at financial institutions, only 0.7% of adult women borrowed from financial institutions compared with 1.9% of adult men in 2014.<sup>5</sup> To improve female and male access to loans by formal financial institutions, the loan size needs to be determined by cash flow-based lending processes rather than collateral.

5. Consistent with the growth of credit to the economy at a CAGR of 28.5% during 2011–2015, lending to small businesses is dominated by banks and grew substantially at a CAGR of 34.1% over the same period, although from a very low base. The Central Bank of Uzbekistan reports that banks' small business loans outstanding increased from \$0.1 billion equivalent in 2007 to \$4.7 billion in 2015, which represented 7.1% of GDP (Table 2).<sup>6</sup> Nevertheless, the growth of bank credit to small businesses from 2011 to 2015 remained marginal compared to small businesses' 56.7% contribution to GDP in 2015, and the ratio of small business loans to total bank credit improved from 23.9% to 28.3% during 2011–2015.

**Table 2: Bank Loans Outstanding to Small Businesses, 2011–2015**

Item	2011	2012	2013	2014	2015	CAGR
Total bank loans (SUM billion)	15,651	20,392	26,530	33,534	42,685	28.5%
Loans to small business (SUM billion)	3,742	5,346	6,982	9,158	12,112	34.1%
Microcredit loans <sup>a</sup> (SUM billion)	752	1,023	1,366	1,907	2,526	35.4%
Loans to women (SUM billion)	485	492	698	960	1,255	26.8%
Loans to small businesses (% of total loans)	23.9	26.2	26.3	27.3	28.3	
Total loans (% of GDP)	20.1	21.1	21.9	23.1	24.9	
Loans to small business (% of GDP)	4.8	5.5	5.7	6.3	7.1	
Microcredit loans (% of GDP)	0.9	1.0	1.1	1.3	1.4	
Loans to women (% of GDP)	0.6	0.5	0.6	0.7	0.7	
GDP (current prices, SUM billion)	77,752	96,589	120,861	144,867	171,369	

CAGR = compound annual growth rate, GDP = gross domestic product.

Sources: Central Bank of Uzbekistan; Government of Uzbekistan, State Committee of the Republic of Uzbekistan on Statistics.

<sup>5</sup> World Bank. Global Findex Database. <http://datatopics.worldbank.org/financialinclusion> (accessed 1 June 2016).

<sup>6</sup> Central Bank of Uzbekistan. *Banking Sector Performance*. Unpublished.

6. Lending to small businesses appears to be reasonably diversified, with 65% of loans outstanding to small businesses provided in regions outside the capital. However, credit to small businesses in rural Uzbekistan is still insignificant (para 5). Consistent with the concentration of small business activities in trade and services, bank loans to these sectors accounted for half the outstanding loans by the end of 2015. The share of small business loans to manufacturing entities is at a very significant 30%, reflecting the government's protective import substitution policies. Loans to agriculture accounted for 9% of total small business loans.

7. Leasing finance was still insignificant in 2015, representing a book of \$0.9 billion. The tiny leasing finance market is highly fragmented, with 66 leasing finance companies representing a portfolio of \$551 million as of 2015—a 63% market share—with the remaining 37% provided by commercial banks. About 85% of leasing transactions were financial leases, 10% were related to leaseback transactions, and the rest corresponded to operating leases.

8. Access to formal finance is the top constraint to small business growth. A survey of small enterprises revealed that the main sources of capital were personal and family assets, followed by financial support of business partners and friends.<sup>7</sup> Bank credit and other financial services were reported being not sufficiently available.

9. Banks require small businesses to provide collateral valued at 175% of the loan amount, compared with 125% for large companies. Because of the informal nature of their business, high reliance on cash flow revenues, and the lack or limited existence of financial documentation and property titles, small businesses do not meet the standard requirements for obtaining bank credit. Banks need to adapt their lending processes, build expertise in analyzing undocumented business cash flows, and provide critical investment capital prudently to help small businesses grow.

10. High loan interest rates, which may be unviable for funding investments, result from (i) the administrative costs of originating loans and required documentation that small business cannot produce, (ii) the absence of mobile banking technology-supported credit underwriting, and (iii) high credit risk.<sup>8</sup>

11. The lack of business skills, experience, and knowledge among small business owners represents an additional obstacle to small business growth and creditworthiness. Potential borrowers have limited information and awareness about the implications of borrowing, and they lack skills in preparing simple budget and business plans, and in marketing products and services.

## **2. Government's Sector Strategy**

12. The government has set small business development at the top of its reform agenda for 2016–2020.<sup>9</sup> It has improved legislation to facilitate establishing and operating small businesses by reducing taxes and simplifying registration, licensing, and reporting requirements. It

<sup>7</sup> Center for Economic Research. 2014. *Entrepreneurs of Uzbekistan as a basis for formation of the middle class*. Tashkent.

<sup>8</sup> Interest rates for bank loans in sum range from 11% to 25% per annum, while interest rates for foreign currency loans range from 6% to 15% per annum. Interest rates include the weighted average cost of capital and a risk premium, which reflects the rate of currency depreciation.

<sup>9</sup> Government of Uzbekistan. 2015. *Presidential Decree No. 4725: On the measures to ensure reliable protection of private property, small business and private entrepreneurship, and remove barriers to their accelerated development*. Tashkent.

continues to support small business finance by targeted credit through financial institutions. Its medium-term financial sector development strategy, 2016–2020 anticipates an increase in lending to small businesses by 2.2 times by 2020, from \$4.2 billion equivalent in 2015.<sup>10</sup>

### 3. Asian Development Bank Sector Experience and Assistance Program

13. Since 1996, the Asian Development Bank (ADB) has supported small businesses in Uzbekistan through five financial intermediation loans, five capacity building technical assistance projects, and an equity investment in Ipak Yuli Bank. ADB (i) helped develop agro-processing to increase rural employment, (ii) provided funds for working capital and fixed assets financing, and (iii) improved the capacity of the participating financial institutions. Main lessons from these projects indicate the need to (i) engage in policy dialogue on regulatory and other impediments to MSE development; and (ii) build capacity in participating financial institutions to support sound appraisal and supervision of subprojects, credit risk management policies, and corporate governance and financial disclosure policies.

14. In addition to supporting small business development, ADB is assisting the government's Housing for Integrated Rural Development Program through a multitranche financing facility.<sup>11</sup> The program aims to develop the rural housing market, encourage the creation of MSEs, 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.<sup>12</sup>

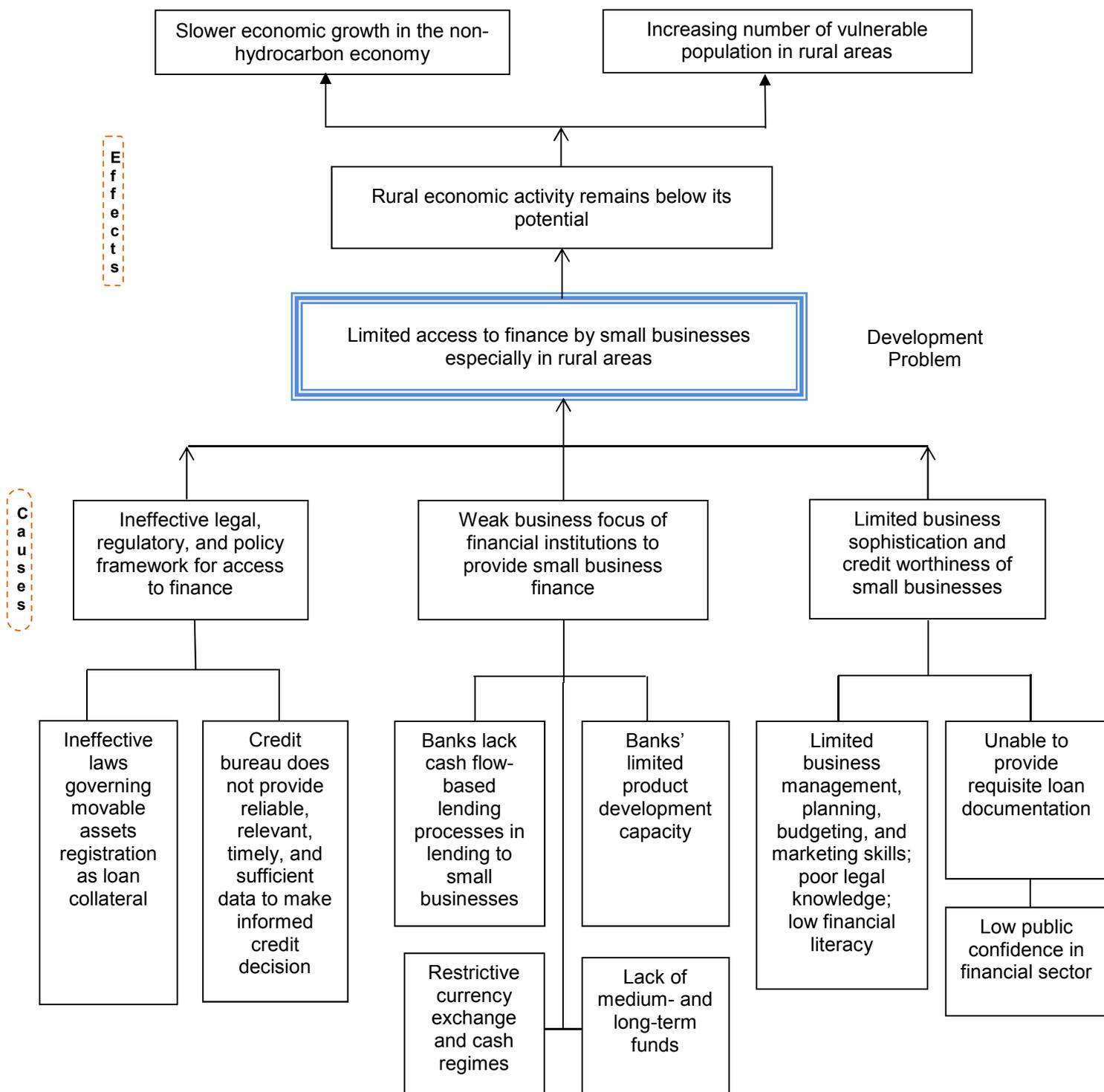
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<sup>10</sup> Government of Uzbekistan. Forthcoming. *Medium-term financial sector development strategy, 2016–2020*. Tashkent (under approval).

<sup>11</sup> ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Multitranche Financing Facility to the Republic of Uzbekistan for Housing for the Integrated Rural Development Investment Program*. Manila.

<sup>12</sup> ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Equity Investment in JSC Bank Ipak Yuli of Uzbekistan*. Manila.

### Problem Tree for Finance



### Sector Results Framework (Finance, 2016–2021)

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>Total bank lending to small businesses increases to SUM8,562 billion in 2021 (2015 baseline: SUM2,446 billion)</p> <p>Microfinance lending maintains a 35% annual increase during 2016–2021</p> <p>Bank credits to women's small businesses maintain a 30% annual increase during 2016–2021</p> <p>SUM2.4 trillion committed in housing loans for 40,800 new rural homes from 2012 to 2016, of which 30% beneficiaries are women (2010 baseline: 7,647 rural houses)</p>	<p>SME finance and microfinance</p> <p>Housing finance</p>	<p>Small business lending increased by \$100 million equivalent by 2021</p> <p>Housing finance increased by \$400 million by 2021</p>	<p><b>Planned key activity areas</b> Rural Finance Development Project (\$400 million)</p> <p><b>Pipeline projects with estimated amounts</b> Small Business Finance Project (\$100 million)</p> <p><b>Ongoing projects with approved amounts</b> Small Business and Entrepreneurship Development Project (\$50 million)</p> <p>MFF: Housing for Integrated Rural Development Investment Program (\$500 million)</p> <p><b>Equity investment</b> Equity Investment in Joint-Stock Commercial Bank "Ipak Yuli"</p>	<p><b>Planned key activity areas</b> At least 40,000 additional mortgage loans extended by 2020</p> <p><b>Pipeline projects</b> At least 60% of the number of subloans from PFIs onlent to small businesses outside of Tashkent by 2021 At least 20% of the number of subloans from PFIs onlent to women-owned small businesses by 2021</p> <p><b>Ongoing projects</b> 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>At least 39,000 housing loans with a value of at least SUM2.4 trillion provided to targeted beneficiaries, of which 30% are women</p> <p><b>Equity investment</b> 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 SUM32.0 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, MFF = multitranchise financing facility, PFI = participating financial institution, SMEs = small and medium-sized enterprises.  
 Note: ADB interventions include outputs and incremental targets beyond the period covered by the country partnership strategy, 2012–2016 for Uzbekistan.  
 Source: ADB.