Small and Medium Enterprise Investment Program  
(RRP KAZ 44060)

SECTOR ASSESSMENT (SUMMARY):  
FINANCE: SMALL AND MEDIUM-SIZED ENTERPRISES FINANCE AND LEASING

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. Kazakhstan’s transition to a market-oriented economy paved the way for private sector development after 1991. Some of the privatized state-owned enterprises became medium-sized or large enterprises, while all small and some medium-sized enterprises developed from scratch. In its formative years, the small and medium enterprise (SME) sector was characterized by highly variable growth.\(^1\) Over the last 6 years, the number of registered SMEs has increased from almost 556,000 to 895,000.\(^2\) SMEs now represent 92% of all enterprises. SME growth slowed down from 16% in 2006 to 7% in 2009. The number of registered medium-sized enterprises decreased in 2008 by 7%.

2. Not all SMEs that have been registered are active. In 2009, only 64% (almost 574,000 SMEs) were in operation. This share was only marginally higher than in 2005 (63%). The financial crisis had only a negative impact on medium-sized enterprises since their number decreased (–7.5% in 2007, –4.5% in 2008) while starting to increase again in 2009 (+0.9%). Over the years, individual entrepreneurs gained in relative importance representing 89% of all active SMEs in 2009 compared with 85% in 2005. Small enterprises lost importance with their share decreasing from 14.4% in 2005 to 10.6% in 2009.

3. The nominal output of SMEs, while increasing at an accelerated rate from 2006 (26.7%) to 2007 (29.6%), sharply contracted by 6.9% in 2008 reflecting the impact of the financial crisis. However, it recovered by almost 9% in 2009. Average output per enterprise reached T3.9 million in 2009, an increase of 1.6% over the previous year when it dropped by almost 18%.\(^3\) The average output was T201.6 million for medium-sized enterprises and T23.1 million for small enterprises, while individual entrepreneurs produced on average goods and services worth T0.8 million. The average output of individual entrepreneurs contracted sharply in 2008 (–19.3%) and 2009 (–13.6%). Average small business output recovered in 2009 (+17.1%) after it dropped by a similar percentage in 2008. The financial crisis affected the average output of medium-sized enterprises with some delay when it declined by 7.3% in 2009.

4. The SME sector has not kept pace with general developments in the economy. The SME contribution to gross domestic product decreased from 18% in 2005 to 14% in 2009. From 2005 to 2008, productivity in terms of nominal output per employee increased by 30.5% from T1,246 million to T1,626 million. However, the increase slowed down in 2006 and 2007 while productivity decreased by 5% in 2009 as a result of the sharp drop in output (–6.9%) that surpassed the decline in the number of employees (–1.9%).

\(^1\) The Law on Private Entrepreneurship (31 January 2006) defines small enterprises as those with not more than 50 employees and average net assets of not more than the tenge equivalent of $0.5 million in annual average assets. Medium-sized enterprises are defined as enterprises having not more than 50 employees or not exceeding the tenge equivalent of $3 million in annual average assets.

\(^2\) Excluding farms.

\(^3\) Equivalent to $26,496.
5. The SME sector is not diversified. Sixty percent of small businesses operate in the trade (37%) and services (30%) sectors, which are characterized by low risk and modest start-up capital. Twenty-three percent are active in agriculture, followed by transport and communications (8%). Only 3% of active SMEs have expanded into manufacturing.

<table>
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<th>Table 1: Key Indicators of Small and Medium-Sized Enterprises (%)</th>
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<td><strong>Indicator</strong></td>
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<td>Increase in the number of active SMEs</td>
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<td>Increase in SME employment</td>
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<td>Increase in SME output (in current prices)</td>
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<td>Growth in nominal bank lending to small businesses</td>
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( ) = negative number, SMEs = small and medium-sized enterprises.

Sources: Ministry of Economy and Budget Planning, Government of Kazakhstan; Statistics Agency, Government of Kazakhstan; and National Bank of Kazakhstan.

6. SMEs face a number of constraints to development. While entrepreneurship has become more common and gained a more stable and trustworthy reputation, the persisting cultural bias against entrepreneurship poses many challenges. As a result, most entrepreneurs are young with limited business experience.

7. Many regulations have come into force over the last years and, together with administrative procedures, have stifled the daily operations and competitiveness of SMEs. Overregulation (frequently changing, incomplete, partly contradictory, nontransparent, and inadequately enforced laws and regulations) inflicts losses on entrepreneurial activity.

8. There are many unnecessary barriers and unduly bureaucratic procedures. Launching a business faces challenges. According to Doing Business 2010 data, the steps to be followed (7) and the time it takes to register (20 days) are above the Organization for Economic Co-operation and Development average. The existence of an extensive list of the types of production, goods, and services that are subject to licensing, accreditation, standardization, or certification impedes entrepreneurial initiative. Obtaining licenses takes about 32 days compared to 26 days in Eastern Europe and Central Asia, according to the World Bank’s Doing Business report.

9. Government agents have a tendency to interfere with and exercise excessive controls over day-to-day entrepreneurial activities. Conditions affecting SMEs fall into the competence of more than one ministry or state agency while state bodies have different levels of authority (city, oblast, republican office), each with powers of inspection. This often leads to an overlap of inspections. Even though the Law on Private Entrepreneurship (footnote 1) stipulates that the primary task of state oversight is to ensure product safety and protection of property, environmental safety, and national security, certain state agencies do not strive for a reduction of their control and supervisory functions.

10. The assessment of taxes is a problem for small enterprises as a consequence of

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4 Excluding medium-sized enterprises.


7 International practice suggests that business licensing is mainly used to enforce environmental protections and to supervise the depletion of natural resources. Even then, in most cases licenses are only required when it is obvious that the risks or potential damages outweigh the advantages of noninterference in entrepreneurial activities.
cumbersome and time-consuming tax reporting requirements. The tax system is complex, subject to interpretation, and changes frequently. Many entrepreneurs consider the level of taxes to be excessive. The informal economy—estimated by the World Bank to represent about 34% of gross national product—poses major competitive challenges to SMEs that operate in the formal economy. High taxes and fees imposed on formal sector activities, an imperfect legal structure with loopholes, and difficulties registering new or informal businesses are cited as the major reasons for engaging in informal activities.

11. SMEs have limited access to external finance. Most SME investment is financed by internal resources. Banks usually give priority to low-risk, large borrowers with profitable investments and sound collateral. SMEs are considered higher risk because they often lack good, profitable projects, clear titles to real estate and other collateral, clear managerial targets and succession plans, and available credit histories. SMEs hesitate to approach banks because of cultural barriers and because they do not want strict monitoring by banks. The availability of bank credit for expansion and modernization has also been impacted by the global financial crisis. Unsustainable growth in bank lending, including lending to the SME sector, from 2005-2007 was driven by access to foreign borrowing. Credit growth stalled at the onset of the economic crisis in August 2007 when international credit dried up, leading to a liquidity crunch. Most local banks were hit hard by the cut-off from the international capital markets and slowing economic growth, and reduced the size of their loan books to repay their debts. The banking sector continues to face serious problems and is expected to recover slowly.

12. SMEs have unmet needs for lease financing. Leasing has been available since 2000, and the market has been steadily growing, albeit slowly. This has been attributed to contradictions and awkward interpretations of the Law on Financial Leasing, as amended (2004) and the Tax Code, as amended (2009), and limited capital resources for leasing operations. There are currently 15 leasing companies, with a total portfolio of $100 million (T14.7 billion), of which up to 70% represents SME leases, a tiny percent of fixed capital investments. Most leasing companies were established by commercial banks, while others were set up by oblast and municipal governments to support the agricultural sector.

2. Government’s SME Sector Strategy

13. A number of government initiatives have been undertaken in recent years to address the obstacles facing SMEs. The state Roadmap for Business - 2020 and the Accelerated Industrial-Innovative Development of Kazakhstan 2010–2015 provide the general policy framework. With a narrowly based economy concentrated in the hydrocarbon and mining sectors, the aim is to diversify the production base and give prominence to the development of the SME sector.

14. To address legal impediments, the Law on Private Entrepreneurship mandated the establishment of advisory councils at central and local state agencies to review statutes that negatively affect private entrepreneurs with a focus on the regulatory impact in terms of costs.
and benefits for the business sector. It specifies an accelerated registration procedure for businesses, and allows small businesses to carry out their activities on the basis of a standard charter that significantly simplifies the preparation of documents. While the introduction of one window registration has facilitated the procedure, simplified registration has not yet been fully achieved.

15. There have been attempts to curb inspections of small businesses by: (i) limiting the total number of inspections in a certain period (e.g., small businesses shall not be inspected more than once a year); (ii) reducing the number of controlling bodies (depriving bodies that do not have the status of "state bodies" from their inspectorate functions); and (ii) subjecting all inspections to obligatory registration with the Office of the General Prosecutor. The closure of a business or temporary cease of business activities needs to be approved by court decision.

16. To facilitate SME financing, several laws were passed. The Law on Microcrediting Organizations (2003) led to the creation of more than 300 such organizations. The Law on Financial Leasing (2000) provides tax incentives for leased transactions. The government also established the Damu Entrepreneurship Development Fund (Damu) in April 1997 as a nonbank financial institution. In October 2008, Damu became part of the Samruk–Kazyna National Welfare Fund, its sole shareholder. Damu operates with branches in all 14 regional centers of the country and in Astana city, using state financial assets to support small business development. It implements a number of programs including a microfinance program, an SME loan guarantee program, a program for direct financing of SMEs, and the stabilization program while providing non-financial services to SMEs.

17. Recently, in recognition of the increasing demand for SME finance and decreasing availability based on current market conditions, the Ministry of Economic Development and Trade, the government agency that oversees SME development and Damu—in consultation with key stakeholders—adopted a results-based action plan to facilitate SME Access to Finance, 2010–2014. The plan seeks to ensure that viable SMEs have sustainable access to working capital and medium- to long-term finance. It includes a policy framework to address constraints to such access and key guiding principles.

3. ADB Sector Experience and Assistance Program

18. Since 2006, the ADB has been supporting SME development in Kazakhstan through direct loans without sovereign guarantee and private credit guarantees. In 2006, Alliance Bank received a $100 million partial credit guarantee and $50 million loan and BTA Bank received a $75 million loan. In 2007, Bank CenterCredit received a T6 billion loan and Kazkommertsbank received a $100 million partial credit guarantee. As a result of the financial crisis, Alliance Bank and BTA Bank declared a moratorium on their principal payments and requested restructuring of outstanding debt. The restructuring of Alliance Bank has been completed and BTA Bank’s restructuring is expected to be finalized in the fourth quarter of 2010. The government has requested ADB support for SMEs over the medium term. ADB is exploring future non-sovereign operations and new secured lending products combined with tighter loan portfolio monitoring to address potential risks. Future non-sovereign operations will be closely coordinated with the preparation of future tranches under the investment program.

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11 Small business registration must be completed no later than 3 working days after the required documents are filed. For other legal entities, state registration has to be completed within a 10-day period.
12 Except for the investigation of criminal cases.
Problem Tree for Finance: Small and Medium-sized Enterprises Finance and Leasing

Unsustainable economic growth
Increase in poverty
Decline in living standards

Lower than potential employment generation in SMEs

SMEs are not able to exploit investment opportunities, actualize potential growth, and increase employment

Ineffective financial intermediation, providing only limited capital to viable SMEs

Banks’ lack of loanable medium term funds
High SME sector risk

Sudden withdrawal of external funding
Low deposit base
Weak capacity of SMEs
Low labor productivity
High regulatory and tax burden on SMEs
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<td>SMEs have increased access to medium term credit on a sustainable basis</td>
<td>SME loan accounts opened by PFIs increased from 116,556 in 2009 to 145,249 million in 2014</td>
<td>Medium term financing to SMEs</td>
<td>Number of SME loans increases from 23,338 in 2009 to 29,083 in 2014</td>
<td>Planned key activity areas</td>
<td>5,118 SME borrowers reached, including women entrepreneurs</td>
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<td>Outstanding SME loans increase from T1,708 billion in 2009 to T2,129 billion in 2014</td>
<td>Improved effectiveness and efficiency of Damu</td>
<td>Number of women entrepreneur borrowers under Damu programs increases from 16% of loans in 2009 to 21% in 2014.</td>
<td>Credit lines for SMEs (100% of loan funds)</td>
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<td>Improved financial sector outreach with a focus on women entrepreneurs</td>
<td>Damu receives a credit rating.</td>
<td>Institutional development of Damu (60%) of ADB TA funds</td>
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<td>More women are participating in Damu training (baseline to be collected as part of GAP)</td>
<td>Financial sector outreach (40% of ADB TA funds)</td>
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<td>SME Access to Finance Action Plan implemented</td>
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<td>Improved capacity of SMEs in the areas of financial planning, business development</td>
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ADB = Asian Development Bank; Damu = Damu Entrepreneurship Development Fund; GAP = Gender Action Plan; PFI = participating financial institution; T = Tenge; TA = technical assistance.