LEVERAGING SME FINANCE THROUGH VALUE CHAINS IN KAZAKHSTAN

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Abstract

One of the major issues for SME development has been access to finance. This paper examines the current state of SME development and financing in Kazakhstan. It also examines the current state of the development of value chains and discusses barriers for agriculture value chain financing. The paper discusses key barriers to SMEs’ access to finance and suggests possible ways to overcome these in line with development of the value chains.

Keywords: SMEs, financial institutions, government policy and regulation, economic development, financial markets, value chains, Kazakhstan

JEL Classification: D25, G3, G21, G23, G28, G32, G38, H25, L20, O16, O19, A2
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1. INTRODUCTION AND OVERVIEW OF SME ROLE IN ECONOMY AND SME FINANCE

1.1 Breakdown of Economy and Growth Performance by Sector

Kazakhstan has been successfully building its market economy since gaining independence in 1991. The constitution has established private property rights, and the development of small enterprises was officially announced as a priority for economic policy. Twenty-eight years later, we can now see that the bet on development of the private sector has paid off, though the potential for further development of small enterprises remains significant.

Its rich mineral resource base allowed Kazakhstan to develop oil and gas and mining sectors. This was accomplished through large-scale privatization of the big industrial enterprises and attracting foreign investments. Kazakhstan is an oil economy: it possesses more than 3% of world reserves of oil. The country increased the production of crude oil and gas condensate from 1 million barrels per day in 1993 to 1.7 million barrels per day in 2016, with oil exports reaching 70 million tons (USEIA 2017).

Oil production is concentrated around the three largest projects: Karachaganak, Kashagan, and Tengiz. Kazakhstan’s two largest projects, Tengiz and Karachaganak, accounted for 50% (Tengiz 35%, Karachaganak 15%) of the country’s production in 2016 (Energy Intelligence Group 2017). High concentration can also be seen in other mineral resource extraction sectors—mining, coal production, agriculture (grain and wheat production)—as well as in the transport, construction, and banking sectors. Large private industrial and financial conglomerates are in fact a legacy of Soviet central planning and therefore have closer ties with other conglomerates in the former Soviet Union countries than with local companies in Kazakhstan. In addition, this small number of large companies mostly procures sophisticated goods and services that are not produced in Kazakhstan.

Kazakhstan has performed well in attracting FDI into its economy. By 2016, the country had attracted $150 billion of FDI and its stock to GDP level reached 55%, higher than in most neighboring countries (OECD 2017). However, most of the foreign investments—70% of total FDI stock—have been directed into natural resource extraction. The challenge is still to attract investment into other sectors and activities, as well as retaining current foreign investors.

Due to the period of high oil prices in the 2000s, the Government of Kazakhstan has followed a resource nationalism policy to increase its role in the economy. As a result, the economy of Kazakhstan is now dominated by state-owned enterprises (SOEs). In the early 1990s, 87% of the workforce was employed by SOEs. Many of the country’s leading sectors are dominated by companies owned by Kazakhstan’s national holding Samruk-Kazyna, including the extractive sector, transport and storage, and information and telecommunications. The banking system is dominated by privately owned entities; however, the state, through fully- and quasi-state-owned entities, is both the largest depositor and the largest borrower (IFC 2017).

Currently Samruk-Kazyna, the largest holding company of the SOEs, and its subsidiaries account for an estimated 30% of total employment (IFC 2017). In 2015, there were still over 27,000 registered state-owned legal entities, of which over 1,000 employed more than 250 people. The government has set a target to decrease
the share of SOEs’ gross value added to GDP to 15% by 2020, partially through a new privatization program.

The banking sector in Kazakhstan has been slowly recovering from the financial crisis of 2007, mostly due to the state support. Hence, for the last ten years the private sector has lost the possibility of borrowing from the banking system. In order to support economic activity, in 2010 the government introduced the state program Business Roadmap 2020 to finance the small and medium-sized enterprises (SME).¹ However the devaluation of the tenge in 2015 led to increased currency risks that froze the SMEs’ investment plans and suspended long-term lending by banks.

Table 1: Overview of the Banking Sector in Kazakhstan

<table>
<thead>
<tr>
<th>Total loans, $ billion</th>
<th>44</th>
</tr>
</thead>
<tbody>
<tr>
<td>As % of GDP</td>
<td>35</td>
</tr>
<tr>
<td>Corporate loans (excluding SMEs), $ billion</td>
<td>20</td>
</tr>
<tr>
<td>Loans to SMEs, $ billion</td>
<td>15</td>
</tr>
<tr>
<td>As % of total loans</td>
<td>32</td>
</tr>
<tr>
<td>Retail loans, $ billion</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: NBK (2017b).

Non-performing loans (NPL) with a debt of more than 90 days in the banks’ portfolio for SME loans in 2016 went down to 8.8% (6.7% for total business loans). This decrease from 2015 was due to the fulfillment by commercial banks of the requirements of the National Bank of Kazakhstan (NBK), according to which the maximum level of NPL should be no more than 15% of the total loan portfolio in 2015 and no more than 10% in 2016.

Kazakhstan joined a Customs Union with the Russian Federation and Belarus in 2010 and later the Eurasian Economic Union in 2015. This led to an increase in competition in the domestic market for which most of the local SMEs were not ready. In addition, the sharp decline in oil prices in 2014 has led to an increased budget deficit and reduced state support for the private sector.

Summarizing, SME development in Kazakhstan is facing a number of significant challenges, including the following:

- The largest producers in the country have restrictively high standards for most of the manufacturing goods and services they consume and are mostly oriented to global markets.
- In many sectors, the SOEs are competing with the private companies and introducing distortions to the market economy.
- Financing of the SME sector is limited due to the inactivity of the banking sector.
- Economic integration brings more competition from Russian companies that are more established and have larger economies of scale.
- There is high dependence of local economic activity on global oil prices.

¹ Decree of the President of the Republic of Kazakhstan N925 from 17 February 2010.
Thus, over the past 27 years in Kazakhstan, development of the SME sector has faced numerous challenges, including the lack of access to bank lending, devaluation, increased competition from foreign companies and products due to the opening of the domestic market, the concentration of resources in the hands of the state, and the ultimate dependence of business activities on oil prices.

1.2 Role of SMEs in Economy by Sector

**Definition of SME in Kazakhstan.** According to Article 24 of the Entrepreneurial Code of the Republic of Kazakhstan (hereinafter, the Entrepreneurial Code), depending on the average number of employees and average annual income, business entities are divided into small enterprises, including micro-businesses; medium-sized enterprises; and large enterprises (Code of the Republic of Kazakhstan (2015). These categories are used for the purposes of state statistics, state support, and the application of other laws.

In terms of state statistics, only the criterion of average number of employees is used. The average annual number of employees of business entities is determined by taking into account all employees, including employees of branches, representative offices, and other separate divisions of the subject, as well as the individual entrepreneur.

With reference to state support, two criteria are used to define the size of the firm: average number of employees and average annual income. The average annual income is the sum of the total annual income for the last three years, divided by three. This also applies to business entities that, in accordance with the tax legislation of Kazakhstan, apply a special tax regime based on a patent or a simplified declaration. It is important to note that state support programs for private entrepreneurs may provide other criteria.

Small enterprises include individual entrepreneurs without a legal entity and legal entities with an average of no more than one hundred employees and an average annual income of no more than three hundred thousand times a monthly calculated indicator (MCI).

A micro-business is defined as a small enterprise with an average of not more than fifteen employees or an average annual income of not more than 30,000 MCI.

<table>
<thead>
<tr>
<th>Table 2: The Official Criteria for Defining the Size of an Enterprise in 2018</th>
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<tbody>
<tr>
<td>Kazakhstan: national statistical definition of SME</td>
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<tr>
<td>Number of employees</td>
</tr>
<tr>
<td>---------------------</td>
</tr>
<tr>
<td>&lt;15</td>
</tr>
</tbody>
</table>

Kazakhstan: for state support purposes

<table>
<thead>
<tr>
<th>Number of employees</th>
<th>Micro</th>
<th>Small</th>
<th>Medium-Sized</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;15</td>
<td>&lt;100</td>
<td>100–250</td>
<td>&gt;250</td>
<td></td>
</tr>
<tr>
<td>Annual turnover in $ million*</td>
<td>&lt;0.21</td>
<td>&lt;2.14</td>
<td>2.15–21.5</td>
<td>&gt;21.5</td>
</tr>
</tbody>
</table>

* Average USD/KZT rate for 2018 is 344.71 tenge = $1.

**SME Statistics.** Data on SMEs are produced by the Statistics Committee of the Ministry of National Economy of Kazakhstan. The data on the number of enterprises is collected using the Business Register, which is based on the databases operated by the Ministry of Justice and the State Revenue (Tax) Department of the Ministry of Finance. In December 2013, the criteria for defining the size of a firm changed. According to the new methodology, the number of employees became the sole defining indicator of the size of the enterprise for statistical purposes. In addition, starting from 2014, the number of employees in small enterprises increased from 50 to 100 people (Code of the Republic of Kazakhstan (2015). As a result, statistical data on SMEs in Kazakhstan before and after 2014 became largely incomparable.

### 1.3 The Current State of the SME Sector in Kazakhstan

There are 12 SMEs per 1,000 citizens in Kazakhstan. This number is comparable to the Russian Federation. However, developed countries on average have 30 SME per 1,000 citizens.

The role of the SME sector in the economy of Kazakhstan is relatively small. SMEs contributed 26% of GDP in 2017. This percentage is relatively low, especially when compared to OECD countries, where SMEs contribute more than half of the country's GDP. In 2016, SMEs made up 96% of all enterprises registered in Kazakhstan. The SME sector employs over 3 million people, or a third of the total workforce.

In 2017, there were over 383,000 registered enterprises in total, of which only a third—133,000 enterprises—were actively doing business (reported production or sales in their statistical reports) (Statistics Committee of MNE RK 2018). This is mostly relevant to small enterprises, as in most cases they prefer to put business operations on hold than shut down the company, in order not to have a mandatory tax audit conducted by the State Revenue Department.

The distribution of enterprises by size is skewed toward small enterprises, which comprise 94% of all enterprises with active status. Medium-sized enterprises account for 4% and large enterprises for the remaining 2%.

<table>
<thead>
<tr>
<th>Table 3: Number of Firms by their Status and Size in 2016</th>
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<tbody>
<tr>
<td><strong>Total Registered</strong></td>
</tr>
<tr>
<td>Large enterprises</td>
</tr>
<tr>
<td>Medium-sized enterprises</td>
</tr>
<tr>
<td>Small enterprises</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>


Labor productivity in SMEs is 30% lower than the average level in the economy. In 2017, labor productivity in SMEs per employee amounted to $13,000. There are several factors

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2 Statistics Committee of the Ministry of National Economy of Kazakhstan. http://stat.gov.kz/faces/respondentsPage/respondentsStatForm2018?_adf.ctrl-state=x0zab5w8_4&lang=ru&_afrLoop=1179306199144259%40%3F_afrLoop%3D71179306199144259%26lang%3Dru%26_adf.ctrl-state%3De7fg309kt_174

3 Statistics Committee of the Ministry of National Economy of Kazakhstan. Main indicators of the number of legal entities, subjects of individual entrepreneurship, branches and branches of foreign legal entities in the Republic of Kazakhstan as of 1 January 2018.
that can explain this situation. Firstly, three-quarters of the total goods and services produced by SMEs originate from the services sector, which has low productivity and low incomes (Halyk Finance 2019). Secondly, average labor productivity numbers are affected by the high labor productivity in resource extraction sectors that are highly capital intensive. These sectors—including oil and gas and mining—generate 20% of GDP while employing only 2% of the working population. As a result, the productivity of almost 3 million self-employed people is about six times lower than that of those who are formally employed (OECD 2018b:133).

2. STATUS OF FINANCIAL INCLUSION FOR SMES

2.1 Credit

The Asian Development Bank (ADB) defines financial inclusion as “ready access for households and firms to reasonably priced financial services” (ADB 2015b:71). Banks remain the main source of funding for SMEs in Kazakhstan. At the same time, SMEs are the main borrowers from banks and account for over 80% of their business loans portfolio (EBRD 2017a). In part, this result is due to the fact that large businesses can attract cheaper funding than from local banks due to their ability to attract equity and debt financing in foreign and domestic markets.

Lending to SMEs in Kazakhstan has been growing since 2014. Over the past three years, the SME loan portfolio grew by 73.7%, while new lending to SMEs increased by 65.5% over the same period. In this regard, the share of loans to SMEs among the total volume of commercial loans reached 33.6%, and new loans grew by 25.7%. Interest rates for SMEs have steadily increased over the past two years from a record low of 11.5% in 2014. In 2016, they reached 14.0%, which is lower than that of large enterprises, which stood at 14.5% (OECD 2018a:148).

Although almost all SMEs have an account at a formal financial institution, the share of firms using bank loans remains relatively low. This applies to the share of firms using banks to finance investments (16%), firms using banks to finance working capital (13%), and firms with a bank loan or line of credit (20%) (OECD 2018a: 148). The main reasons for the low use of credit remain the restrictively high rates for loans and high requirements for collateral levels, usually in the form of real estate.4

The geographic outreach of the banking sector in Kazakhstan is also rather low: the country has a ratio of 130 bank branches per million inhabitants compared to 470 in Germany or 440 in Ukraine (OECD 2013a: 27). Few banks have an extended network of local branches, especially in regions like Akmola, Kyzylorda, and North-Kazakhstan, and most of them concentrate their operations in major cities. Transaction costs increase for SMEs as they have high commuting times to reach the nearest local bank branch.

According to the European Bank for Reconstruction and Development (EBRD), there is a pronounced direct correlation between the size of a company and its ability to access bank loans. As a result, SMEs, to which the overwhelming majority of companies belong in most emerging markets and in developed countries, are more likely to face a shortage of loans. Small enterprises in most cases do not have enough collateral for lenders; nor can they show the required level of transparency of their operations (EBRD 2017a).

The heads of virtually all banks surveyed in the Banking Environment and Performance Survey (BEPS) II expressed serious concerns about the solvency of SMEs that are

applying for loans. The survey also suggests that the banks’ own problems with financing, although important, are not the only explanation. The BEPS data also show that for companies that lack transparency, the probability of being confronted with credit restrictions is constantly much higher than for companies that are relatively transparent (EBRD 2017b).

2.2 Kinds of Financial Institution Involved

SMEs in Kazakhstan are highly dependent on the banking sector to meet their financing needs. However, an alternative source of finance that is becoming increasingly relevant in the country is microfinance. As of January 2019, 157 microfinance organizations (MFOs) were registered in Kazakhstan (NBK 2019a). They provided 226 billion tenge ($0.59 billion), of which loans for SMEs accounted for only 4 billion tenge ($10 million). One of the reasons for the remarkable growth in MFOs is that their regulations are not as tight as those for commercial banks. For example, licensing is not required for those MFOs that do not attract deposits from the population. The main clients of microfinance institutions in Kazakhstan are non-bankable micro- and small enterprises, as well as retail borrowers.

In February 2018, ADB signed a loan agreement with KMF, the largest local microfinance organization. Under the agreement, ADB will provide a loan of 72 billion tenge ($200 million) for SME funding in all regions of the country. The Government of Kazakhstan and its SME funding operator (Damu Fund) have guaranteed the loan. The loan was given under the Supporting Resilience of Micro, Small and Medium-Sized Enterprise Finance Project.5

Among non-banking sources of financing, leasing has the largest market and is growing steadily. In the six years since 2010, leasing and rental grew by 2.8 times. The factoring market is also developing dynamically: initially launched by independent factoring companies, it has entered the sphere of interest of commercial banks (OECD 2018a: 148).

There are 32 insurance companies registered in Kazakhstan, of which 22 are members of the state-owned Insurance Guarantee Fund. The assets of the insurance companies are relatively low, at 2% of GDP. The average insurance premium amount is $60 (NBK 2017b). According to the World Trade Organization (WTO) accession requirements for Kazakhstan, foreign insurance companies will be allowed to establish branches five years after accession—i.e., not before 2020.

The Kazakhstan Stock Exchange (KASE) has been operating since 1993. After the pension reform and the creation of private pension funds, KASE experienced rapid growth in trade volumes. However, following the government’s 2013 decision to consolidate all pension savings into a single state-owned fund, the number of listed companies dropped from 354 in 2010 to 142 in 2017. Currently, the main operations of KASE concern foreign exchange (52%) and repurchase agreement transactions (46%), whereas government and corporate securities remain negligible (1%). Stock market capitalization is at $47 billion and corporate bond market capitalization $24 billion. The NBK owns 50.1% of KASE shares.

SMEs and entrepreneurs need to have local access to finance, especially in the initial stages of their development, through equity finance, microfinance, and local financial institutions like credit cooperatives. These associations are also close to potential borrowers, have privileged information on their creditworthiness and operations, and can

benefit from informal social pressure to avoid moral hazard. Credit cooperatives and microcredit institutions are key local players able to provide funds to companies, and should have connections with local banks and institutions. Kazakhstan has credit cooperatives in selected sectors, such as agriculture, but they have limited financial impact compared to bank finance and government-supported programs.

From 2020, foreign banks will be allowed to establish branches in Kazakhstan. This was a WTO accession requirement for the country. This could increase the supply of financial products available for SMEs and foster competition in the local market. Overall, it is expected that the entrance of new banks will have a positive effect on financing of the SME sector, especially for SMEs that sell goods and services to other countries (EBRD 2017a).

2.3 Financial Technology for SME Funding

New forms of innovative finance, such as peer-to-peer lending and crowd-sourced equity funding, can increase the financing options available to SMEs. These lending instruments are not currently available in Kazakhstan, as there is no legislative base in place. However, a number of countries have already successfully utilized this tool for SME financing, while their governments continue to stimulate crowdfunding activities, mainly through changes to financial regulation.

3. FINANCIAL KNOWLEDGE AND SKILLS OF SME ENTREPRENEURS

3.1 Assessments of Financial Literacy

Financial literacy is a crucial factor in ensuring access to finance. Financial literacy is the ability of individuals to make informed judgments about financial products and behavior and to take part in financial decisions. Financial literacy helps improve access to finance through a better understanding of financial products. Low financial literacy is a significant obstacle for SMEs to access funding, as they are usually considered high-risk borrowers due to their poor financial reporting and weak management skills. There is no official financial literacy assessment available in Kazakhstan.

SMEs’ financial literacy implies the ability to translate knowledge and skills into the business. There are several qualities of financial literacy for SMEs:

- An adequate level of personal entrepreneurial competencies, personal finance skills, and business management skills.
- An appropriate level of understanding of functional financial management systems.
- An appropriate level of understanding of SME lifecycle funding and other financial service requirements.
- An understanding of legal, regulatory, and tax issues as they relate to financial matters.
- An understanding of the range of legal recourses when necessary—namely, in case of bankruptcy or other situations of financial distress.
3.2 Financial Education Strategy

In Kazakhstan, there has never been a comprehensive national financial strategy; neither is there a strategy that focuses on the financial literacy of SME and entrepreneurs. SMEs' financial education has been conducted mainly by financial institutions (banks, insurance companies, etc.). The Damu Fund provides free financial education for SMEs and its courses are mandatory for all of its borrowers. EBRD has been delivering trainings on how to run small business and mentoring opportunities as part of its Women in Business program. Of course, these initiatives are not addressing the problem in full, and the coverage of these programs is limited.

4. BARRIERS TO SME FINANCE

4.1 Supply Side

In 2011–2014, SME credit rates were on average by one percentage point higher than on corporate loans. In 2015–2016, amid state support, the reverse process occurred: interest rates for SMEs were almost two percentage points below corporate ones, though, given the lack of growth in new lending, the lower level of interest rates apparently did not play a significant role in expanding lending to SMEs. At the end of 2017, interest rates on corporate loans and SME loans leveled and stood at about 14%. The real interest rate adjusted for inflation has averaged 6% since 2010.

There are two key reasons for high market interest rates: relatively high inflation and, consequently, higher rates for attracting money (deposits, bonds, etc.); and a relatively high credit risk among borrowers (legal entities and individuals). With high inflation, depositors and creditors are not interested in placing their money on deposit and into bank bonds if they do not offer interest rates higher than inflation. In turn, banks as financial intermediaries will not be able to put the credit rates below the cost of attracting deposits.

Another factor is that SMEs usually have limited collateral to secure the loan, or no collateral at all in the case of newly established business. Due to increased requirements for loan provisions in Kazakhstan, local banks have higher collateral requirements for SMEs, especially for newly established businesses.

In addition, the high concentration of the banking sector, with the largest bank (Halyk Bank) representing half of total assets, does not encourage competition among banks and with SOEs.

The poor outreach of the banking sector remains a constraint, especially for SMEs, which generally report more difficulty than large companies in obtaining loans from banks. Banks prefer larger commercial clients, which are generally more profitable and can offer more guarantees.

In addition, after the financial crisis of 2008, there was a period of high level of defaults on loans in Kazakhstan. As a result, to receive income from their activities, banks were forced to charge a higher interest margin due to the system credit risk of domestic borrowers. This led to much higher interest rates on bank loans compared with developed countries. That is why the interest rates on bank loans over the past 15 years have not been significantly below current levels, even in periods of favorable economic conditions in Kazakhstan and rapid growth of loan portfolios of banks (2006–2007).
There is an issue of information asymmetry when it comes to lending operations for SMEs. A credit registry could potentially help overcome this issue. In Kazakhstan, there is a credit registry for the credit history of firms called The Strongest, and 14% of SMEs have an active credit history. Currently there are only eight companies that have obtained The Strongest certificate. However, SMEs are not forced to have their reports audited: there is no such requirement by law and no additional incentives, such as through participation in public procurement.

For farmers, there are several barriers to face when looking to access financing from commercial banks:

- Rural farmers and SMEs face long commuting times to reach their nearest bank branch, and multiple trips to gather information, sign forms, and go through the general loan approval process. The insufficient network of regional and local centers such as extension centers or local financial agencies also hinders the transfer of information and competencies regarding financial instruments and offers.

- High transaction costs also impact banks, which face increased marketing and sales costs in order to reach target clients. As a result, many banks choose to focus their limited resources on cities and on larger firms that require bigger loans. High transaction costs disproportionately impact the financing decisions of SMEs and individual farmers in comparison with larger firms.

- Agribusiness is an activity with a strong risk exposure: production outputs are highly variable because of weather conditions, seasonal fluctuations, and volatile commodity prices. Investment level is consequently undermined by risk default: deliquescent loans are significantly higher in agribusiness than in other sectors.

- The low return on investment (ROI) in the agribusiness sector means that private banks do not see the sector as attractive relative to other industrial sectors in the economy. The structurally low agribusiness ROI is further worsened by the low productivity of agriculture in Kazakhstan. Agribusinesses are plagued by low absolute productivity and low productivity growth rates. Use of seeds and fertilizers is insufficient and agricultural machinery is outdated.

As a result of all these factors, banks compensate for the risk linked to the variability of production with high nominal interest rates for lending or high collateral.

The EBRD indicates that in Kazakhstan there is a relatively high proportion of companies facing credit constraints. In 2013–2014, this figure reached 76%—that is, double the figure in 2005 (38%). The following categories of enterprises are more often confronted with credit restrictions: small enterprises, companies that are not exporters, and companies whose financial statements are not audited by auditors (EBRD 2017a).

The results of the Business Environment and Enterprise Performance Survey (BEEPS) show that a significant proportion of companies complain about cumbersome loan procedures and strict requirements for collateral. These problems are mostly caused by the increased requirements for reporting and the provision level on loans. The regulator introduced these requirements after the financial crisis of 2008 in order to minimize new NPL accumulation. As a result, banks require high collateral coverage in the form of real

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7 http://www.thestrongest.kz/ru/strongest-companies/.
8 Companies facing credit restrictions are companies that need additional borrowing, but have either been rejected when applying for bank loans or who dare not apply for such loans.
estate or equipment, especially from SMEs, which usually lack audited financial statements (EBRD 2017b).

Based on observational data, the EBRD makes the assumption that the effective establishment of relations between companies and banks in many transition countries is still hampered not only by changes in banking systems, but also by structural factors (EBRD 2017a).

Last but not the least is the lack of incentives for the banks to lend to SMEs. Currently, banks are caught up in a situation where they have enough liquidity but the post-financial crisis regulation is much tighter when it comes to provision. For banks, it has become prohibitively expensive to work with SMEs. There are administrative costs for banks to maintain the regional network and assess the risks of each possible client. In addition, there is a trade-off between providing loans to SMEs to get slightly higher returns with higher risks, and market operations with the central bank, with stable returns on the base interest, which does not increase the NPL level. There is low appetite for risk from the banks when it comes to lending to SMEs. As a result, there is little competition for SME loans, and instead banks compete for consumer loans and credit cards. When asked about the reason for the low level of lending for SMEs, banks usually argue that they do not make ‘good enough’ clients, meaning companies with collateral or audited reports.

4.2 Demand Side

The overarching issue with the demand side of SME financing in Kazakhstan has several dimensions.

Firstly, there is very small number of medium-sized enterprises in general. Most of the medium-sized companies are state-related or highly dependent on state regulation. Current tax policy favors small enterprises and does not stimulate the consolidation of business. This, in turn, leads to a lack of credit history and audited reporting among potential local business borrowers. Without such incentives, SMEs are not interested in providing more information for the credit registry, especially if they have no immediate need to attract external funding. There is a problem with SMEs’ intention to register, and how many SMEs see bank loans as a preferential funding source.

4.3 Institutional Aspects

Access to finance is not the most important barrier for firms in Kazakhstan. Only about 10% of firms have reported it to be their major problem. More firms have reported that corruption, informal sector practices, workforce quality, and tax rates play a more significant role (World Bank 2017).

The business climate in Kazakhstan in general is relatively favorable for SME development. The country has achieved a steady improvement in its overall regulatory environment for business over the last decade. In 2018, Kazakhstan ranked 28th in the world in the World Bank’s Ease of Doing Business Index. The current ranking is a significant improvement from 58th place in 2011, and is higher than the Russian Federation, which ranked 31st in 2018.9

The growth of SME lending is limited due to the weak credibility of SME reporting, as SMEs are not required to report in accordance with International Financial Reporting Standards.

In addition, the state remains dominant in many sectors of the economy in Kazakhstan despite the extensive privatization conducted in the 1990s. The 100% state-owned welfare fund Samruk-Kazyna controls a large share of the economy through its holdings in enterprises such as KazakhTelecom (telecommunications) and KazMunaiGaz (the national oil and gas company). Samruk-Kazyna is estimated to hold stakes equivalent to 60% of the country’s GDP (UNECE 2012: 3).

4.4 Gender Issues

In Kazakhstan, gender barriers are mostly relevant to the rural population, where women lack access to financial services due to the fact that they do not have regular employment, pension accounts, bank accounts, credit history, financial education, and business knowledge and skills. There are no legal barriers for female entrepreneurs starting or running a business. On the other hand, there is no national state program to support women-led businesses.

5. STATUS OF DOMESTIC AND GLOBAL VALUE CHAINS IN KAZAKHSTAN

5.1 Definition of the GVC

The global value chain (GVC) refers to the full range of cross-border, value-added business activities that are required to bring a product or service from conception, design, sourcing raw materials, and intermediate inputs stages to production, marketing, distribution, and supplying the final consumer (ESCAP 2007).

The value chain concept has evolved with trade and has become more complex as goods and services have become more sophisticated. According to the United Nations Conference on Trade and Development (UNCTAD 2013), 80% of world trade now involves GVCs. This is largely attributed to the increased import content of exports, which increased from 20% in 1990 to 40% in 2010, and is set to reach 60% by 2030.

There are four basic types of GVC:

1. International supply markets, where transactions are made based on arm’s length relationships between buyers and sellers across borders, requiring minimal coordination and cooperation (e.g., commodity markets).

2. Producer-driven networks, where the lead firm (such as an automobile or consumer electric appliance assembler) plays a central role in exercising control over the international network of subsidiaries, affiliates, and suppliers.

3. Buyer-driven networks, where large retailers, marketers, and brand manufacturers (such as Levi’s in the apparel industry and Walmart as a multinational retailer) source from the decentralized network of suppliers across borders.

4. Integrated firms, where hierarchical governance systems are implemented throughout the international networks, and which produce all major goods and products in-house, characterized by vertical integration and strong managerial control. This type has become rare these days, but can still be found, for example, in the American automobile industry (ADB 2015).
5.1.1 Belt and Road Initiative and GVCs in Kazakhstan

The Belt and Road Initiative (BRI) launched by the leadership of the People’s Republic of China in 2013 can become an important factor in promoting GVCs in Kazakhstan. Currently, over 80 countries are taking part in the initiative with the broader aim of enhancing policy coordination, connectivity, trade, financial integration, and people to people contacts, and so forging greater international economic integration.

In 2015, the PRC announced the transfer of 51 industrial production sites from the PRC to Kazakhstan. As of 2017, 12 sites, mainly from the processing industry, had been transferred. In addition, five agreements had been signed aimed at creating cluster cooperation zones in transport infrastructure, trade, processing industries, construction, agriculture, and other areas (Vakulchuk and Overland 2019). However, so far most of the progress has been seen in one sector, transport infrastructure, with agriculture being the sector with the highest potential for development.

In May 2016, Gulmira Isayeva, Kazakhstan’s deputy agriculture minister, announced that Chinese companies were in talks to invest $1.9 billion in 19 agricultural projects as part of the BRI, though the announcement emphasized that Chinese companies would not be allowed to own Kazakh land. More recently, on 11 July 2017, Kazakhstan and the PRC signed seven agreements worth a total of $160 million at the Kazakh-Chinese Agriculture Investment Forum in Astana (Bizhanova 2018).

The main question with the BRI projects in Kazakhstan remains how the large-scale BRI project will influence the development of SMEs and to what extent local SMEs will be involved in the BRI projects. There is a global practice when Chinese companies implement Chinese-funded projects with non-existent local content and knowledge transfer—for example, the $1.5 billion project for the construction of the light rail transport system in Astana that is being implemented by the Chinese construction company. State policy should address this issue and find means to use BRI projects to promote SME development and to increase the participation of SMEs in global value chains related to BRI.

BRI projects aimed at infrastructure development also contribute to better connectivity between Kazakhstan and the PRC, as well as among Central Asian countries. This can create an opportunity for international development organizations to provide support for SMEs’ participation in BRI projects and GVCs. Coupling these hard investments with soft investment in trade facilitation, policy regulation, and better information flow could contribute to SMEs’ participation in global and regional value chains.

5.2 SME Participation in Value Chains in Kazakhstan

SMEs in Kazakhstan are mostly focused on the domestic market. As a result, they are heavily dependent on the local economy and the income of the local population. Large companies consume high-technological services and goods that are mostly imported. The number of medium-sized enterprises is relatively small. Hence, SMEs mostly focus on public procurement and retail sales. Limited access to financing does not allow SMEs to invest in technological development in order to become a supplier for large companies and to compete in other countries’ markets.

The participation of SMEs in international trade operations is rather one-sided: imports are widely developed, but exports are poorly represented. SME exports account for about one-fifth of total exports ($6 billion in 2016) and are highly dependent on the volume of total exports. SMEs act as intermediaries in the commodity trade; hence SME exports are mainly concentrated in oil and grain production regions. SME exports
therefore reflect the overall specialization of the economy in commodities. At the same time, SMEs account for more than 60% of the import of goods. However, SMEs mostly import finished goods for domestic consumption, and few intermediate goods for further production and export of finished products.

The fragmentation of global supply chains is an opportunity for SMEs to unite in the supply chains of large firms and thus capture positive flows from the transfer of technology, skills, and know-how. For local companies, one opportunity would be to link into global supply chains that target the neighboring markets of the Russian Federation and the PRC, not only in terms of logistics and the supply of raw materials, but also in creating an export-oriented production base in Kazakhstan.

However, in developing countries, the development of such ties can take a long time due to market inefficiencies. These include the fact that local SMEs require more technological upgrades to meet the needs of foreign partners, local SMEs may not be of the appropriate size or be able to work properly on the network, and they may not have information about the available opportunities. In these cases, it is possible for the government to intervene and support the simplification of business relationships between existing value chains and SMEs.

In general, clusters and supply chains are not highly developed in Kazakhstan, so the key questions relate to which sectors/clusters are important and how something new can be developed—for example, new clusters or supply chain organizations.

ADB’s research on SMEs in Kazakhstan conducted in 2015 revealed the following obstacles for SMEs on the way to becoming part of a GVC (ADB 2015: 47):

- Firms in Kazakhstan felt strongly disadvantaged about their capacity to meet international product or quality standards.
- Firms have faced difficulties in the business environment.
- Primary and services sectors, importers, and micro-firms have had trouble finding skilled workers and professionals. The manufacturing sector seems to have had fewer issues with skilled labor.
- The primary and services sectors, again, felt that the institutional support they received was weak. Importers and those without trade seemed to have the same feeling toward inadequate institutional support.
- It is not surprising that micro-firms had less capability to deal with international product and quality standards and nontariff barriers.
- Younger firms felt there were many disadvantages in their business sector (or toward their own capability perhaps, due to a lack of confidence as newcomers to the market).

5.3 Agricultural Supply Chain

5.3.1 Current Situation: Products Actually Involved

Kazakhstan’s agricultural supply chain is underdeveloped, and so are agriculture and farming. Farmers sometimes directly transport their produce to open markets (bazaars) where consumers buy directly from them. In other cases, farmers sell their produce to retailers. Agricultural farms produce the raw material base: dairy products, grains, vegetables, fruits, etc. that need further processing are transported to processing plants that make various kinds of finished products from the basic raw materials. Wholesalers or middlemen take care of the logistics operations, like packaging, distribution,
transportation, and delivery to retailers and consumers (Rana 2014: 93). There are some peculiarities that characterize the functioning of food supply chains in Kazakhstan. Buyers provide inputs and assistance to farms, including investment assistance, trade credit, bank loan guarantees, and management advisory services. At the same time, FDI has brought about food retail chains and the internationalization of agribusiness markets. Agribusiness in Kazakhstan is influenced by three main forces:

1. An emergence of vertical integration financed by the private sector.
2. A massive extension of state financing loans to agriculture-related projects.
3. The emergence of a modern food retail sector in metropolitan areas.

These forces will lay the path for agribusiness from most fragmented to modern industrial facilities. This can happen when producers, processors, and retailers develop and implement a system to coordinate the production and supply of farm products, their processing, and distribution, with demand signals along the supply chain (Rana 2014: 94).

5.3.2 Prospects for Development: Products Potentially Involved

Kazakhstan’s agricultural sector contributes significantly to its economy, though its role is dwarfed by the size of the oil exports. The country is the fifteenth largest producer of wheat in the world, growing more than 11 million metric tons annually. Wheat is Kazakhstan’s largest export commodity and accounts for 55% of total agrifood exports. About 30% of the labor force is employed in the agricultural sector, which contributes about 5% to its GDP (Statistics Committee of MNE RK 2019).

Figure 1: Structure of Exports of Kazakhstan in 2017

Kazakhstan’s agricultural sector comprises grain, vegetables, dairy, poultry, fodder, and livestock. Kazakhstan is among the top-ten largest grain producers in the world, including high quality wheat with rich protein content. Almost half of the agricultural output pertains to livestock-related activities. Traditionally, farmers raise sheep, cattle, and horses. Pigs and camel herding are also developed in some parts.

The meat industry accounts for nearly 30% of all food products in Kazakhstan. Nevertheless, local meat production does not cover its consumption: the shortage of meat is covered by imports, including imports of beef, pork, and poultry.

There is also a milk shortage in the country. Milk consumption varies greatly by region. For example, the average per capita consumption of milk in the South Kazakhstan oblast is less than 200 kg compared to an average of 260 kg. A large proportion of dairy products are imported. Also, local dairy products are not competitive in price. As a result, the local market is full of imported goods, especially food products like cheese and butter. The main problem is a shortage of indigenous quality raw materials. There is a need for significant investment in local dairy farms. For example, one of the largest producers of dairy products in the country, FoodMaster (part of the French Lactalis group), controls the entire supply chain of dairy products from milk to the distribution of final products. It has two dairy farms (in Almaty and Pavlodar oblasts) and three processing plants (in Issyk, Shymkent, and Pavlodar), which process products including milk, kefir, sour cream, yoghurts, cheeses, and ice creams. The company’s products are being exported to the Russian Federation and Central Asian countries. The positive impact of such a supply chain on local SMEs is the transfer of know-how, building up local expertise, and quality control standards.

The food processing industry is not developed and is inadequate to meet the demand for processed food products. Most imported products are processed food, and exports are predominantly unprocessed staple commodities. The food processing industry has special support from government and international financing organizations. The major segments of the food processing industry include soft drinks, flour and cereals, plant and animal oil production, meat processing, dairy, and fruit and vegetable processing. The Ust-Kamenogorsk Poultry Factory, located in North East Kazakhstan, is a vertical integrated broiler factory that markets and distributes frozen and cooled chicken, chicken sausages, and smoked chicken. It accounts for almost 50% of chicken produced in Kazakhstan. However, the share of imports in local consumption of poultry remains high.

Kazakhstan is self-sufficient in vegetables in general; however, there is a shortage in fruits production due to harsh climate conditions in most of the country. Therefore, the state now encourages the construction of greenhouses. The number of greenhouses in Kazakhstan is steadily increasing, but the needs are far from being covered. In addition, some of the high-quality fruits and vegetables from greenhouses are exported to other countries, primarily to the Russian Federation.

Kazakhstan can develop its own local production of fruits and vegetables, but that will require a large amount of direct subsidies from the state, which will be difficult once the WTO rules on agricultural subsidies come into power in 2020. Nevertheless, the Central Asian countries with a milder climate can become a source for cheaper fruits and vegetables, and other products that do not grow in Kazakhstan due to the climatic conditions. Processing these goods and making high added value products from them (such as jam, frozen fruits, juices, etc.) can be a more productive way of subsidizing the agricultural sector and will help to increase labor productivity in the agricultural sector. Currently, food processing and food retailing in Kazakhstan contribute to more than 12% of GDP (OECD 2013b: 19).
6. VALUE CHAIN FINANCING ANALYSIS

A lack of access to finance for agribusiness firms is one of the main impediments to improving the sector's competitiveness. Agribusinesses continue to face hurdles in accessing credit, these being similar to the challenges faced by other companies. This reduces their capacity to invest in working capital and fixed assets such as fertilizers and machinery, thus further dampening the sector's productivity. Moreover, the low return on investment of agribusiness compared to that of other sectors, especially extractive industries, adds another layer of difficulty for agribusiness firms' access to financing in an already challenging credit environment.

Access to finance in Kazakhstan is largely driven by the role of non-banking financial SOEs in many sectors. SOEs (such as Damu and KazAgro) are mostly financed from the government budget; they deliver credit programs through which they provide direct loans to companies and subsidize interest rates. In addition, both SOEs and private companies benefit from selected government subsidies and credit programs. The influence of SOEs and public lending is central in Kazakhstan and calls for the highest transparency and efficiency of existing public funds.

Currently commercial banks, KazAgro, and rural credit cooperatives are the main sources of agribusiness financing. Despite a moderate share of loans, microcredit financial institutions in Kazakhstan are key complementary players in providing microfinance and capacity to small farms not reached by other sources.

KazAgro aims to implement the government's policy of supporting development of the agro-industrial sector. KazAgro's market dominance has compensated for the lack of credit. KazAgro is a central finance provider in agribusiness that sustains credit supply in the agri-financing system, as banks are reluctant to increase their lending to the sector.

The KazAgro holding is the main agricultural SOE, composed of seven subsidiary companies in which it has close to 100% equity:

- KazAgroFinance
- Agrarian Credit Corporation (ACC)
- KazAgroGarant
- Food Contract Corporation (FCC)
- Financial Support Fund
- KazAgroProduct
- KazAgroMarketing

Five of these companies provide direct finance to agribusiness companies: KazAgroFinance, ACC, KazAgroGarant, FCC, and the Financial Support Fund. KazAgroFinance leases equipment and machinery to agribusiness companies and finances direct credit for working capital. KazAgroGarant issues concessional loans, as well as credit guarantees. In addition to purchases and interventions in the grain market, FCC has developed lending activities for grain and cotton producers. The Financial Support Fund provides credit to rural micro-producers, including seasonal loans.
7. POLICIES TO PROMOTE SME FINANCE IN KAZAKHSTAN

The state has been playing an important role in providing SMEs access to lending by placing funds in commercial banks, which, in turn, provide preferential loans to enterprises during periods of a lack of liquidity in the market. The largest allocation of state funds for SME lending occurred in 2009, when the interest rate for SMEs was limited to 11.5%. In 2014–15, interest rates for manufacturing SMEs were limited to 6%. As a result of these measures, an unusual situation arose in the market, when in 2009, 2015, and 2016 the interest rates for SMEs were lower than the total average interest rates of business loans.

Since 2010, the government has provided soft lending, subsidizing interest rates and loan guarantees for SMEs as part of the Business Roadmap 2020 program and as part of the Damu Entrepreneurship Development Fund. Loan guarantees—a new financial instrument in Kazakhstan—have increased from three guarantees in 2010 to 2,600 at the beginning of 2017 (OECD 2018: 148).

Currently, direct state support of SMEs in Kazakhstan is fairly modest in size. For example, Damu Fund has supported around 5% of the total number of existing SMEs. The government plans to consolidate budget expenses in the near future and even cut them in relative terms. The reason for this is that government support for SMEs in Kazakhstan has been driven by two main factors: the need to support the emergence of new small firms and support for the SME sector after the banking sector crisis in 2008. Government SME state support strategies are pursuing several goals: maintaining current levels of employment, and increasing productivity and competitiveness.

In order to support SME development, the government has been subsidizing part of the interest rate for SME loans with a rate of not higher than 19%. Damu Fund was created to serve as an operator for state programs in the field of entrepreneurship development. Damu Fund has a market share of 8% of all loans for business purposes, up from 5% in 2014. Damu’s SME support program does not cover trade and construction, which accounted for half of all loans to businesses. Hence Damu Fund’s share increases to 16%, which shows the increasing importance of state support in SME sector development.

The state program for productive employment and mass entrepreneurship has provided microcredits since 2015: on average, the total annual funding budget is from T10 billion to T30 billion. Interest rates on microloans on average equal the inflation rate, and loans are usually provided for between five and seven years.

Government support for SMEs is carried out through various development programs. As a response to the crisis of 2008–2009, the state program Business Roadmap 2020 was developed. This program is being implemented in four areas: supporting new business initiatives; improving the business sector; curtailing entrepreneurs’ currency risks; and increasing entrepreneurial capacity. The period of the program covers 2010–2020. In 2017, expenses for implementation of the program were around T17.4 billion, which was significantly below what it was in 2016 (T56.6 billion). In the current and following year, costs are not expected to exceed T9 billion as provided by the program; currently, as the end of the program is approaching, its extension is being discussed. It is hard to say what is the cause of the reduction in spending on this program. It is possible that the regions will seek funding sources themselves, and
development institutions will attract funds on the open market or through budgetary loans.

ADB has been actively involved in government efforts for SME development. In particular, in 2011, ADB provided a $500 million loan to Damu Fund under Kazakhstan government guarantees. The loan was disbursed in three tranches (2011, 2014, and 2015), and the financing of SMEs has not had industry restrictions. The loan funding was used to finance 2,000 projects worth 210 billion tenge.

Government policy instruments to foster SME access to finance include the following (OECD 2018a: 81):

- Government loan guarantees
- Special guarantees and loans for start-ups
- Subsidized interest rates
- SME banks

The gender issues in SMEs' development has been addressed by several initiatives, among which the EBRD’s Women in Business program can be mentioned as one of the successful. This program was launched in 2015; since then, more than 20,000 loans have been disbursed to SMEs headed by women for a total amount of 26 billion tenge. The Ministry of National Economy has been a partner of this program by providing guarantees for loans.\(^\text{11}\) ADB has also developed a Gender Action Plan for its lending partners in Kazakhstan, in which it has set the goal of increasing the volume of lending to woman-owned businesses and directing at least $50 million to finance woman-owned businesses.\(^\text{12}\)

### 7.1 SME Funding through Public and Private Equity Funds

The first public venture fund in Kazakhstan was created in 2004 and was called National Innovation Fund; later it became the National Agency on Technological Development (NATD), and is currently called QazTech Ventures, a 100% state-owned venture fund. In 2011–2018, NATD gave 316 innovative grants, amounting to 11.5 billion tenge ($30 million at 2019 exchange rate). The difficulty in developing venture funding using the public funds was the perception of giving public money for free, and defining who would be responsible for the success or failure of such an investment. When it comes to budget, there are a lot of controlling agencies that oversee the use of public funds.

Another equity management fund is Kazyna Capital Management (KCM), which invests as a limited partner in different equity funds in various sectors. Over the years, KCM has invested over $400 million in 12 funds. One of these funds is the Kazakhstan Growth Fund, a $80 million joint fund with the European Bank for Reconstruction and Development with a focus on investing in the manufacturing and services sectors. Another KCM portfolio fund is the $100 million Almex Baiterek Agriculture Equity Fund, which is partially publicly funded.

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Current main strategy documents of ADB operations in Kazakhstan offer the following guidance regarding SME funding through private equity funds:

- ADB’s Country Partnership Strategy (CPS) for Kazakhstan for 2017–2021, in its first pillar “Strengthening foundations for economic diversification”, states that “ADB will consider investing in equity funds [italics added] and private companies and offer continued support for trade finance to local banks, aiming to close market gaps and promote international trade activity of companies in Kazakhstan” (ADB 2017:9). So far no concrete steps have been taken in this direction.


There are some constraints related to equity fund operations in developing countries. One of the main constraints is the limitation of the local investment pool and the need to define the exit strategy.

8. CONCLUSIONS AND RECOMMENDATIONS

8.1 Recommendations to the Government of Kazakhstan

Based on the research conducted, a set of recommendations has been developed for the Government of Kazakhstan. Recommendations are mostly focused on the macro situation with SME development in the country:

1. Include in the SME support policy measures to stimulate SMEs to register with the credit register. Existing credit risk databases include a very limited number of SMEs and are effectively non-existent. The policy to promote credit risk databases can target SMEs of a certain size— for example, those over 50 employees. Being registered with the credit register could be a requirement for getting access to SME support tools—for example, participating in public procurement and having access to credit guarantees and loans with subsidized interest rates. Such measures can help SMEs to build their credit history and have access to finance in the long term.

2. In order to facilitate the promotion of export-oriented SMEs, the government can introduce incentives for SMEs to participate in GVCs. This can be done through providing long-term financing for SMEs with offtake agreements with global companies. Another tool could be subsidizing the interest on trade credits for such SMEs. The existing state fund KazakhExport, that aims at promoting non-mineral export, is mostly focused on working with medium-sized companies and does not currently provide flexible services to small enterprises.

3. The credit guarantee mechanism should be promoted further. Currently it is part of the 100% state-owned Damu Fund. Given the important role of this mechanism in promoting the development of SMEs and the possible decrease in public funding available for Damu Fund, it is recommended to spin off this activity into a separate entity, the Kazakhstan Credit Guarantee Fund (KCGF). Such an entity should actively engage with international donors and international financial institutions, and work on a commercial basis. Examples of

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such credit guarantee funds are the Credit Guarantee Fund¹⁴ in Turkey and the Credit Guarantee Fund Tajikistan.¹⁵ The goal of such a transformation should be to increase the share of private and international funds and to decrease the share of public funds. This will also lead to more transparent and effective operations of such funds.

4. One possible solution could be the ongoing privatization of small and medium-sized enterprises that can support the establishment of new SMEs. These new private businesses would have higher quality assets that they can use as collateral for securing bank loans.

5. Create favorable conditions for micro-business development. Design a separate state support policy for micro-businesses with fewer than five employees. Currently, the SME support policy targets a heterogeneous group of firms with employee numbers ranging from 1 to 100, and in some cases up to 250 people. State policy to support micro-business could include easy business registration and simple taxation, with the focus on easing tax administration and offering tax holidays for prioritized areas and regions (for example, rural areas).

6. Prioritize the development of medium-sized enterprises. This would be a major step toward creating a diversified complex economy. In order to promote the consolidation of fragmented small businesses, the tax regime for medium-sized enterprises should be changed to be more favorable than that of small enterprises. Medium-sized enterprises have more resources and expertise to become part of GVCs and to export their goods and services. Public procurement could be used as an additional incentive tool to promote the development of medium-sized enterprises. For example, thresholds (procurement lot size) for small enterprises can be introduced, above which only medium-sized and large enterprises can be considered as suppliers.

7. There is a need to develop a comprehensive national financial education strategy with a focus on SMEs’ needs. In order to do that, the government needs first to map all the main initiatives carried out by public and private stakeholders in the country (including the Damu Fund, banks, Atameken chamber, business incubators and accelerators, business programs at universities, and others). All of these stakeholders should be part of implementing the national strategy in order to increase the effectiveness of the program and to cover all target groups.

8. There is a great need for a general national financial education strategy that will cover the population. This strategy should also address the issue of financial education for SMEs and entrepreneurs. Push and pull factors should be combined when designing the national strategy. The government’s role should not be focused on providing free-of-charge training and the dissemination of educational information; rather, it should focus on organizing, stimulating, and coordinating society’s efforts to make financial sectors and their services more available to larger numbers of those who will use them responsibly. Working closely with the main stakeholders—financial institutions and NGOs—should be at the core of the new strategy to ensure buy-in from a wider range of population groups.

¹⁴ https://aecm.eu/kgf-credit-guarantee-fund/.
8.2 Recommendations to International Donors

In addition to recommendations for the government, there is a set of recommendations for international donor organizations working in Kazakhstan. These recommendations are mostly focused on fine-tuning the funding schemes for SME development in the country.

1. Launch a new program for local banks to finance trade loans for SMEs aimed at promoting regional trade. The improved connectivity due to BRI-related infrastructure development and the economic liberalization in Uzbekistan create an opportunity for regional trade development. ADB could become a main driving force behind the emerging boom in regional trade by funding trade operations for SMEs in Kazakhstan. Given the short time period of trade finance operations, ADB could see a significant impact from limited funding. Moreover, starting such a program could be a relatively quick operation, as most of the local banks have such trade facilitation services in place. The new program could target the SMEs that focus on the development of trade with Central Asian countries and BRI-related projects.

2. Start a private equity fund in Kazakhstan targeting export-oriented medium-sized companies. Kazakhstan could become the first country in Central Asia where ADB launches a private equity fund. ADB has extensive expertise in equity funding, including operations in developing countries. Kazakhstan has experience of creating a joint private equity fund between the EBRD and the Baiterek state fund. ADB could invest in a number of such private equity funds, each focused on a certain sector with significant export potential, such as agriculture, transport and logistics, manufacturing, and services. Private equity funds in Kazakhstan could become a starting point and a testing ground for the use of this financial instrument across the Central Asian region. There is more possibility of creating a competitive industry and competitive enterprises with international management, which will attract not only donor funds, but also public funds: that is why in my paper I suggest 10% from the managing partner, 20% from a donor organization, and the rest from public funds. In this way, the donor will have to choose an international fund manager, and the manager will choose the right company to invest in. ADB has experience of creating and investing in equity funds worldwide. ADB first invested in private equity funds (PEFs) in 1983, primarily to promote SMEs in developing countries. Between then and 31 December 2007, approved investments in PEFs totaled 75, with a combined value of $900 million.

3. Diversify the channels for SME funding through cooperation with microfinance organizations (widen the practice further) and private equity funds, and support the development of crowdfunding platforms and the crowd-sourced equity funding sector. Currently, SME funding is supported mostly through securing guarantees from the government and disbursing funds using the Damu Fund, which has a regional network and access to SMEs. This scheme ensures that funds are disbursed fully and in time. However, in the long run, it is advisable not to rely only on one channel to provide support for SMEs.

4. ADB could discover options to provide local banks with financing for trade loans for SMEs aimed at promoting regional trade. Another tool that international donors can support is insurance for exports operations for Kazakh companies through the existing state entity KazakhExport. The gradual opening and
liberalization of Uzbekistan creates a positive momentum for such regional trade facilitation schemes.

5. One possible solution is to focus on funding export-oriented SME companies that are already a part of, or can potentially become a part of, the GVC. In this case, the exit strategy would be to sell such a company to the larger global companies that are part of this GVC. Another approach for Kazakhstan is to focus on SMEs in Kazakhstan that can be part of the larger BRI projects targeting the Chinese market. Such companies could go public using the Astana International Financial Center that operates under the common law. Of course, equity funding would be focused on investing in more mature medium-sized firms with stable export operations. This would create an additional incentive for local companies to grow and consolidate operations in one legal entity instead of maintaining a number of small firms.
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