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Role of the JSC “Fund for the Development of
Entrepreneurship “Damu”
for diversification of small and medium business sector
development in the Republic of Kazakhstan

In the sectoral structure of gross value added a share of industrial sector was stable and high comprising 32.92 % during the last four years. This proves a potential role of industrial sector in ensuring economic diversification.

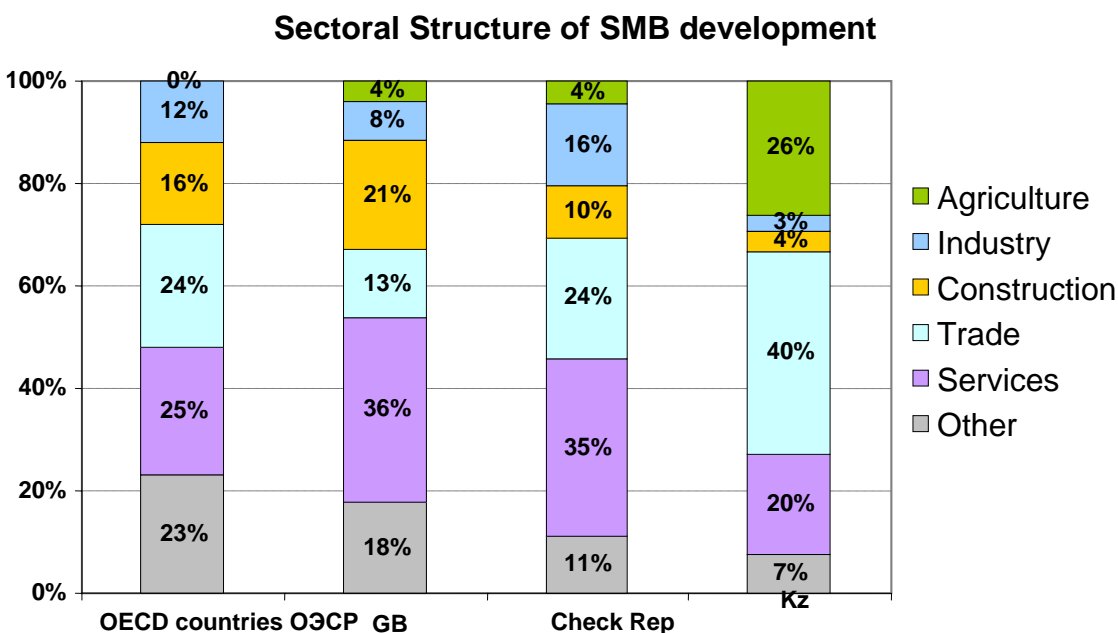
At the same time, a negative trend of drop down in the share of processing industry in the total volume of GDP. Thus, this amount in 2003, amounted to 14,2%, in 2005, a share of processing industry dropped down 12%, in 2006 - 11,6%. In total volume of industrial production a share of processing sector dropped down from 43,3% in 2003 to 36,6% in 2006.

The above dynamics is a result of an on-going intensive growth of mining sector and simultaneous slowing down of manufacturing sector growth.

The fact that the Government pursues a policy of divergence from the raw orientation, and economic diversification through the increase of the role manufacturing sector, including small and medium business raises concern

During the year of 2007, a sectoral structure of small and medium business has been having the following indicators: most part of SMB are engaged in trade – over 40%, in agribusiness – 26%. Low share of SMB is involved into manufacturing activities – 3% and construction – 4%.

Picture 1.



Share of SMB engaged in manufacturing sector of economy serves as an important indicator of qualitative development of small entrepreneurship.

Picture 1 show that only 3% of operating SMB are engaged in manufacturing activities, which is 4 times less compared with the similar indicators of developed countries.

This fact proves again that such a trend in SMB development does not facilitate in economic diversification. Manufacturing companies, and being more precise those of them that are engaged processing industry should play the most important role in diversification.

Another concern relates to the fact that within the last six years there is a trend of decline in a share of SMB engaged in manufacturing sector among an overall number of operational small business companies.

19184 operating SMB are engaged in industrial sector of economy which comprises 3 % of total number of SMB. Most part of them

17 932, or 93% are concentrated in processing sector, which means that most part of SMB are mostly engaged in processing activities. Out of all SMB, 57 %, or 10 246 companies are registered as legal entities, or small business companies and only 43% represent private persons.

Within the latest years a reduction in the number of operational small businesses in processing industry goes down, thus, the number of small companies in 2003 totaled 10 312, at the beginning of 2007 it dropped down 13,4% reaching 8 926. In practice, declining number of active small businesses is registered in all sectors of processing industry except for the metal processing and production of metal works. The highest decline rate is typical for SBE engaged in production of leather and leather goods and shoes manufacturing g– 55%, followed by food industry – 35,5%, textile and light industry – 34%, wood processing and manufacturing of wood articles – 20% , etc.

SBE occupy the least share in total number of operational SME (16%) among all other legal forms, including private entrepreneurs (PE) and farmers (F), although they ensure a maximum input into a gross domestic product of the country (10,5%) as compared with Individual Entrepreneurs (3,7%) and farmers (1,6%). They ensure over 60% of total production output in all sectors of economy. A positive role of SBE is proved in the industry where only 10 % of active SBE ensures 14% of output production share of SBE in all sectors. SBE plays a similar role in construction sector: 19% of active SBE ensures 27% of total production output share of all SBE, and SBE in transport and communication occupying only 6% of total number of all SBC in the sector ensures 8% of total production output of SBE in all sectors.

SBE operating in transport and communication sector considered as unattractive for commercial banks in terms of crediting. Relying on 6 % in sectoral break down in terms of the number of acting SMB, they obtained only 4% of all loans provided by commercial banks for SBE in sectoral split. While SBE in construction sector appeared unattractive for crediting by commercial banks. Occupying a share of 19% in terms of the number of active businesses in sectoral break down, they obtained only 26% of total amount of loans from commercial banks for construction sector. This was caused by rapidly increasing prices on real

estate property within the last years. SBE operating in trade sector occupies the highest share on this indicator. Falling under a share of 39% in sectoral break down they obtained 37% of all loans provided by commercial banks for SBE.

Multiplicative effect of 1% increase in the number of active SBE when resolving both social and economic objectives appeared to be the best; 1 % surplus of SBE within 2003-2007 has been ensured mostly by increase in the number of employed by 0,8%, while PE ensured 0,8% and F 0,31%, and surplus in the amount of product output by 6,5%, while PE comprised 3,8% and F - 0,65%.

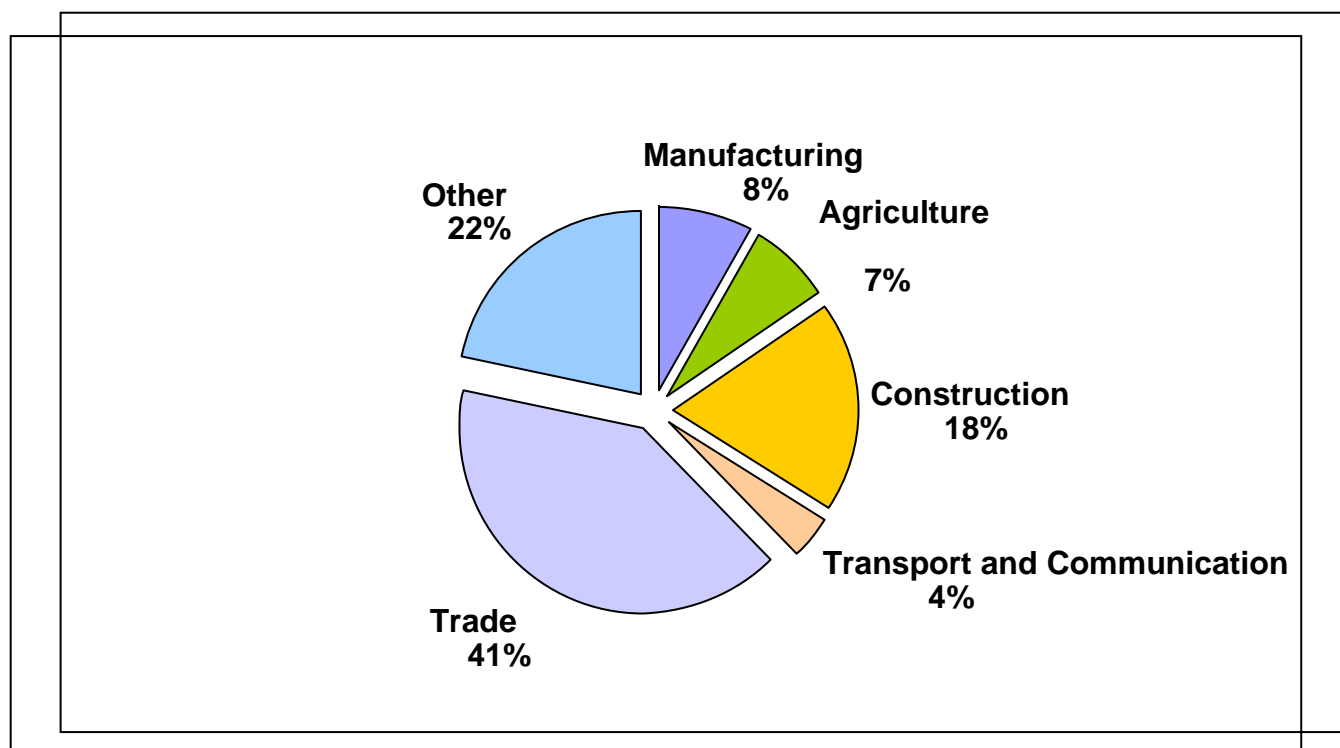
Unfortunately, SBE at present are mostly engaged in trade, occupying the highest share in the total number of active SBE (39%) and are least developed in terms of the number of SBE operating in manufacturing sector, their share in total number of active SBE amounts to 9,5%, and in SMB 1,5% only. With regard to the share of SMB in manufacturing sector, SBE occupies a leading position 53% ensuring 91% of total production output of SMB in this sector. With regard to the rates of the number of SBE growth within the given period of 2003-2007, SBE in manufacturing sector (8%) lag behind the similar indicators of SBE in other sectors, the same trend is typical for the rate of growth of credits from commercial banks for SBE in this sector (266%), which is almost the worst indicator among all industries. Multiplicative effect of 1% surplus in the number of active SBE in the manufacturing sector within the last five years proves that the surplus in the number of active SBE in this sector although at a lower extent but helps in positive resolution of some of the tasks including employment of population (1,3%), and economic task of increase in the volume of product output (14,7%).

Thus, the companies operating in the sector of small and medium business and having a high potential for expansion of domestic production, improvement of competitiveness of their products, and as a result enhancement of their role in diversification of economy include small businesses, operating in the form legal entities or small business companies, as well as medium businesses operating in priority sectors of processing industry, transport and communication.

Sectoral structure of credits from commercial banks for small businesses according to the results of 2007 shows that: up to 40% of credits provided for trade development; up to 21% - in construction sector; 8% - for agribusiness and 7% in manufacturing sector.

At that, a share of small businesses operating in agribusiness and manufacturing sectors drops down in the in the structure of sectoral distribution of credits resources by commercial banks.

Scheme 2.



Ratio of loans provided by commercial banks for small business against GDP in Kazakhstan comprises 8,8%, in the U.S. this indicator reaches 20%, in EC countries 30%, in Japan 35%.

Percentage interest rates of commercial banks for small business remain high and average 15-18%, interest rates on small loans average 22-29%.

Comparative analysis of loans provided by commercial banks for a period with a credit banking portfolio as of end of the period proves that a share of short-term credits intended for floating capital (for a period less than a year) in credit portfolio of commercial banks remains high

which means that less credits are intended for modernization of capital assets and expansion of production capacities.

Such trends in SMB development in processing sector require relevant correction measures from the Government, and targeted funding programs on support of SME in processing industry in particular.

The Fund was set up pursuant to the Government's Decree № 665 as of April 26, 1997 «On set up of a Fund of Small Entrepreneurship Development», as a non-bank financial organization in a form of closed joint stock company intended to stimulate promotion of economic growth of small businesses in the Republic of Kazakhstan and improve efficiency of allocated state funds intended for small business support.

Starting from September 2006 the Fund became a part of the group of companies managed by the JSC “Fund for Sustainable Development «Kazyna».

Since it started its operation, the Fund provided financing for more than 2878 small businesses projects of total value 33 299,9 mln. KZT, which is 2,2% of total value of credits given to SBE by commercial banks. .

Based on sectoral break down this funding have been distributed as follows: over 29% have been provided for industrial sector, 18% - for the development of micro financial sector, 10% - for transport and communication, 10% - agriculture, 6% - construction, 3% - trade and 24% - other sectors.

From the beginning of 2008, the Fund did not perform any activity relating to targeted credit of SMB due to transition to the system of SMB crediting through the Program of conditional placement of funds in commercial banks pursuant to decision made by a single shareholder.

However, as a result of impact of liquidity crunch in the U.S. followed by the global financial crisis, commercial banks in Kazakhstan also experienced a liquidity crisis, that resulted in sharp reduction of the volumes of loans for the economy in general and SBE in particular.

Increase of the Government finance support for SBE became an urgent issue.

In such conditions the Government did not leave these problems unattended. In particular, for stabilization of the state of SBE sector, it

allocated credit resources in the amount of 48,8 bln. KZT placed through the Fund on the Program of conditional placement in commercial banks to be provided for SBE.

The results of these trenches and mechanisms of SBE support through commercial banks appeared both positive and negative. Positive outcomes include:

- timely financial help for SBE in the age of expanding liquidity crisis of commercial banks
- Prevention of reduction in the share of credits for SBE from commercial banks.

Negative impact:

- The structure of entrepreneurs in sectoral break down remained unchanged. Trade sector remains dominating;
- Interest rate for final borrowers did not drop down (effective rate – 20,1%);
- Distribution of funds between the regions appeared uneven (54% of funds were concentrated in 4 regions 22% - Almaty, 14% - Karaganda, 8% - Eastern Kazakhstan region, 8% - Pavlodar);
- Low impact on expansion and modernization of capital assets of SBE. Most part of funds were provided for crediting of floating funds (67%) and investments (33%).

Thus, it revealed a need in correction of further state support of SBE.

To improve a quality of the content and sectoral structure of SBE to complement the other financial support programs for SBE of the Fund it was necessary to develop a focus targeted program implemented through a mechanism of targeted funding of those of the small and medium businesses (SMB), that possess a high potential for diversification in SBE.

With that in mind, “Damu” Fund developed a new program titled “Damu-Koldau” for direct funding for SBE.

Major objective of the Program is to assist in qualitative development of small and medium business and enhancement of the role of SBE in the process of economy diversification.

This goal is planned to be achieved by the Fund through the

following tasks:

- provision of financial support for active SBE engaged in priority sectors in accordance with the Strategy of industrial and innovative development of the country's economy;
- ensure reduction in cost of credit resources for active SBE engaged in priority sectors in accordance with the Strategy of industrial and innovative development of the country's economy;
- ensure expansion and modernization of capital assets as well as their technological revamp.

The following businesses fall under criteria for funding based on this Program:

Compulsory requirements to borrowers:

- Small or medium business company – legal entity in accordance with the RK legislation;
- A project must be a part of the group of projects aimed at set up of integral production system of competitive product gradually developing technological and economic chain of added values;
- Qualified personnel for realization of projects including managerial staff of a company;
- No debt liabilities on:
 - taxes and other mandatory payments to the budget;
 - on commercial banks and credit organizations loans involved into certain types of banking operations.

Preferential requirements for borrower:

- Export orientation or import replacement intended activity of manufactured products;

Interest rate for borrowers shall be established at the rate similar to refinancing rate set up by the National Bank of the RK.

Effective implementation of this program would have the following results:

1.Improvement of the quality of quantitative structure of SBE, which is a growth in the number of SBE in a form of legal entity as a result of transition of part of the SBE as a result of increase of the capital assets and number of employees;

2. Improved competitiveness and export orientation of goods produced by SBE;
3. Enhancement of the role of SBE in the process of diversification of Kazakhstan's economy;
4. Increase in the number of newly established and maintained jobs.

Thus, effective implementation of this Program as one of effective tools for improvement of the level of SMB development by providing affordable funding, ensure expansion of domestic production, improvement of competitiveness of SBE products and as a result enhancement of the role of SBE in the process of diversification of Kazakhstan's economy.