

Financial Support for the Development of the SME Sector in Kazakhstan

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Abstract

The purpose of this work is to investigate the significance of developing the nation's small and medium-sized business sector, explore a set of organizational/economic conditions of financial support for small and medium-sized enterprises (SMEs), and examine some of the key characteristics of existing financial support for the business environment within the economy's priority sectors in the Republic of Kazakhstan. In conducting the study, the authors employed the statistical method, comparative analysis and summarization, the systemic and sociological approaches, graphical representation of information, and the integrated approach. The study's key objectives include the following: to investigate the significance of instruments of financial support for SMEs, including lending, subsidizing, guaranteeing, collateral support, and microfinancing; to identify a set of possible ways to enhance the activity of second-level banks in relation to granting long-term loans to businesses; to explore the significance of Messages to the Nation from the President of the Republic of Kazakhstan, the government's '2020 Business Roadmap' program, 'The Program for the Development of Productive Employment and Mass Entrepreneurship for the Period 2017–2021', and the activity of such major organizations as the Damu fund, KazAgroFinance, and Agrarian Credit Corporation in relation to funding the activity of SMEs.

Keywords: Lending; Subsidizing; collateral policy; Financial support; SMEs; Innovation; Competitive environment; Subsidizing the interest rate; Guaranteeing; Collateral support; Microfinancing; Development of production (industrial) infrastructure; Business ideas.



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1. Introduction

Fostering mass entrepreneurship is the foundation for economic development in any country. Small and medium-sized enterprises (SMEs) help ensure employment for the population, facilitate healthy competition, fill the market with new goods and services, and create favorable conditions for the effective use of material assets. The successful operation of SMEs in many countries around the world is associated with that their large production complexes are not placed in opposition to SMEs and large associations do not repress SMEs. On the contrary, they complement each other across a variety of sectors and in the area of innovation. Thus, these nations have managed to overcome sectoral and regional monopolism, cultivate a competitive environment, and create new jobs within their economy. SMEs in those countries provide for the hopes of large enterprises.

The significance of the study is determined by the fact that an attempt was made to analyze the effectiveness of financial support for the development of small and medium-sized businesses in Kazakhstan, to identify the strengths and weaknesses of their activities, to determine the reasons for the trends in the SME lending system, and to identify promising areas for optimizing credit mechanism for financing SMEs.

The study supplements the practical methodology for expanding the capabilities of the system to stabilize the financial sector and proposes a set of measures aimed at encouraging banks to remove problem loans from their portfolios.

2. Methods

In developed countries, SMEs serve as the foundation for the stable development of production. The sector's typical share in the economy in those countries is 50–70% of GDP. The authorities devote significant amounts of attention to galvanizing the development of this sector and provide SMEs with all kinds of support to help them enhance their business practices, including various activity enhancement programs and major concessions with respect to funding and lending.

The Kazakh government, likewise, attaches a lot of significance to the development of the nation's SME sector, treating the issue as a priority objective in the state's policy, as it governs the successful implementation of economic

and social programs. Much attention in the annual messages of the President of the Republic of Kazakhstan is devoted to the need to bolster the business environment. This has helped lay down some groundwork for the development of the republic's SME sector.

3. Results and Discussion

Currently, SME contribution to the nation's GDP is 20–25%. The sector employs around 60% of the employable population. SMEs in Kazakhstan are mainly focused on trade and commerce, automotive services, manufacture of household goods (over 46%), construction (14%), operations with real estate, rentals and services (12%), and industry (11%). Notably, most SMEs are based within the commercial sphere. There is very little focus on the economy's priority sectors and small innovation activity. Within the trade and commerce sector, the majority of entrepreneurs are engaged in the sale of foreign goods. The government is putting in significant effort to encourage SMEs to direct their activity toward the economy's priority sectors and set up enterprises that are fitted out with the latest technological equipment. Over the past few years, the Kazakh government has allocated significant budgetary funds toward support for SMEs operating within the economy's priority sectors. However, some of these funds fail to be utilized efficiently, although there is excessive wear and tear on plant and equipment. As a consequence, there are declines in labor productivity and increases in the prime cost of commodities and, consequently, declines in the overall level of SMEs' competitiveness.

The amount of focus on science-driven activities within the republic's SME sector is minor at the moment. This is a testimony to the unsatisfactory technical and technological condition of many SMEs in Kazakhstan at this time. Consequently, the sector is characterized by low indicators in terms of both gross value added contribution to GDP and employment for the population as opposed to other countries. One of the key causes of this is high interest rates on loans to entrepreneurs. Today's interest rates of 17–19% offered by banks to business entities in Kazakhstan appear not to be very favorable for SMEs. It is hardest for beginner entrepreneurs or those just entering the SME environment ([Statistics Committee of the Ministry for the National Economy of the Republic of Kazakhstan](#)). The '2020 Business Roadmap' state program, launched in 2010, has helped expand significantly the spectrum of instruments for the support of entrepreneurship. The program comprises 4 major groups of measures for the support and development of the business sector: support for new business initiatives, sectoral support for entrepreneurs, minimization of currency risk within the context of foreign economic activity, and boosts in entrepreneurship potential.

The first group of support measures implies the use of the following instruments:

- subsidizing the interest rate;
- providing guarantees on bank loans;
- developing the production (industrial) infrastructure;
- grants for new business ideas.

The second group of support measures deals with:

- subsidizing the interest rate on credit agreements on financial leasing with banks or leasing companies;
- guaranteeing bank loans granted toward projects.

The third group of support measures implies subsidizing the interest rate on loans to entrepreneurs undertaking projects where receipts in foreign currency total 10% of total receipts in a fiscal year.

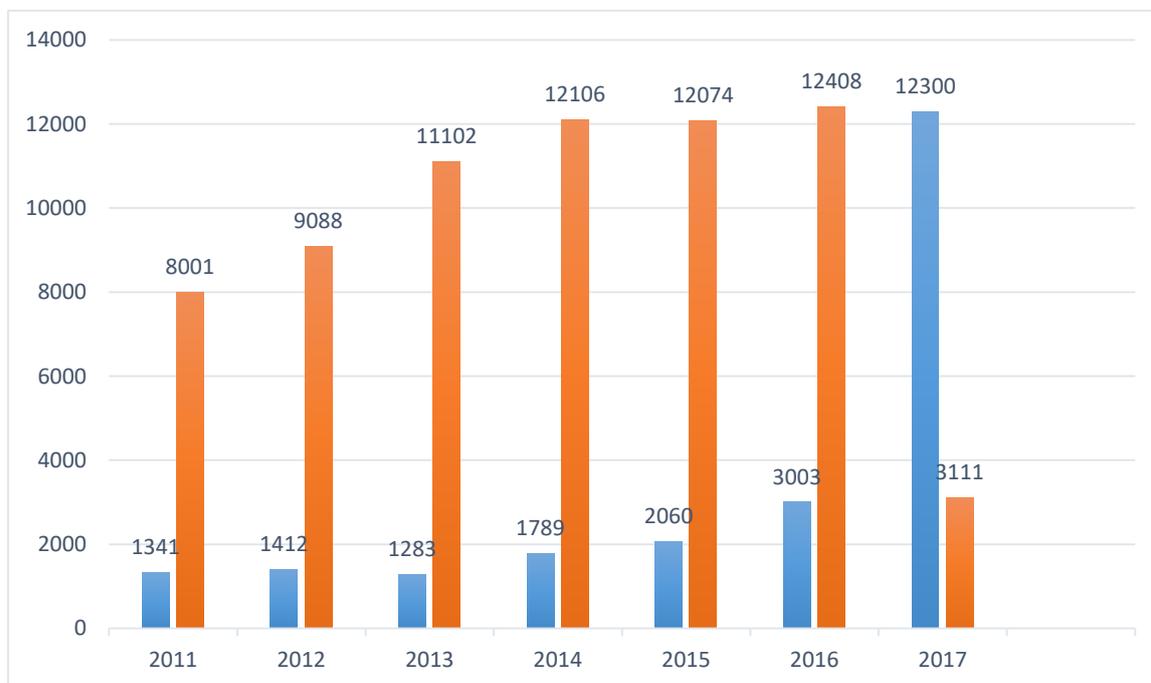
The fourth group of support measures is associated with addressing the need to:

- provide support to beginner entrepreneurs;
- provide training to top managers at SMEs via universities and R&D instruments;
- provide business trainings on business relationships ([Resolution of the government of the republic of kazakhstan № 301., 2010](#)).

Lending to small businesses, subsidizing the interest rate, and guaranteeing bank loans may come with high risk, as entrepreneurs running an SME may be short of the required liquid collateral assets. In Kazakhstan, state support for SMEs is provided through the Damu fund, which performs the functions of an agent concerned with keeping track of and monitoring the use of funds from the state budget, as well as credit lines from the European Bank for Reconstruction and Development (EBRD) and the Asian Development Bank (ADB). The fund provides support for SMEs via the implementation of special programs on project finance and leasing and on the development of microfinancing. It acts as a guarantor of loans to SMEs from second-level banks and performs the functions of an operator concerned with placing the funds from stabilization programs implemented by the Government of the Republic of Kazakhstan.

Currently, the fund serves as a fiscal agent concerned with subsidizing interest rates on bank loans to entrepreneurs and guaranteeing loans before banks. In addition, the fund performs the functions of an operator concerned with training beginner entrepreneurs and persons with an entrepreneurial talent, with a focus on providing consultation to top managers and conducting business trainings. To encourage second-level banks and microloan organizations to provide urban entrepreneurs with loans with a rate of 6%, the fund funds these credit organizations and guarantees loans granted by them. Any bank or leasing company can grant entrepreneurs loans the interest rate on which is subsidized by the fund. Concurrently, entrepreneurs can obtain from the fund guarantees on a loan ([Damu](#)). For instance, if a bank's rate on loans is 19% per annum, the fund subsidizes 7%, and the entrepreneur pays the remaining portion – 12%. This helps ease some of the strains that go with taking out a loan. Total lending to SMEs in Kazakhstan is listed in Figure 1.

Figure-1. Total lending to SMEs in Kazakhstan. Compiled by the authors based on data from the Kazakhstan Institute for Strategic Studies under the President of the Republic of Kazakhstan.



As is evidenced from the above diagram, in 2017 total lending in Kazakhstan increased slightly on 2016, by 1%, coming in at 12,700 trillion tenge.

In 2017, lending to small businesses increased on 2016 from 23.6% to 24.2%, a growth of 0.6%. The 5-year period between 2013 and 2017 saw an increase in the share of lending to this sector in the total volume of loans provided to the economy, although growth in 2017 was not very big. Based on data from the Kazakhstan Institute for Strategic Studies under the President of the Republic of Kazakhstan, in 2017 the share of loans to SMEs within the loan portfolios of second-level banks totaled: 7% in agriculture, 13% in industry, 14% in construction, 37% in trade and commerce, 5% in transportation and communications, and 24% in other sectors ([Kazakhstan Institute for Strategic Studies under the President of the Republic of Kazakhstan](#)).

The '2020 Business Roadmap' program was rebranded in 2015, becoming more extensive and accessible – it was termed 'The '2020 Business Roadmap' Single Program for the Support and Development of the Business Sector'. The program comprises three major focus areas. Under the first area, subsidies may be granted to entrepreneurs who are willing to operate in towns and rural settlements. Under the above program, the fund covers 10% of a loan or 10% of a lease deal. The length of a loan is 3 years. Going forward, the term may be extended to 6 years. The second focus area has subsidies and guarantees extend to priority sectors within the economy. Here subsidies are granted to the tune of 7%.

The third focus area implies minimizing currency risks within markets in which entrepreneurs engaged in activity related to export-oriented projects operate. Support is provided to SMEs which are engaged in exports or which have had their receipts in foreign currency for at least 6 months by the time of applying for a loan at a bank. These entities may obtain a loan from the fund with 6% being subsidized. Entrepreneurs operating within the agricultural sector often lack collateral support. Here a helping hand is lent by the fund, which guarantees up to 85% of the loan, sharing risk with the entrepreneur and providing the required portion of the collateral. For beginner entrepreneurs, 85% is guaranteed on a possible loan of up to 20 million tenge. For entrepreneurs who have been around, on loans of up to 360 million tenge 50% will be guaranteed. On loans ranging between 360 million and 1.8 billion tenge, the size of the guarantee may be 20%.

At the same time, many banks in Kazakhstan are currently unable to grant SMEs long-term loans, with lending mainly limited to short-term loans for replenishing their working capital. A serious issue facing the nation's banking sector today is the large number of problem loans within banks' loan portfolios, which is creating significant risks for the entire banking system. In many cases, the business environment is in need of long-term loans for the purchase of machinery, equipment, and other fixed assets. Therefore, up to now SMEs have been funded mainly through the state budget by way of the Damu fund.

The exacerbation of the world financial crisis and declines in the growth rate of the world economy have been a major concern for banks, as their access to external sources of borrowing has been limited. The lack of funding for banks has led to declines in the volume of long-term lending within the economy as a whole and to SMEs in particular. The anti-crisis measures adopted in 2008 to help stabilize the financial market have helped overcome the development of negative trends within the Kazakh economy. The government has allocated from the Kazakhstan National Fund as much as \$10 billion to help stabilize the financial sector (\$4 billion), develop the housing sector (\$3 billion), provide support for SMEs (\$1 billion), develop the agro-industrial complex (\$1 billion), and implement infrastructural and breakthrough projects (\$1 billion) ([National Bank of Kazakhstan](#)).

4. Conclusion

Banks, normally, end up with substandard assets when they grant loans to insolvent borrowers provided with a loan against a substandard pledge: money and assets that come in the future, insurance from affiliated companies, under the guarantee of natural persons, and irrevocable loans to fund the businesses of banks' shareholders. However, these measures have failed to help resolve the issue of non-performing loans (Gumar and Serikbaev, 2018).

One of the latest Messages to the Nation from the President of the Republic of Kazakhstan (January 10, 2018) sets out a set of priorities with respect to "resetting" the financial sector. These measures may be regarded as a solution to the above-mentioned problems within the Kazakh financial system. The key tenor of this part of the Message can be distilled down to the following four areas: revitalizing the banking system, enhancing existing measures on protecting citizens' interests in financial markets, providing businesses with long-term financial resources, and developing the financial market. It is resolving these issues that should help reduce risks for the financial system and ensure its steady growth, as well as economic growth and the development of the SME sector in the country. In this regard, to help minimize the volume of non-performing loans and create the conditions for further growth in lending for the economy, the republic's monitoring authorities have implemented 'The Program for Boosting Financial Sustainability within the Banking Sector', aimed at ensuring capitalization support for banks (Five social initiatives from the President, 2018).

The Program provides for two-thirds of capitalization support to be ensured by the government and one-third by the shareholder. The state invests funds on a repayment basis. Banks create provisions by way of current revenue. In the event there is not enough revenue, provisions are created at the expense of the shareholder.

The five social initiatives brought forward by the President of the Republic of Kazakhstan devote special attention to the issue of "resetting" the financial sector via revitalizing the banking system, providing businesses with long-term loans, and expanding the microfinance sector. Implementing relevant measures aimed at revitalizing the banking sphere should create the preconditions for restoring credit activity within the financial system.

'The Program for the Development of Productive Employment and Mass Entrepreneurship for the Period 2017–2021', signed into law by the Kazakh government in 2016, sets out a set of effective conditions for lending to small businesses, sole entrepreneurs, and farmers, as well as citizens who are willing to start a business. The state currently provides concessionary loans as part of the above program. Entrepreneurs in cities and mono-cities are granted microloans through seven second-level banks and two microfinance organizations, which are funded through the Damu fund for the development of entrepreneurship. Loans in rural areas are granted through the Fund for Financial Support for Agriculture, as well as 13 microfinance organizations and over 10 credit societies, which are provided with resources through Agrarian Credit Corporation. Concessionary microloans are granted for a period of 5 years, while loans for projects undertaken within the livestock farming sector and those related to the creation of agricultural cooperatives are provided for a period of 7 years, with the annual effective interest rate not exceeding 6% (Resolution of the Government of the Republic of Kazakhstan, 2016).

KazAgroFinance subsidizes interest rates on the lease of machinery required to open relevant platforms, commercial dairy farms, and greenhouses and purchase of pedigree breeding units. Owing to lease support from KazAgroFinance, there is work conducted with respect to upgrading the agricultural machinery fleet. In terms of principal lending terms, the Damu fund provides loans for a period of 5 years, while for projects undertaken within the livestock farming sector loans are granted for a period of 7 years, with an interest rate of 6% per annum. The maximum size of microloans is 8,000 monthly calculation indexes. Pursuant to the rules, no less than 20% of the total of volume of funds granted should be directed toward funding startup projects. The fund's collateral policy is the most flexible and loyal measure among the nation's financial institutions. For instance, second-level banks do not accept collaterals which they deem to be low-liquidity, including land plots intended for agricultural use. The fund may accept movable and immovable assets as a collateral, with no restrictions imposed in terms of what year an item is put into operation. Agrarian Credit Corporation grants microloans through microfinance organizations and by way of funding credit societies. If there is not enough collateral support, credit societies and microlending organizations provide the opportunity to make use of guarantees from KazAgroGarant. Enhancing financial support for SMEs should facilitate boosts in the competitiveness of SMEs and provide the impetus for expanding the spectrum of instruments of support for small businesses and help speed up the process of boosting SME contribution to the nation's GDP to 50%.

Lending, subsidies, collateral policy, and other instruments of financial support for SMEs are the most flexible and loyal measures. Funding projects undertaken by small businesses using these instruments should help boost employment for the population. Subsidizing interest paid on the lease of machinery and technological equipment should help speed up the process of technical support for SMEs. As a result, the nation should witness boosts in the efficiency and scale of business activity across the republic, which, strategically speaking, should help boost SME contribution to the nation's GDP to 50%.

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