

INSIGHT

Constraints to SME Growth in Kazakhstan and How to Overcome Them



Small and medium-sized enterprises lack access to financing and market opportunities. Photo credit: ADB.

A study of Kostanay region provides insights into developing sustainable businesses in the country.

Introduction

Small and medium-sized enterprises (SMEs) form the economic backbone of many countries. They support the economy by creating jobs and by producing goods and providing services.

In Kazakhstan, however, the SME sector is relatively small and has yet to reach its potential as a building block for private sector development and economic growth.

A study conducted by the Asian Development Bank (ADB) of SMEs in Kostanay region in the northern part of the country provides insights into the challenges faced by these enterprises and what they need to grow. The study is part of the support provided by ADB to the Akimat of Kostanay (regional authority) for the development of SMEs.

Kostanay region is a scaled-down version of Kazakhstan with mining and agriculture dominating the regional economy and with its northern areas relatively urbanized (Rudniy, Lisakovsk, Kostanay, and Zhetykara) and a low population density in the south. Like in other regions with monotowns (single-industry towns), the dependence of urban settlements on large enterprises affects employment and the economic well-being of these towns. A principal example is the mining town of Arkalyk and to a lesser extent, Zhetykara and Lisakovsk. The findings of the study therefore may be applied to other regions in

the country or even used to develop initiatives on the national level.

This study may also be useful to developing economies in Asia and the Pacific as it examines the key barriers to developing SMEs and entrepreneurship potential, the factors that affect private sector development, and alternative solutions for economic diversification and growth.

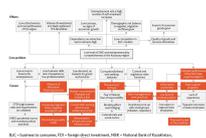
Key Barrier: Lack of Financing

We analyzed several aspects that affect the SME sector: regional economy, spatial development, availability of financial resources, business climate conditions, infrastructure connectivity, etc.

After the diagnostic study, we formulated the hypothesis that access to finance is the key barrier to SME development. Thereafter this was tested through a mass survey, town halls, interviews, focus groups, and statistical analysis. The hypothesis was proven partly true. The reasons were the inability of SMEs to satisfy the collateral requirements of banks and high-interest rates that exceed SMEs' rate of return (average is 15%).

Moreover, we found that SMEs lacked sustainability because of systemic factors, including weak interregional connectivity, low economic and demographic density, low purchasing power, absence of startup and innovation activities, low level of trust in authorities, and information asymmetry.

Figure 1: Problem Tree Analysis of SMEs in the Kostanay region



Source: ADB.

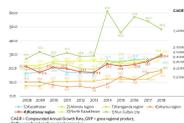
Analysis of the SME Sector

As of 1 January 2020, there were 14,151 registered SMEs in Kostanay region. Those still operating are a little less than half at 7,068. Those that suspended activities were 2,844 as opposed to 1,724 entities 2 years ago. The number of newly registered SMEs last year is fewer than in 2017, 866 as opposed to 880 in 2017. If we include individual entrepreneurs and farmers, the ratio of SMEs in operation to registered entities is higher at 70%. Apparently, operating as a legal entity is riskier than as an individual entrepreneur. In total, the number of SMEs of all types has grown by 9.9% in 2019 from 2018, the number of employed in the same period grew by 10.5%, and output increased by 14.3%.

The share of SMEs in the gross regional product (GRP) of Kostanay region is 29.4% in 2018, outstripping the national average of 28.4%. However, by computing the compounded annual growth rate (CAGR) over the last 10 years, we see that the region has not shown much progress at 14.92%, compared with the national average of 20.72%. This means that in some other regions of Kazakhstan, a

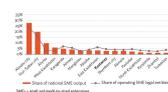
dynamic SME sector accompanied economic growth, whereas Kostanay region's SME sector had not grown much, perhaps it lost momentum for dynamic growth on a sectoral or district level.

Figure 2: Share of SMEs (Gross Value Added) in GRP from 2007 to 2018 in Kostanay Region and Other Regions (%)



Source: ADB based on data from Committee of Statistics, Ministry of National Economy, Republic of Kazakhstan.

Figure 3: SME Output by Region (2019)



Source: ADB, based on statistics obtained from Committee of Statistics, Ministry of National Economy, Republic of Kazakhstan.

Short-term borrowings dominate financing

Traditional financial channels for SMEs, such as commercial banks, are gradually losing ground to short-term, small-scale financing with high-interest rates in the Kostanay region. Moreover, most individual entrepreneurs use unsecured consumer loans to finance working capital. This confirms that the majority of regional SMEs are in survival mode and cannot consider expanding operations or markets.

In nominal terms, the volume of loans provided by commercial banks decreased to 21.7% of the gross domestic product (GDP) in 2018 from 26.7% of GDP in 2014. This shows that the economy grew faster than business borrowings.

In Kostanay, loans with a maturity of more than 1 year declined to 33% in 2018 from 67% in 2014. Today, the tenor of credit lines is at least two times less than required by SMEs. However, alternative sources of financing for private entities (such as venture capital and collective financing) are highly underutilized in the region.

Social disparities and demographic changes

The main challenges for the development of a sustainable SME sector are disparities in living standards in different regional districts and the lack of economic opportunities for the poor and vulnerable.

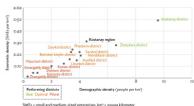
Kostanay region has been a donor of labor resources to other regions of Kazakhstan and the Russia Federation. In 2014–2018, 178,408 people left the Kostanay region. Out of this number, 87% moved to other regions of Kazakhstan, primarily to Nur-Sultan, and 13% went abroad, mainly to Russia.

The demographic changes in the region were not common across districts and settlements. To understand which districts fell behind and decreased or increased in population, we need to use the rate of natural increase (RNI).^[1] Despite the worst conditions in terms of liveability, southern districts showed a net increase in population compared with northern districts and urban settlements, such as Lisakovsk and Rudniy. Kostanay city and Kostanay district stood out; they demonstrated steady population growth. Hence, there are two major trends in the region—the growth of the population in an uninhabited territory in the south and the natural decrease in populations in the areas closer to Russia. However, not only migration but also the highest death rates have left the Kostanay region with a negative net balance of the population.

Potential for private sector development

Kostanay region is a scaled-down version of the country with dominant industries of mining and agriculture, with a relatively urbanized northern part and low density in the south. In order to see the level of spatial development within the region and, at the same time, understand the potential for entrepreneurship development, we need to compare all districts along two dimensions: economic density (SME per km²) and demographic density. Two districts are leaders—Zhetykara and Kostanay district. Both districts surround two major cities: Kostanay and Rudniy, which are dominated by the services sector and manufacturing.

Figure 4: Disposition of Districts of Kostanay Region in Terms of Spatial Development, 2018



Source: ADB consultants, based on statistics obtained from the Committee of Statistics, Ministry of National Economy, Republic of Kazakhstan and the Akimat of Kostanay region.

Interregional connectivity and the provision of basic needs to existing residents play a role in diminishing populations. SMEs would grow if there are markets that depend solely on people who live in territories with a relatively high standard of living. Our analysis shows which district economies are dominated by SMEs, which ones provide better conditions, or where entrepreneurs are more active and perform better.

Recommendations

SMEs in Kostanay region are significantly limited in development by internal and external conditions: low market concentration, territorial development disparity, and low level of trust among constituencies in the region, specifically between SMEs and state authorities.

This study addresses traditional problems with access to finance, access to human resources, and access to information, among others.

The following proposed activities revolve around nine tasks and 42 initiatives that the Akimat could adopt to overcome the barriers identified above and promote the development of SMEs and the

economy in the region. We set these nine tasks for the Akimat to work on for the next 5 years with the main objective of increasing to 35% of the SME sector's share in the regional economy (GRP):

1. Improve the capacity of Akimat's personnel, specifically in the departments that frequently interact with entrepreneurs.
2. Simplify processes of state services delivery, especially for land use permits, construction permits, a connection of utilities to production and/or services facilities, and state procurement procedures.
3. Increase and diversify sources of financing for SMEs.
4. Improve access of SMEs to information on markets, state policies and initiatives, and other relevant data for private sector development.
5. Increase the number of innovative SMEs and the share of investments in fixed capital among regional private entities.
6. Improve the level of connectivity between large urban settlements, including reducing the travel times of commuters.
7. Increase net population growth in the region by decreasing migration flows to other regions and improving social infrastructure (livability conditions).
8. Decrease the death rate among SMEs by improving feedback mechanisms with active entrepreneurs and engaging other state bodies and institutions.
9. Facilitate market concentration of business entities and people, including the growth of urbanization rate in the region.

The roadmap consists of four thematic areas, all devoted to the development of the private sector in Kostanay region:

1. Access to finance,
2. Spatial development and competitiveness of the territory,
3. State services (processes improvement), and
4. SME growth and competitiveness.

[1] Rate of natural increase (RNI) is expressed in per mille (%); Ppm - one tenth of the percentage, that is a thousand share of the number. There are two ways of calculating RNI. One is by combining net of birth to death rates, divide by population net change, and then get the Ppm. The other is by adding migration net change to the equation. Therefore, in our case, we take the natural increase of a district, divide by an annual net of population, and multiply by 1,000 to get the Ppm of RNI for a certain territory.

Resources

Asian Development Bank (ADB). [Kazakhstan: Support to Small and Medium Enterprises and Entrepreneurship Development Project.](#)



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Iskandar Gulamov oversees all country programming and thematic work at the

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Prior to ADB, Yerlan Khassenbekov was the partner at a small boutique consulting firm, The Center for Research and Consulting LLC. He specializes in the study of the development of the entrepreneurial sector, including business environment, access to finance, investment activities, influence of entrepreneurial activity on macroeconomic indicators, and analysis of entrepreneurial development factors.



Asian Development Bank (ADB)

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